

NSW Productivity and Equality Commission

# Review of funding models for local water utilities

Final report

July 2024



## Acknowledgement of Country

We acknowledge that Aboriginal and Torres Strait Islander peoples are the First Peoples and Traditional Custodians of Australia, and the oldest continuing culture in human history.

We pay respect to Elders past and present and commit to respecting the lands we walk on, and the communities we walk with.

We celebrate the deep and enduring connection of Aboriginal and Torres Strait Islander peoples to Country and acknowledge their continuing custodianship of the land, seas and sky.

We acknowledge the ongoing stewardship of Aboriginal and Torres Strait Islander peoples, and the important contribution they make to our communities and economies.

We reflect on the continuing impact of government policies and practices, and recognise our responsibility to work together with and for Aboriginal and Torres Strait Islander peoples, families and communities, towards improved economic, social and cultural outcomes.

Artwork:

*Regeneration* by Josie Rose



# About the NSW Productivity and Equality Commission

The NSW Productivity and Equality Commission (the Commission) was established by the NSW Government in 2018 under the leadership of the state's inaugural Commissioner for Productivity, Peter Achterstraat AM.

The Commission is tasked with identifying opportunities to boost productivity growth in both the private and public sectors across the state to continuously improve the regulatory policy framework and other levers the NSW Government can pull. Productivity growth is essential to ensure a sustained growth in living standards for the people of New South Wales, by fully utilising our knowledge and capabilities, technology and research, and physical assets.

The Commission's priorities include:

- fit-for-purpose regulation
- efficient and competitive NSW industries
- improved public service delivery
- climate-resilient and adaptive economic development.

Since its inception, the Commission has undertaken several reviews on productivity matters and published the landmark Productivity Commission White Paper 2021: Rebooting the economy. More of the Commission's work can be found on our website: [productivity.nsw.gov.au](https://productivity.nsw.gov.au).

## Disclaimer

The views expressed in this paper are those of the NSW Productivity and Equality Commission alone, and do not necessarily represent the views of NSW Treasury or the NSW Government. The NSW Productivity and Equality Commission's recommendations only become NSW Government policy if they are explicitly adopted or actioned by the NSW Government. The NSW Government may adopt or implement recommendations wholly, in part, or in a modified form.



# Preface

Dear Minister,

I am pleased to present the Final Report of the Review of Funding Models for Local Water Utilities (LWUs). This report responds to the Terms of Reference issued in August 2023, addressing the critical need for reform within the LWU sector to enhance service delivery and financial sustainability.

Local Water Utilities are essential to the well-being of regional communities, ensuring the provision of safe, reliable water and sewerage services.

As a first principle, the Review recognises that LWUs are council-owned businesses, with responsibility for their management and financial sustainability squarely on local councils. This requires councils to ensure that these essential services are effectively managed to meet their communities' needs and circumstances.

However, many LWUs, particularly those in smaller and remote communities, face significant challenges, including water security risks, financial instability, and aging infrastructure. These issues are further compounded by the costs of evolving regulatory standards, population changes, and the impacts of climate change.

As such, the Review sees an ongoing role for well targeted NSW Government funding to the sector. This role should be more clearly defined and should focus on improving the capacity of councils to operate efficient water and sewerage businesses, consistent with community expectations and statutory requirements, where they cannot fund this from their own revenue base.

## Key recommendations for LWU sector reform

- 1. Adopt funding principles for future NSW Government funding:** The report establishes clear funding principles to guide future NSW Government funding. These principles aim to ensure consistency, targeting, and alignment with government objectives, providing a stable foundation for funding allocations.
- 2. Use a strategic planning-led approach:** The review underscores the need for a better integrated, strategic planning-led approach for the LWU sector. Building on the Town Water Risk Reduction Program and Regulatory and Assurance Framework, this approach is crucial for better alignment of planning efforts at the state, regional, and local levels. The NSW Government and every LWU should be able to effectively identify future challenges, set clear objectives, and ensure that investments are efficiently prioritised and resources are used optimally.
- 3. Develop a new LWU Investment Framework:** Central to our recommendations is the creation of a new LWU Investment Framework, which should include:
  - An LWU Funding Policy that provides clear guidelines for future funding allocations, ensuring consistency and alignment with government objectives.
  - A Sector Priorities Plan to help prioritize investments based on strategic needs and available resources, guiding the NSW Government's funding decisions.
  - A requirement for LWUs to demonstrate a pathway to achieve full cost recovery consistent with the National Water Initiative Pricing Principles. The Policy should also identify expectations and support pathways for councils to move their LWU businesses to capital structures appropriate for water utilities.
- 4. Utilise Community Service Obligation (CSO) funding:** For those councils unable to achieve full cost recovery through user charges, the Review recommends the introduction of a CSO payment

mechanism to provide predictable and reliable NSW Government funding. This approach should incentivize efficient service delivery while ensuring affordability for regional communities.

- 5. Improve regulation and standards:** The review calls for an improved approach to regulating water quality and environmental standards and a new water security standard. This involves ensuring that regulations are fit-for-purpose, addressing identified problems without imposing unnecessary burdens on LWUs. By refining these standards, we can ensure that LWUs meet necessary requirements while operating efficiently.

### Implications for regional communities

The proposed approach to funding for the LWU sector relies on:

- The NSW Government establishing clear long-term policies and increasing its focus and effort to building collaborative approaches with LWUs who need most assistance to address sector, regional, and local water issues.
- Local councils taking greater responsibility for lifting the performance of their LWUs and for specifying any support required from the NSW Government, including CSO funding and regional water solutions, consistent with user pays principles in the first instance.

Local councils will benefit from a more predictable and stable funding environment, enabling better planning and management of water and sewerage services. Long term support better targeted to those communities with the greatest need through the introduction of a CSO payment mechanism.

### Conclusion

The proposed reforms are built on extensive consultation and detailed analysis, aiming to create a robust framework that supports the delivery of essential water and sewerage services across NSW.

Implementing these recommendations will require a concerted effort from all stakeholders, led by the Department of Climate Change, Environment, Energy and Water, in partnership with local councils and other NSW Government agencies. A collaborative approach to delivering these reforms over the next 12 to 18 months is necessary to secure a sustainable future for the LWU sector.

I extend my gratitude to the many stakeholders who contributed to this review, and I look forward to the Government's consideration of our findings and recommendations.



Yours sincerely,  
Peter Achterstraat AM  
NSW Productivity and Equality Commissioner

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# Abbreviations

Acronym	Term
CPI	Consumer Price Index
CSIRO	Commonwealth Scientific and Industrial Research Organisation
CSO	Community Service Obligation
DCCEEW	The NSW Department of Climate Change, Energy, the Environment and Water
EPA	The NSW Environmental Protection Authority
kL	kilolitre
LGA	Local Government Area
LWU	Local Water Utility
OLG	The Office of Local Government
SOC	State Owned Corporation
TRB	Typical residential bill
TWRRP	Worn Water Rick Reduction Program
NWI	National Water Initiative
WACC	Weighted average cost of capital
RAF	NSW Regulatory Assurance Framework
PAS	Payment Assistance Scheme
SLA	Service Level Agreement

# Glossary

Term	Definition
Affordability	<p>Affordability refers to the ability for households to pay for the water and sewerage services without suffering undue hardship.</p> <p>At an LWU scale, those utilities with a higher portion of low-income households will have face greater affordability impacts when generating increased revenues from their customer base. Affordability can be a relative concept so that rising levels of financial hardship may be the result of price increases more generally (food, housing, petrol, other utility services) rather than increases in prices in the urban water sector.</p>
Basic Level of Service (LOS)	A level of service of water and sewerage services considered a reasonable minimum set and quality of services for the purposes of establishing the quantum of any NSW Government funding to this ensure the service is considered affordable.
Capital structure	The combination of debt and equity used by utilities to finance their operations and investments. For NSW local water utilities, it ensures an optimal balance between borrowed funds and equity to maintain financial stability, meet government expectations, and support sustainable service delivery. This mix influences the utility's financial performance, risk, and cost of capital
Customer service obligation (CSO)	A publicly reported payment for a service or policy objective to an entity that would otherwise not be able to provide the service in a financially sustainable manner. In the case of LWUs this could be a result of a significant lack of the capacity to pay within its customer base and the low number of connections.
LWUs	LWU sector is defined as water utilities run by councils in NSW. This excludes Central Coast Council, County Councils and Water Management Authorities under the <i>Water Management Act 2000</i> .
LWU Sector	LWU sector includes local water utilities, the department and other regulators, industry associations, the private sector, and other interested stakeholders as outlined in the Regulatory Assurance Framework.
Long term capital and operating plan	A strategic framework used to outline projected capital investments and operating expenditures over a 10-year period. It aligns asset management and investment decisions with service delivery priorities, ensuring efficient resource use. The plan should integrate financial modelling, risk management, and performance monitoring to maintain robust asset management practices.
Level of Service (LOS) objectives	Describes the desired level of performance for a particular service or performance measure of a water and sewerage system.
Minimum Standard	An LWU requirement underpinned by a legislative or regulatory instrument.

Term	Definition
Hardship	<p>Hardship and associated policies relate to individual customers genuinely having difficulty paying their bills, for example, by allowing some customers to set up repayment plans.</p> <p>The notion of hardship in utilities is related to financial difficulty which may be the result of a change of circumstances, such as unemployment, illness or relationship breakdown and poverty. Poverty also elevates the risk of other issues resulting in financial difficulty.</p> <p>Hardship policies do not directly address affordability of services.</p>
National Water Initiative Pricing Principles	<p>Guidelines under the National Water Initiative that help set fair and efficient water prices for town water services in Australia. They ensure prices reflect true costs, promote full cost recovery, and encourage sustainable and efficient water use. These principles cover asset valuation, cost recovery, and tariff setting to support transparent and equitable water pricing.</p>
Regulatory and Assurance Framework (RAF)	<p>The NSW Regulatory and Assurance Framework (RAF) for local water utilities adopted in 2022. The RAF applies to local water utilities in regional NSW from 1 July 2022, covering (1) local government councils exercising water supply and sewerage functions under the NSW Local Government Act 1993 (2) water supply authorities exercising water supply and sewerage functions under the NSW Water Management Act 2000 and (3) guidelines for managing the provision of water supply and sewerage services by councils under the Local Government Act.</p>
Service level agreement	<p>A service level agreement (SLA) is a formal agreement between the NSW Government and a service provider (in this case a local water utility) that specifies the expected service standards, performance metrics, and responsibilities, as the basis for Community Service Obligation funding.</p> <p>Recognising that LWUs are local council owned businesses, this approach is modelled on the NSW Treasury's Commercial Policy Framework, which aims to instil private sector efficiency and accountability in government businesses.</p>
Water Security	<p>Water security is a measure of how well a utility can meet the water supply needs for customers and communities. A utilities water security will change over time because of changes to supply and demand, including the impacts of climate change, population growth, and extreme events.</p> <p>Water security analysis assesses the long-term risk a regional city, town, or community faces in accessing a reliable water source. The concept takes into account the desired service levels that meet customer and community needs, values, and preferences.</p>



# Executive summary

## What has the Productivity and Equality Commissioner been asked to do?

Local councils are responsible for the efficient operation of water and sewerage services in New South Wales (NSW). These services are provided by 85 council-owned and operated local water utilities (LWUs) servicing around 90 Local Government Areas (LGAs).

Through the Town Water Risk Reduction Program, which was established in December 2020, the NSW Government has recognised the need to investigate alternative funding models for LWUs. In August 2023, the Minister for Water requested the Productivity and Equality Commission (The Commission) investigate funding options for LWUs to reduce service risks and improve financial sustainability for the sector - see Terms of Reference (Appendix A). In doing so, the Review has also considered:

- The diverse challenges facing the LWU sector in providing services across NSW including differences in customer numbers, revenues, costs and location
- The historic role of NSW Government funding across the sector, including recent grant programs
- The role of minimum levels of service across the sector and the implications for funding decisions
- The extent to which alternative funding models could improve the performance of LWUs
- Transition pathways to a new funding approach and ways to leverage the capabilities of State-Owned Corporations (SOCs)
- Pensioner rebates.

Throughout this review the Commission has respected the NSW Government's policy position that there shall be no forced amalgamations and that councils will continue as the owners of their water and sewerage assets.

## Approach

The Review recommends a new strategic planning and funding approach to enable local water utilities in NSW to operate on a more financially sustainable basis. The Commission has undertaken a broad range of consultation, research, and modelling to inform the Review's findings and recommendations, including:

- Analysis of the existing legislative, regulatory and funding framework LWUs operate in.
- Public release of an Issues Paper in February 2024 which identified key issues impacting the ability of LWUs to sustainably deliver the services their communities expect. In response we received 42 detailed public submissions from across the sector.
- Extensive consultation with local government, State Government agencies, industry and other stakeholders via site visits and targeted discussions.
- Detailed analysis of the existing financial and service delivery performance of LWUs and a consideration of future costs.
- Analysis of possible future costs to provide different levels of service and the scope of different funding and financing options to allow LWUs to recover their costs.
- Analysis of best practice in other jurisdictions, previous reviews, and published research on operations and funding of LWUs.

## Funding across the LWU sector

LWUs have operational and financial autonomy and are responsible for managing their operations, costs and generating revenues. Revenue from customers is the most significant source of funding for LWUs, generating around \$1.4 billion per annum.<sup>1</sup> These revenues and the extent to which they recover efficient costs vary significantly across LWUs. LWU customer revenues range from just under \$1.4 million to almost \$95 million per year.

Generally speaking, LWUs aim to achieve cost recovery over time. Charges are set by individual LWUs to meet their operating requirements. As a consequence, there is significant variation across LWUs in both the level of cost recovery achieved as well as the charges incurred by customers. Average bills vary significantly across LWUs, ranging from \$1,016 in Murrumbidgee Council to \$2,535 in Brewarrina Shire Council.<sup>2</sup>

The NSW Government has provided around \$80 million in funding per year to the LWU sector over the past decade through several grant programs. Historically, funding to the sector has been provided for emergencies or via grants programs to help councils struggling with the short-term capital needs to deliver a particular infrastructure project.

The demand for NSW Government funding across the LWU sector will grow in the future. Looking forward, it is difficult to assess the scale, scope and distribution of funding assistance across the sector as there is the complex interplay between customer expectations, service standards, capital planning and the differing potential revenue generation across 85 LWUs that effect this demand. In addition, the stance of the NSW Government and the design of funding programs directly effects the operational incentives and funding plans of LWUs.

In such a dynamic environment it is important to get the fundamentals correct so that any funding is targeted to those that need it most, addresses priority needs and provides strong incentives to focus on outcomes.

## Smaller LWUs face the greatest challenges

Each LWU faces unique challenges due to their number of connections, and financial capacity. For example, 61 of the 85 LWUs, or 71 per cent, have less than 10,000 connections, with 19 of these having less than 2,000 connections.<sup>34</sup> LWUs can also face unique challenges, such as highly dispersed service areas, difficulty attracting or affording specialist skills and varying water security and water quality challenges. Over time, the combination of issues can have flow on impacts on LWU performance.

Across NSW location plays a role as, in general the further west a LWU is located the lower the customer base and revenues. While most (81 per cent) LWUs are in areas classified as 'regional' by the Australian Bureau of Statistics, 19 per cent are in remote areas in Western NSW and they tend to service some of the most socio-economically disadvantaged communities in NSW. As a result, these LWUs typically experience higher water bills, which places additional cost of living pressures on these vulnerable communities. The 16 remote LWU have an average revenue per connection of \$1,388 compared to the LWUs classed as regional with \$1,087. Within this remote grouping the highest revenue per connection is \$2,433 which is almost twice the average.

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<sup>1</sup> In \$2021-22, based on five-year average to 2022.

<sup>2</sup> Average usage bill. In \$2021-22, based on five-year average to 2022.

<sup>3</sup> The NSW Department of Climate Change, Energy, the Environment and Water (DCCEEW) maintains a significant database of local water utilities performance against a range of asset management, operational, and financial metrics (The Performance Monitoring Database). The data is freely available online.

<sup>4</sup> 19 (22 per cent) are classed as very small LWUs have less than 2,000 connections, 42 (19 per cent) are small LWUs - between 2,000 and 10,000 connections, 10 (12 per cent) are medium LWUs - between 10,000 and 20,000 connections, and 14 (16 per cent) are large LWUs - having more than 20,000 connections.

## **Many LWUs are struggling, and future challenges will only exacerbate cost and price pressures**

Future challenges are expected to have significant cost and price implications for local communities. Responding to changes in regulatory standards, population changes, increasing water security and climate change risks, replacing ageing infrastructure and increases in costs are all emerging concerns for LWUs and local councils. We have also heard LWUs face a shortage of skilled people to effectively manage water and sewerage operations and that LWUs are competing for the same, limited labour pool placing further pressure on costs. While these trends will impact LWUs differently, they are likely to place upward pressure on both capital and operating costs.

LWUs will need to generate higher own source funding to ensure ongoing financial viability. The Commission's review of current prices indicates that many LWUs have the potential to increase their user charges and increase customer revenues over time. Specifically, our analysis suggests that the LWU sector have the capacity to raise additional revenue of over \$6.5 billion over 20 years (\$2024-25).

While such increases may be justified on the basis of ensuring ongoing financial sustainability of LWUs, whether this is adequate to meet future funding challenges depends on a range of factors including customer expectations, and the cost and timing of required investments. The Commission also acknowledges that each LWU is an independent business and higher customer revenues will allow some but not all LWUs to meet the costs of delivering services.

## **Existing funding arrangements undermine LWU incentives to operate efficiently**

Historically, the NSW Government has played a significant role in funding the LWU sector's capital works under various grant programs. Despite some recent improvements in program design, capital grants continue to create poor financial incentives for the LWU sector. Over the long-run, grants:

- Are an uncertain and volatile funding source
- Are often poorly targeted and at risk of political interference
- Create a bias towards capital solutions
- Move away from 'user pays' charging while reducing price signals to customers.

## **Laying the foundations for an autonomous, efficient and financially sustainable LWU sector**

The Commission recognises the existing and future challenges faced by LWUs, and the need to provide targeted funding to those LWUs which are not financially sustainable. Notwithstanding this, it is important that LWUs demonstrate that their operations are as efficient as possible and that customers are making a reasonable level of contribution for the services they receive.

Against this benchmark the Commission has formed the view that the current funding model for LWUs is not effectively working and needs urgent reform. This Review outlines a new approach to strategic planning and funding which is fairer, more transparent and will foster more efficient and financial sustainable LWUs able to meet future challenges.

The recommended approach is based on a partnership between NSW Government and LWUs and will create a framework for setting strategic priorities to ensure that the financial resources are allocated in a transparent and consistent way to optimise the effectiveness of finite government resources.

Funding for LWUs needs to be informed by a comprehensive principles-based framework to ensure the delivery of the NSW Government's commitment to 'provide healthy, safe and reliable water supplies' in regional and remote communities. Accordingly, there are three major areas of reform across the whole of the LWU sector:

1. **Fit for purpose regulation** – the NSW Government should ensure that the water quality, security and environmental requirements that it places on the LWU sector are based on identified problems and that any proposed response is thoroughly considered to ensure that money is spent wisely.
2. **Working to develop a common understanding and strategic development of priorities** – the NSW Government should work with LWUs to develop a new strategic understanding of the LWU sector and identify state-wide priorities so that funding addresses the most urgent problems facing the sector.
3. **Development of a Local Water Utilities Funding Policy, including the establishment of a Community Service Obligation (CSO) funding mechanism** – to ensure that NSW Government funding is provided to those LWUs who need it the most and partnerships can be agreed where required.

Funding programs must become smarter and be based on partnerships where required.

While CSOs will be targeted to LWUs who struggle with cost recovery, we have heard that funding may be required to address specific issues such as skills shortages. The introduction of a CSO does not rule out flexibility in funding programs such as training initiatives, including training 'on country' for First Nations water operators and delivering training through a collection of councils.

Regardless of the mechanism the principles which should guide the funding framework include the following:

- funding aligns with explicit NSW Government objectives,
- that there is consistent treatment of LWUs,
- funding is targeted to those LWUs that are facing affordability issues and are transparent,
- funding provides a predictable and stable source of financial support,
- funding is linked to measurable performance improvements, and
- administration costs are minimised where feasible.

Applying these principles should mean that LWUs do not receive funding unless they demonstrate that they are providing a basic level of service efficiently and that they are unable to increase user charges in order to generate additional revenues without such increases leading to enduring affordability issues for consumers.

In addition, the Commission has found there are a set of Local Government Areas (LGAs) in Western NSW that are unlikely to be able to operate LWUs on a commercial basis without ongoing external support. This region should be the priority group of LWUs considered under the new funding approach.

The challenges these LWUs face include low revenues, difficulties in retaining skilled staff, accessing appropriate training and increasing costs due to water quality and security issues. Even though they face common challenges, the councils are not homogeneous. Increasing costs and the shift to a CSO funding model represents the opportunity to establish a sustainable solution.

As such a fourth area of reform is recommended: A fundamental reform process review of the water and sewerage service delivery and financial sustainability in Western NSW.

It is essential that the principle of co-design is followed in this review.

## Delivering change

The proposed funding approach could reduce overall NSW Government expenditure and reduce the cost to taxpayers compared to a continuation of the practices from the past 20 years where funding has been provided in a reactive manner to water sector challenges as they arise. **Figure 1** provides an overview of the proposed LWU Sector Reform Package.

The proposed reforms should be implemented prior to the provision of new funding programs to the LWU sector.



Implementation will require a sustained and collaborative effort led by Department of Climate Change, Energy, the Environment and Water (DCCEEW) in partnership with local water utilities and sector representatives, and should be supported by agencies across the NSW Government.

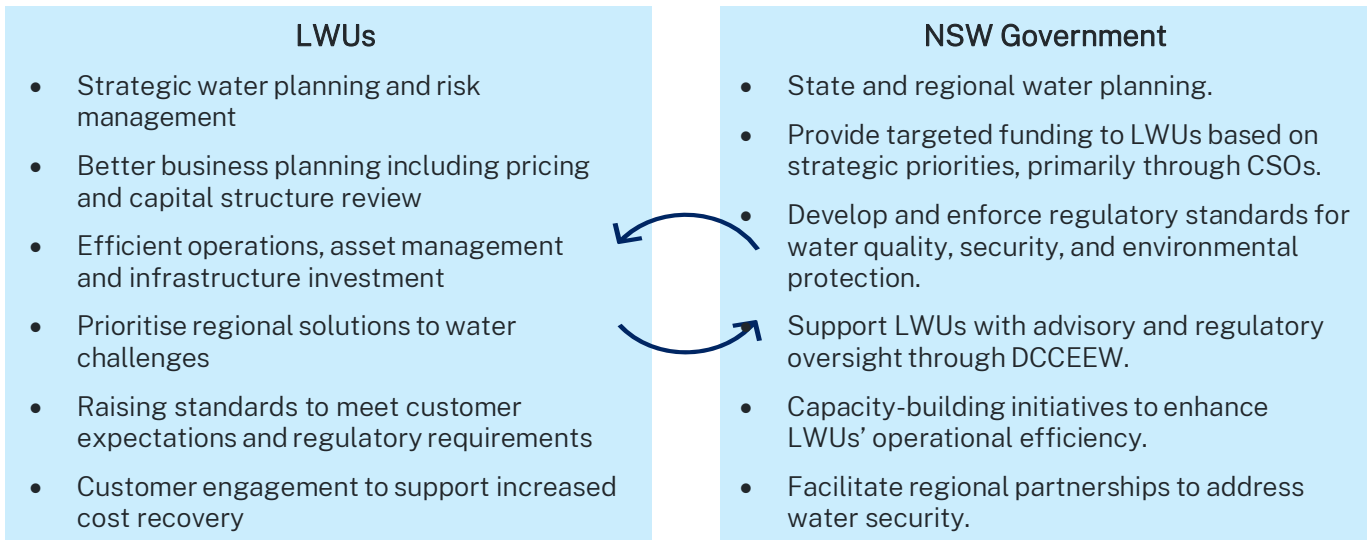
The DCCEEW should lead the LWU Sector Reform Implementation Steering Committee and respective Working Groups, with support from other agencies. A separate Regulatory Review Steering Committee should focus on improving regulatory approaches and designing a new approach for water and sewerage services in Western NSW, and include senior representatives from DCCEEW, OLG, NSW Health and EPA. The reforms will need to be supported by extensive engagement with the LWU sector and industry.

The Commission's proposed recommendations to deliver on this new approach are outlined in the following section – Recommendations and actions.

Figure 2: Proposed strategic planning and funding approach to LWU sector

- LWUs are council-owned businesses
- Financial sustainability through efficient operations and strategic planning.
- Funding alignment with explicit objectives to provide predictable, stable support.
- Enhance transparency, accountability, and effectiveness of resource allocation
- User-pays pricing approach that reflects true costs and maintains affordability.
- Collaboration between NSW Government and LWUs to address water security, regulatory compliance, and service delivery.
- Outcome-focused standards for water quality, security, and environmental protection.
- Regional collaboration to achieve economies of scale and improve service delivery.
- Maintain high standards of customer engagement and satisfaction.

Strategic Partnership approach between NSW Government & Local Water Utilities



- |                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|--------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Fit for purpose regulation</b>                            | <ul style="list-style-type: none"> <li>• Ensure implementation of minimum water quality standards is efficient</li> <li>• Ensure implementation of minimum environmental standards is efficient</li> <li>• Set outcomes-focused standard for water security that can be implemented at the local level</li> <li>• Incorporate customer retail service standard into RAF</li> </ul>                                                                                                                                                                                                                              |
| <b>Establishing LWU priorities</b>                           | <ul style="list-style-type: none"> <li>• Publish Preliminary Sector Overview to support new funding approach</li> <li>• Publish Sector Priorities Plan &amp; use as basis of investment in LWU sector</li> <li>• Integrate RAF into Integrated Planning &amp; Reporting Framework</li> </ul>                                                                                                                                                                                                                                                                                                                    |
| <b>Develop LWU Funding Policy</b>                            | <ul style="list-style-type: none"> <li>• Enhance efficiency, transparency &amp; effectiveness of LWU funding by establishing funding principles</li> <li>• Adopt LWU Investment Framework to ensure targeted funding to LWUs &amp; minimise overall costs to NSW Government</li> <li>• Adopt LWU Funding Policy</li> <li>• Adopt CSO Policy as primary funding approach to LWUs</li> <li>• Develop &amp; adopt Basic Level of Service as part of LWU Funding Policy</li> <li>• Evaluate pensioner rebates on all water &amp; wastewater services and propose best way of delivering policy objective</li> </ul> |
| <b>Review of Western NSW water &amp; wastewater services</b> | <ul style="list-style-type: none"> <li>• Identify most efficient &amp; effective structure for Western NSW LWUs</li> <li>• Develop Strategic Business Case for new funding approach to Western NSW LWUs (before progressing to Final Business Case)</li> <li>• Introduce new structure and funding approach for Western NSW LWUs</li> </ul>                                                                                                                                                                                                                                                                     |

# Recommendations and actions

## The role of NSW Government and its funding

- Recommendation 1**      **Assess the design of any future funding approach against LWU funding principles identified by the Commission.**
- These include ensuring that funding is aligned to NSW Government objectives, consistent, targeted and transparent, predictable and stable, linked to improved performance, and easy to administer.
- Targeting will mean that an LWU should not receive funding unless it demonstrates it is providing a basic level of service efficiently and that it is unable to increase own source revenues in the first instance.
- Recommendation 2**      **Use the LWU funding principles to review Safe and Secure Water Program funding that has been earmarked but not formally allocated.**
- DCCEEW should utilise the findings of this review to ensure that its approach to targeting is fit for purpose and addresses affordability issues. This should identify opportunities to allocate funding to councils with less capacity to fund or finance new capital investment through user charges and capital structure reform.

## Using a strategic approach to better allocate funding

- Recommendation 3**      **Prepare a stocktake of existing strategic planning for LWU sector, including state, regional and local plans, and develop a preliminary Sector Overview outlining future challenges, expenditure, and potential funding shortfalls to support a new funding approach.**
- The preliminary Sector Overview should identify the current pipeline and priorities in the sector (both operational and capital) and critical gaps in LWU or NSW Government planning.
- The development of the Sector Overview should be governed by a Steering Committee including NSW Treasury and Infrastructure NSW and involve LWUs and sector representatives.
- Recommendation 4**      **Develop a LWU Investment Framework to ensure funding to LWU sector is well targeted and minimises overall cost to NSW Government.**
- LWU Investment Framework should include a *LWU Funding Policy* and a *Sector Priorities Plan*.
- The Framework should improve alignment between the objectives of the NSW Water Strategy, regional water strategies, and NSW Government funding programs through the *Sector Priorities Plan*.
- The NSW Government should not agree to any new funding programs for LWU sector until the Framework has been adopted.
- Recommendation 5**      **Prepare a draft LWU Funding Policy, with release for sector consultation prior to finalisation.**
- The draft LWU Funding Policy should be released by early 2025 for discussion with LWUs, with a first formal Policy to be finalised by mid-2025. The Funding Policy should outline pathways to enable councils to seek funding and give effect to the LWU funding principles.

- Recommendation 6**      **Work with LWUs and other NSW Government agencies to develop a Sector Priorities Plan**
- A *Sector Priorities Plan* should set out the NSW Government’s priorities for the LWU sector over the short to medium-term (2 to 4 years).
- DCCEEW should develop an interim Plan, based on existing water strategic planning, as soon as practicable, and revise the Plan by the middle of 2025, incorporating any updated water strategic planning available. The Plan should be updated annually.
- Recommendation 7**      **Make strategic planning for water supply and sewerage services an explicit requirement for all councils in regional NSW, with key elements of the Regulatory Assurance Framework to be incorporated into the Integrated Planning and Reporting Framework.**

### **Establishing CSO payments**

- Recommendation 8**      **Introduce a CSO payment mechanism as a new funding approach for the sector.**

CSO payments should focus on LWUs which are unable to achieve full cost recovery from user charges without creating undue affordability issues within their communities.

- Recommendation 9**      **Develop a CSO Policy as part of the LWU Funding Policy in consultation with the sector over the next 12 months.**

A CSO Policy should include guidance on eligibility and information requirements, assessment processes, including roles and responsibilities, elements of a service level agreement, and reporting requirements and administration.

- Recommendation 10**      **Provide a report to the NSW Productivity & Equality Commissioner on the implementation of the CSO policy after 12 and 24 months.**

When reviewing the CSO policy, the NSW Productivity and Equality Commissioner should consult sector participants to determine whether the proposed CSO policy should be revised.

### **Service levels and minimum service standards**

- Recommendation 11**      **Ensure that implementation of minimum standards across the sector is efficient.**

To ensure implementation of minimum water quality standards is efficient, NSW Health and the EPA should publish and implement a regulatory and enforcement strategy consistent with the NSW Government Guide to Better Regulation. NSW Health and EPA should conduct Regulatory Impact Statements (RISs) of their minimum standards.

NSW Health and the EPA should contribute to DCCEEW’s development of a Sector Priorities Plan, including scoping aggregate cost and financial implications of relevant standards and setting priorities for investment.

These processes should result in an approach on how to implement standards for LWUs where the cost of compliance is unacceptably high.



Recommendation 12 **Review the role of regulators in planning processes undertaken prior to submission of an application for water treatment and sewage works under section 60 approval processes.**

DCCEEW work with NSW Health and the EPA that regulatory objectives are clear at the commencement of approval processes relevant to s.60 of the *Local Government Act 1993* to ensure that responses are commensurate to risks.

Recommendation 13 **Establish an outcomes-focused standard for water security that outlines NSW-wide expectations while providing LWUs with flexibility to manage given local conditions.**

The NSW Government should prescribe methods and approaches for assessing the performance of an LWU in meeting water security expectations and enable prioritisation for the *Sector Priorities Plan*. The Level of Service Objective for water security for LWUs should be set by the NSW Government based on an acceptable risk.

DCCEEW should conduct a Regulatory Impact Statement (RIS) of the establishment of a outcomes-focused water security standard.

Recommendation 14 **Develop a voluntary customer retail service standard for LWUs.**

A voluntary customer retail service standard should be developed to outline procedures and practices to protect customers, and be included in the Regulatory Assurance Framework.

Elements of this guidance should be made mandatory for receiving funding for any revised state funded hardship payments to ensure implementation of critical state policies such as privacy protection and family violence prevention.

Recommendation 15 **Develop and adopt a Basic Level of Service description under its LWU Funding Policy in consultation with the LWU sector.**

The Basic Level of Service (LoS) should:

- include drinking water supply, wastewater and financial assistance as services
- outline a level of service guidance for the purposes of requesting funding
- provide guidance on extending services to new areas.

## Provision of Services in Western NSW

Recommendation 16 **Immediately establish a reform process to identify and implement the most efficient and effective structure for providing water and sewerage services in Western NSW.**

The reform process should ensure councils and customers retain responsibility for any decision-making pertaining to their council's involvement. The reform process should be conducted on an opt-in basis.

Recommendation 17 **Develop a Strategic Business Case (SBC) for CSO funding to Western NSW LWUs based on the output of the reform process.**

The Commission considers that a new Western NSW LWU entity could be the first candidate for a CSO agreement.

## Pensioner rebates

- Recommendation 18 **Evaluate pensioner rebate on all water services before the 2025-26 Budget.**
- DCCEEW should lead an evaluation to identify the policy objectives of existing water pensioner rebates and assess appropriateness of existing arrangements for providing concessions, including eligibility criteria.
- The evaluation should consider alternative policy options to deliver on the policy objectives, including exploring broader cost of living options to address affordability challenges for low-income cohorts.
- Recommendation 19 **Fund any targeted concessions/rebates deemed necessary in the LWU sector via a transparent CSO.**
- Recommendation 20 **Develop a service level agreement with OLG where a CSO is paid to all LWUs to support rebates/concessions to address hardship pressures.**
- The service level agreement should include key performance indicators to measure the effectiveness of the CSO in meeting its stated objectives. This could be done in aggregate for the LWU sector with appropriate reporting requirements.
- Recommendation 21 **Include the principles and approach to funding a CSO for hardship rebates in the *LWU Funding Policy* to be developed over the next 12 months.**

# 1 Introduction

In August 2023, the Honourable Rose Jackson MLC, Minister for Water ('the Minister') requested the NSW Productivity and Equality Commission ('the Commission') undertake a review ('the Review') into the funding arrangements for Local Water Utilities (LWUs) across New South Wales. The terms of reference for the Review are provided in **Appendix A**.

The NSW Government's policy position is that there will be no forced amalgamations of local councils and that councils will continue as the owners of their water and sewerage assets. This policy position is a critical assumption of this Review.

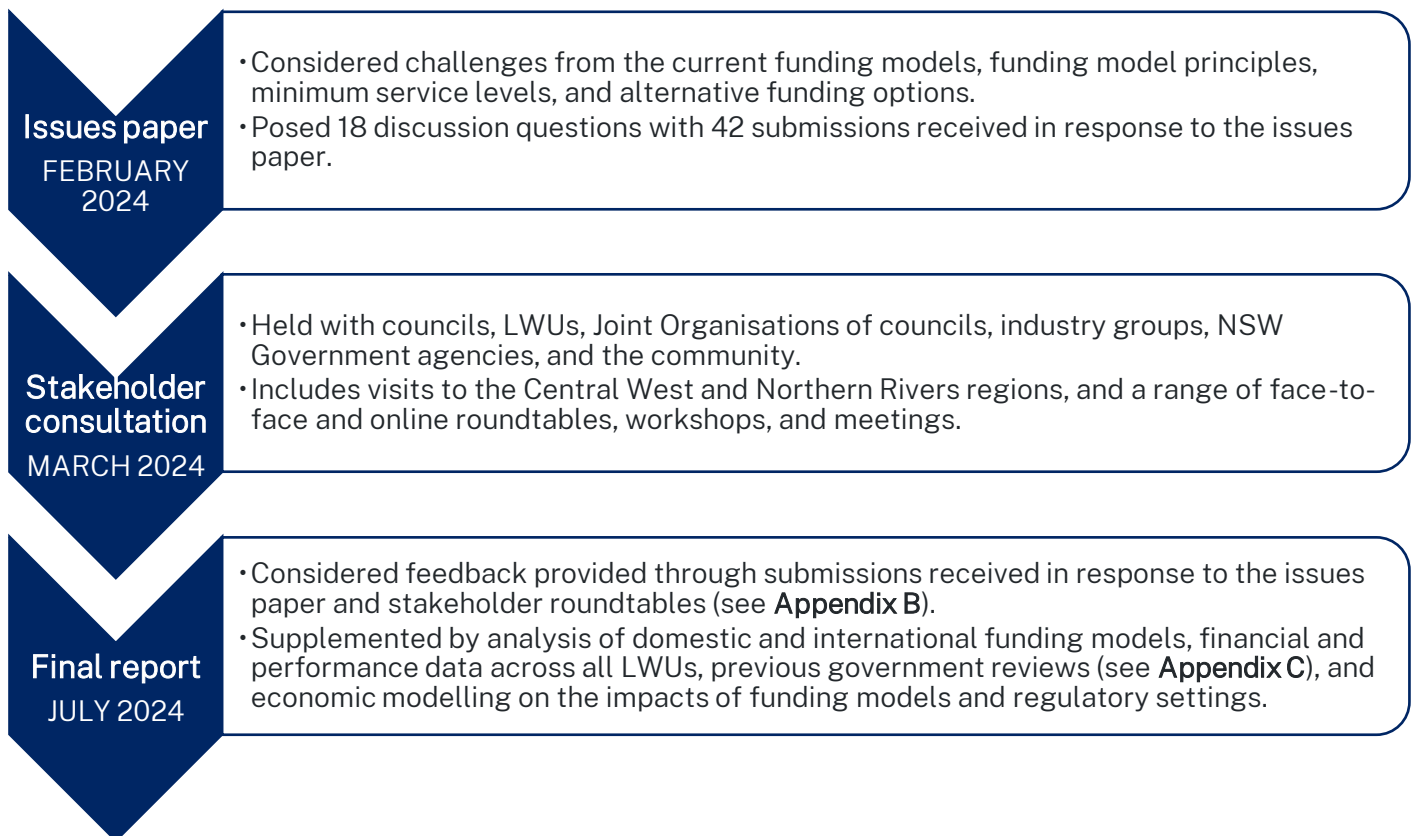
The Review has considered:

- minimum levels of service
- the diversity of LWUs
- the extent to which funding models could positively incentivise and improve the performance of LWUs
- transition pathways to a new funding approach and ways to leverage the capabilities of State Owned Corporations (SOCs).
- pensioner rebates.

The approach for the Review is summarised in **Figure 4**:

- release of an Issues Paper inviting public submissions in February 2024
- stakeholder consultations to discuss the current system, including strengths, weaknesses, and gaps in March 2024
- development of a Final Report with recommendations provided to the Minister in July 2024.

Figure 4: Approach to the Review



To inform the development of options and recommendations, the Review has:

- analysed extensive source materials, including data on the operational and financial performance of LWUs, previous government reviews at State and Federal level, local council and NSW government submissions to other inquiries and observations from reform in other Australian States.
- drawn on public submissions in response to the Issues Paper
- gained input from government agencies, industry and local government through round table discussions, targeted one-on-one consultation and site visits to the Central West and Northern Rivers
- analysed and commissioned modelling to understand the existing financial performance, size, and scale of LWUs in New South Wales and an examination of the future challenges they face.

We have structured the Final Report as follows:

- **Chapter 2** provides an overview of the current state of the sector.
- **Chapter 3** outlines the financial performance and sustainability of LWUs.
- **Chapter 4** identifies some future challenges that will have cost implications for LWUs.
- **Chapter 5** outlines the role of NSW Government in funding the sector.
- **Chapter 6** sets out the strategic framework that LWUs should comply with.
- **Chapter 7** outlines how to set up community service obligation (CSO) payments.
- **Chapter 8** identifies concept of a Basic Level of Service (Basic LOS) for funding purposes and steps to ensure that the LWU regulation is fit for purpose and cost effective.
- **Chapter 9** focuses specifically on the treatment of LWUs in western NSW.
- **Chapter 10** explores existing pensioner rebates and payment assistance schemes for water and sewerage services in New South Wales.
- **Chapter 11** provides an implementation plan which outlines a pathway to transition to a new funding approach.

## 2 Overview of the local water utility sector

### Findings – The Local Water Utility Sector

- **Local councils are responsible for the efficient operation of water and sewerage services in New South Wales** – these services are generally provided by council-owned and operated LWUs.
- **LWUs are subject to a regulatory framework** – the Department of Climate Change, Energy, Environment and Water (DCCEEW) is the primary regulator of LWUs and responsible for overseeing their delivery of safe, secure, sustainable, and affordable services and management of water service risks. LWUs are also regulated by NSW Health, the NSW EPA, the NSW Dam Safety Committee and other regulators for certain functions.
- **LWUs are diverse and face unique challenges** – each LWU is different and faces unique challenges due to factors like the number of connections, location, and organisational and community capacity. Of the 85 LWUs, 19 are very small (22 per cent), 42 are small (49 per cent), 10 are medium (12 per cent), and 14 are large (16 per cent).
- **LWUs set their own prices and service levels** – LWUs are responsible for setting prices based on the costs they face and the levels of service their communities expect. Levels of service also do not apply uniformly across New South Wales as there are no mandatory minimum service levels for LWUs.

### 2.1 Local councils are responsible for the provision of water and sewerage services

Under the *Local Government Act 1993*, local councils are responsible for the provision of water and sewerage services in New South Wales. These services are provided by 85<sup>5</sup> council-owned and operated LWUs servicing around 90 LGAs.

The Joint Select Committee on Protecting Local Water Utilities from Privatisation found that local governments are best placed to own and operate their water and sewerage services in regional New South Wales (Joint Select Committee on Protecting Local Water Utilities from Privatisation 2024). The Committee identified various benefits of local government ownership:

- Councils understand local demographics and can integrate water services and infrastructure planning within a broader urban planning context
- Local governments can collaborate to achieve economies of scale and operate more efficiently
- Privatisation would adversely affect the financial sustainability of councils.

Over the course of the Review, the NSW Productivity and Equality Commission (Commission) heard widespread support for local councils retaining ownership and responsibility for LWUs. The NSW Water Directorate captured the views of many.

Over time, many studies on water services for regional Australia have implied that the only way to achieve sustainable water supplies for smaller communities is with economies of scale. That can be interpreted to mean that the control of water services

<sup>5</sup> Not included in this number are four county councils which operate across multiple Local Government Areas, as well as three water supply authorities and Central Coast Council which operate under the Water Management Act and are subject to economic regulation via IPART. We have not considered these organisations in our analysis for simplicity given their unusual operating environments. County councils should be subject to the recommendations of this review.

must be taken away from local communities. Most communities want to be empowered and supported to solve their problems locally.

(Water Directorate 2024, 16)

The terms of reference for this Review assumes the NSW Government's policy position that there will be no forced council amalgamations, and that councils will continue as the owners of their water and sewerage assets (see **Appendix A:**).

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## 2.2 LWUs are subject to a regulatory framework

The Department of Climate Change, Energy, Environment and Water (DCCEEW) is the primary regulator of LWUs and responsible for overseeing their delivery of safe, secure, sustainable, and affordable services and management of water service risks. DCCEEW's functions are documented in the 'Regulatory and assurance framework for local water utilities' (RAF), which was developed to set common objectives for the sector, provide a rationale for oversight, and clearly document the roles of DCCEEW. According to the RAF, DCCEEW has five key functions:

1. **Policy and strategy** – responsible for the NSW Water Strategy, which sets a 20-year overarching vision for regional and metropolitan water strategies in New South Wales.
2. **Advisory and support** – provides free, independent, and impartial advice and support to assist LWUs manage and reduce risks.
3. **Regulatory** – regulates technical assessment and approvals (water treatment and sewage works, sewage discharge, treatment or supply, works inspections, and discharge of liquid trade waste<sup>6</sup>), and dividend payments.
4. **Assurance** – considers the effectiveness of strategic planning, which includes:
  - a. understanding service needs; water security; water quality; environmental impacts; system capacity, capability, and efficiency; other key risks and challenges; solutions to deliver services; resourcing needs; and revenue sources,
  - b. making and implementing sound strategic decisions,
  - c. implementing sound pricing and prudent financial management, and
  - d. promoting water cycle management.
5. **Funding** – manages programs such as Safe and Secure Water Program and the Aboriginal Communities Water and Sewerage Program.

LWUs are also subject to regulations and guidelines managed by various other state government agencies (see **Table 1**).

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<sup>6</sup> Under section 60 of the Local Government Act and section 292(1)(a) of the Water Management Act.



Table 1: LWU regulatory framework

Agency	Purpose	Regulation/Guideline
NSW Health	To ensure safe drinking water.	<ul style="list-style-type: none"> <li>Australian Drinking Water Guidelines</li> <li><i>Public Health Act 2010</i></li> </ul>
NSW Environment Protection Authority (EPA)	To protect the environment.	<ul style="list-style-type: none"> <li><i>Protection of the Environment Operations Act 1997</i></li> </ul>
Office of Local Government (OLG)	To oversee LWU governance, financial management, and reporting.	<ul style="list-style-type: none"> <li><i>Local Government Act 1993</i></li> <li><i>Local Government Regulation 2021</i></li> </ul>
WaterNSW	To operate and monitor the state's dams and waterways.	<ul style="list-style-type: none"> <li><i>Dams Safety Act 2015</i></li> </ul>

## 2.3 But all LWUs face unique challenges

Each LWU is different and faces unique challenges due to factors like the number of connections, location, and organisational and community capacity.

Most LWUs in New South Wales are small or very small, meaning they have fewer than 10,000 connections (see **Figure 5**). Of the 85 LWUs, 19 are very small (22 per cent), 42 are small (49 per cent), 10 are medium (12 per cent), and 14 are large (16 per cent).<sup>78</sup> Large LWUs – those with between 20,000 and 50,000 connections – are predominately located in coastal areas and around key inland cities such as Wagga Wagga, Dubbo, Tamworth, and Albury.

Small LWUs face unique challenges such as a lack of economies of scale, difficulty attracting or affording specialist skills, and issues with cost recovery. Over time, this can have flow on performance impacts. The Commission's Issues Paper identified that, compared to larger LWUs, small and very small LWUs experience:

- greater water quality and environmental risks,
- greater water security risks,
- lower performance and higher risks according to the operational performance metrics from the Performance Monitoring Database and existing risks ratings<sup>9</sup>, and
- weaker balance sheets due to a lack of economies of scale.

Location also plays a role. While most (81 per cent) LWUs are in areas classified as 'regional' by the ABS, 19 per cent are in remote areas in Western NSW. Very small and remote LWUs tend to service some of the most socio-economically disadvantaged communities in NSW, as shown by the low average Socio-Economic Indexes for Areas (SEIFA). Operating costs per connection for small and

<sup>7</sup> The NSW Department of Climate Change, Energy, the Environment and Water (DCCEEW) maintains a significant database of local water utilities performance against a range of asset management, operational, and financial metrics (The Performance Monitoring Database). The data is freely available online.

<sup>8</sup> Very small LWUs have less than 2,000 connections, small LWUs have between 2,000 and 10,000 connections, medium LWUs have between 10,000 and 20,000 connections, and large LWUs have more than 20,000 connections.

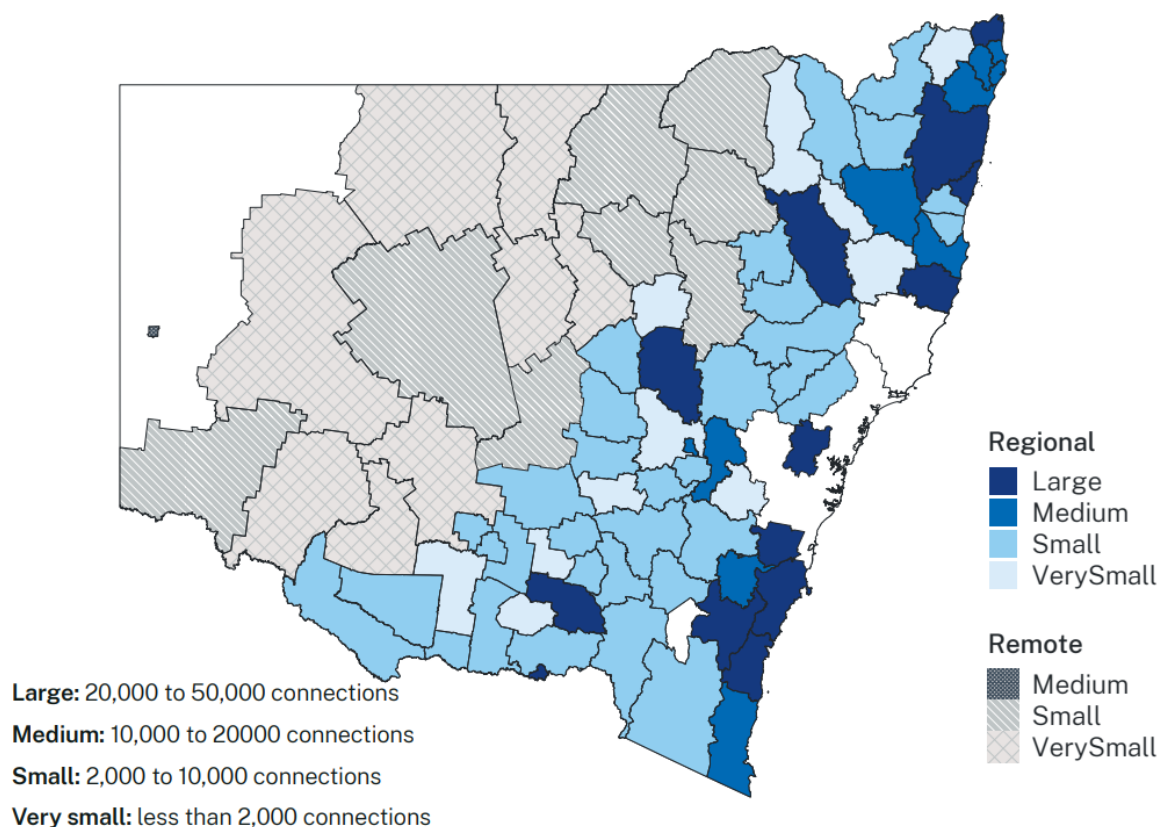
<sup>9</sup> NSW DCCEEW currently uses a risk-based approach to assess water quality, environmental and water security risk by LWUs, which is used to prioritise government funding for capital investments under its Safe and Secure Water Program.

remote LWUs are almost 70 per cent more than in large utilities. As a result, these LWUs typically experience higher water bills, which places additional cost of living pressures on these vulnerable communities. LWUs with less than 2,000 connections in remote areas have bills around 39 per cent higher (\$1,892 vs \$1,358 per annum) than similar sized LWUs in less remote areas.<sup>10</sup> Achieving cost recovery in these very small and remote LWUs would require price increases of around 10 to 20 per cent – or hundreds of dollars a year – on top of their already high bills. Such an increase would place significant hardship on some customers and have significant impacts on local economies.

The Commission’s Issues Paper identified that, compared to similar sized LWUs in regional areas, LWUs in remote areas:

- experience more main breaks
- Lose more water to leakage
- have higher water bills.

Figure 5: Map of the location of different sized LWUs in NSW



Note: Utilities in areas classed as regional by the ABS are in solid colours and those in remote areas are in dashed lines. Source: DCCEEW, ABS, Frontier Economics analysis, NSW Productivity and Equality Commission analysis 2024.

## 2.4 LWUs set their own prices and service levels

LWUs are responsible for setting prices based on the costs they face and the levels of service their communities expect. These generally consist of a set of discrete charges available for each of its services, including:

- **Water charges** – For the supply of potable and non-potable water to residents and businesses, includes fixed and usage charges.
- **Sewerage charges** – For the collection, treatment, and disposal of wastewater from residents and businesses.

<sup>10</sup> \$2021-22, based on TRB average usage measure, 2016-22 financial years, excludes sewerage only LWUs.

- **Recycled water charges** – For the supply of treated wastewater that is re-used for non-potable purposes such as irrigation.
- **Trade waste charges** – Based on the type and volume of trade waste, these are charges for liquid substances other than domestic sewerage. These are typically from businesses, industrial premises, and septic tanks. Each LWU has their own trade waste policy.
- **Water and sewerage developer charges** – Levied on developers to recover part of the infrastructure costs incurred by servicing new developments or changes to existing developments.

The prices charges by each LWU can be measured as the Typical Residential Bill (TRB). There are two ways of calculating the TRB:

- **Standardised method** – the sum of the water and sewerage service bills based on assumed consumption of 200 kilolitres (kL) per year.
- **Actual usage method** – based on actual annual usage of water and sewerage services to calculate the bill.

**Figure 6** provides the TRB by water utility across New South Wales using the actual usage method across five years to 2022.

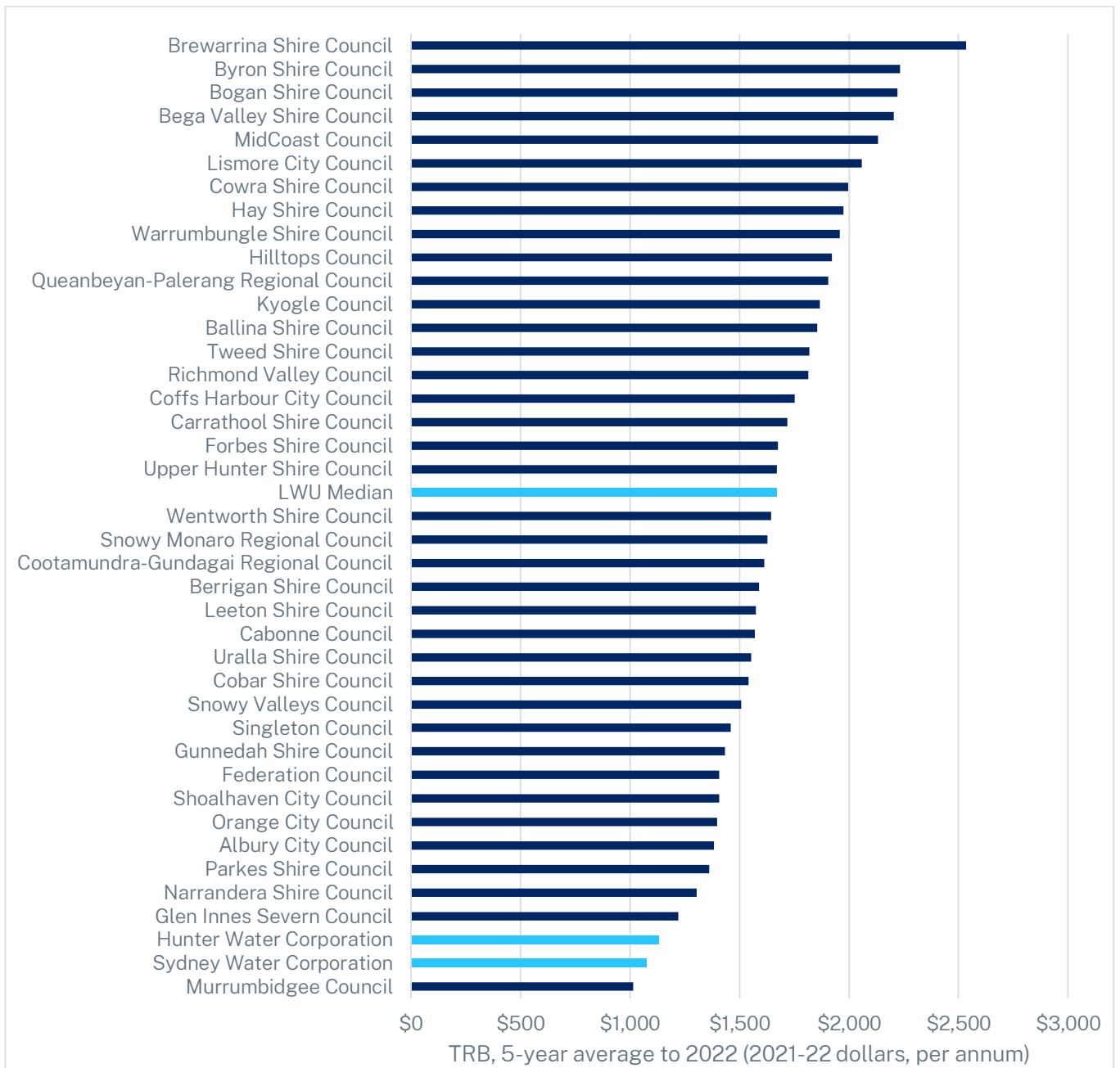
While the median TRB is \$1,671, bills vary greatly across LWUs, ranging from \$1,016 to \$2,535 per year. Using the actual method the highest bill, Brewarrina Shire Council, was \$864 above the median.

Using the standardised method, the TRB ranges from \$1,092 to \$2,577.<sup>11</sup>

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<sup>11</sup> In \$2021-22. Based on a 6-year average to 2022.

Figure 6: Typical Residential Bill based on actual usage, five-year average to 2022 (\$2021-22, per annum)



Note: Analysis excludes sewage only councils under Riverina County Council. Sample councils only, every second result displayed where data exists.  
 Sydney Water and Hunter Water bills based on usage in 2021-22 only.  
 Source: DCCEEW, NSW Productivity and Equality Commission analysis 2024.

**Table 2** shows the five councils with the highest and lowest TRBs based on the actual usage. Interestingly, the TRBs do not differ greatly by size category of utility. The average water usage and sewerage bills of very small LWUs is \$1,714 per annum compared to small (\$1,660), medium (\$1,817) and large (\$1,776) utilities.<sup>12</sup>

<sup>12</sup> TRB based on average usage, 5-year average to 2022, indexed to \$2021-22.

Table 2: Analysis of differences in Typical Residential Bill - Top and Bottom 5 LWUs (\$2021-22)<sup>13</sup>

Highest bills		Lowest bills	
Council	Bill (\$)	Council	Bill (\$)
Brewarrina Shire Council	2,535	Murrumbidgee Council	1,016
Tenterfield Shire Council	2,417	Central Darling Shire Council	1,213
Byron Shire Council	2,233	Glen Innes Severn Council	1,221
Lachlan Shire Council	2,229	Upper Lachlan Shire Council	1,255
Bogan Shire Council	2,222	Narrandera Shire Council	1,304

Note: Analysis excludes sewage only councils under Riverina County Council. TRB based on average usage, 5-year average to 2022.

Source: DCCEEW, NSW Productivity and Equality Commission analysis 2024.

There are no mandatory minimum standards for system reliability for LWUs in New South Wales. This is in contracts to large metropolitan water utilities, such as Sydney Water. As such, the current levels of service are not uniform across the State. Instead, these are set for each supply system, and even for different parts of an individual supply system.

The local approach to setting these levels of services allows communities to understand risks to supply and how different levels of service relate to costs. Ownership of assets also include an onus to agree levels of service with customers.

## 2.5 The NSW Government supports LWUs through grants and rebates

The DCCEEW provides funding for LWUs through several grant programs. The DCCEEW manages two main grant programs:

1. The Safe and Secure Water Program (started 2017) – a \$1 billion program that provides funding for water security, water quality and environmental infrastructure solutions across regional NSW (NSW Government n.d.).
2. The Aboriginal Communities Water and Sewerage Program (started 2008) – a \$200 million program aimed at ensuring the level of water and sewerage services provided to Aboriginal communities is of equivalent standard to nearby non-Indigenous towns (NSW Government n.d.).

These programs, as well as other previous grant programs, are discussed in further detail in **chapter 5**. The NSW Government also plays a role in funding LWUs during times of drought, flood or other water supply and sewerage emergencies.

The NSW Government also provides support through pensioner rebates to assist with cost-of-living pressures. Pensioner rebates for water in New South Wales is discussed in more detail in **chapter 10**.

<sup>13</sup> Based on actual usage, 5-years until 2022 financial year, excludes sewerage only LWUs.

# 3 Financial performance and sustainability of LWUs

## Findings – Sector Funding for LWUs

- **LWUs are responsible for their financial sustainability** – this includes ensuring sufficient revenue streams to allow efficient delivery of the required services.
- **LWUs have access to a range of funding and financing sources** – including customer revenue, borrowings, grants, and subsidies from council. Of these funding sources, customer revenues from end-user charges are the largest and most important source of funding for LWUs. By contrast, there is a limited use of debt funding and a reliance on grants to fund capital works.
- **Customer revenue varies significantly across LWUs** – even though most LWUs generate enough cash flow from customer bills to cover operating costs, many LWUs (especially small and very small LWUs) do not earn sufficient customer revenues to cover total operating and capital expenses, including depreciation and any interest repayments.
- **There are large variations in LWU cost structures** – these differences are primarily driven by size and location. Operating costs per connection for small and remote LWUs are almost 70 per cent more than for large LWUs.
- **Some LWUs have a shrinking customer base** – reflecting the different population growth rates of different geographic areas, some small and very small LWUs are experiencing declining customer numbers while medium and larger sized LWUs are facing increased customer connections. This is expected to further exacerbate the large variances in LWU costs structures, revenues, and customer charges.
- **Some LWUs are unable to achieve cost recovery** – a lower bound pricing approach to set end-user charges means that most LWUs across New South Wales can recover their costs. However, there are some smaller LWUs, and some in remote areas, that are unable to achieve cost recovery. These LWUs are not well placed to deal with future challenges associated with changing demographics, climate change and water security (see **Chapter 4**)
- **Most LWUs do not pay dividends or earn a return on capital** – for the 2022-23 period, only five utilities paid a dividend from their water business totalling \$3 million, and six utilities paid a dividend from their sewerage business totalling \$3.5 million (NSW Government n.d.).

## 3.1 LWUs have operational and financial autonomy

LWUs operate on a standalone basis and have operational and financial autonomy. Accordingly, each LWU is responsible for managing its own financial risks to ensure financially sustainable in both the short and longer term. This means that individual LWUs must ensure that over time it has sufficient revenue streams to allow efficient delivery of the services required by their community.<sup>14</sup>

A financially sustainable provider of water and waste treatment services must generate revenues sufficient to recover both its operating costs as well as a return of, and a reasonable return on capital. Long term it is essential that LWUs can replace and upgrade network infrastructure to ensure future ongoing service provision consistent with community needs and expectations. It is also important that LWUs generate a reasonable return on invested assets to justify the opportunity cost of those investments by local councils.

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<sup>14</sup> Intergovernmental Agreement on a National Water Initiative 2004, Pricing Principles paragraph 3(ii).



Ideally, consistent with The National Water Initiative (NWI), these costs should be fully recovered by revenues from customer charges (see **Box 1**). If, however, cost recovery means user charges exceed customers' capacity to pay (i.e. services are not affordable) then LWUs have other funding options available which support long-term financial sustainability over its entire life cycle.

#### Box 1: The National Water Initiative

The NWI establishes an aim of full cost recovery from end user charges of water and wastewater treatment services. It acknowledges there will be some small community services that will never be economically viable and therefore proposes an alternative pricing framework that seeks to maintain continuity of services to meet social and public health obligations.

Lower-bound pricing refers to a pricing strategy where user charges are set at a level which covers a LWU's costs associated with operating and maintenance of a water and sewerage system as well as any administrative costs, externalities, taxes (or tax equivalents), interest payments on debt, and makes provision for the future costs of asset refurbishment or replacement.

Upper bound pricing is the same as lower bound but includes the addition of recovery of a return on capital invested which requires estimating a cost of capital over time.

Benefits of cost reflective pricing are that it:

- Places a discipline on the utility owners to keep costs as low as practically possible.
- Drives good asset planning by encouraging the LWU to consider future capital costs when setting current charges.
- Sends a signal to customers about the opportunity cost of water consumption when the utility sets a usage price reflecting marginal costs.

Where an LWU adopts a lower-bound pricing strategy to set end-user charges, it can use debt and other funding sources to manage variability in cashflows and to remain financially viable in the long-term (Australian Government, Department of Climate Change, Energy, the Environment and Water, 2023).

## 3.2 LWUs have access to a range of funding sources

LWUs have several funding sources available to them, including customer charges, borrowing, grants, and subsidies from councils. Each of these funding sources and the extent to which LWUs rely on them is detailed below.

### 3.2.1 Customer revenues

Customer revenues, which are generated from end-user charges and developer charges, are the most significant source of funding for LWUs. Total customer revenue across LWUs in New South Wales is around \$1.4 billion per annum.<sup>15</sup>

Analysis over a five-year period suggests while there is some variability in customer revenues over time, it is, generally a relatively stable and growing source of funding for LWUs. The real growth in customer revenues was around 1 per cent per annum.<sup>16</sup> This growth is due to modest annual increases in end-user charges as well as increased total water consumption reflecting populations growth in some geographic regions. Importantly, year to year fluctuations in customer revenues are experienced mostly due to climate-related events, such as droughts resulting in water restrictions.

Customer revenues and the extent to which they recover efficient costs vary significantly across LWUs. This is discussed in **section 3.3**.

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<sup>15</sup> In \$2021-22, based on five-year average to 2022.

<sup>16</sup> Based on yearly growth average over five years to 2022, excludes utilities missing data for this time period.

### 3.2.2 Debt funding

As detailed in **Table 3**, LWUs typically have limited use of debt. Reasons for this include:

- Smaller LWUs that experience cash flow challenges find it challenging to access debt funding.
- Debt is not a common source of funding for capital projects. Capital projects tend to be funded from grants.

Table 3: Debt funding statistics by LWU size based upon number of connections, 2021-22 financial year

	Proportion of utilities with zero debt	Average debt to equity <sup>17</sup>	Proportion meeting T-Corp Interest Cover Ratio Benchmark <sup>18</sup>
Large	0%	5%	91%
Medium	0%	6%	100%
Small	40%	6%	85%
Very Small	32%	4%	100%

Source: DCCEE, Frontier Economics Analysis, NSW Productivity and Equality Commission analysis 2024.

Note: Large (20,000-50,000 connections), Medium (10,000-20,000 connections), Small (2,000-10,000 connections) and Very Small (Less than 2,000 connections).

The fact that LWUs have low debt to equity ratios represents a missed opportunity for LWUs and councils because:

- The cost of debt is generally lower than the cost of equity. Hence, by developing and maintaining an efficient capital management plan, a LWU may be able to lower its overall costs.
- Debt funding may allow LWUs to better manage cash flows over time thus mitigating the adverse impacts of short-term variability in customer revenues. This would facilitate long-term planning of maintenance and capital works programs by LWUs.
- Debt funding for maintenance and capital works programs could reduce the reliance of LWUs on grants. In turn, this would provide customers and the wider community with greater confidence in respect of service continuity as well as ongoing service performance improvements.
- Efficient use of debt funding may allow councils to free up scarce resources, currently committed to LWUs, to fund other socially beneficial projects.
- Debt funding would impose additional commercial discipline on LWU management. As the allocation of debt funding is a competitive process, LWUs would need to justify to debt-investors the commercial sustainability of their businesses and any incremental projects for which debt funding is sought.

### 3.2.3 Grants

LWUs typically receive grant funding from governments to undertake asset upgrades or investment such as pipes, dams, pumps, and treatment plants. Currently, the Safe and Secure Water Program provides NSW Government funding for capital projects, prioritised according to a risk assessment. LWUs can also receive financial assistance grants from the Australian Government.

The Commission estimates that over \$1.3 billion has been allocated to LWUs in grants over the last 10 years. The Commission was unable to obtain a detailed yearly breakdown to analyse expenditure over time (discussed further in **section 5.1.1**)

### 3.2.4 Funds from council

In addition to the pensioner rebates, some councils such as the Shoalhaven City Council have Payment Assistance Schemes (PAS), or similar programs are self-funded through the water fund. This PAS provides emergency support for any customer facing financial difficulty. Other LWUs

<sup>17</sup> Excludes LWUs with no debt.

<sup>18</sup> Excludes LWUs with no debt.

provide similar programs. For example, Riverina Water and the Central Coast Council ask customers who are experiencing serious financial hardship to contact them as they can assist those struggling to manage their water bills, such as offering an extended payment plan (Riverina Water n.d.).

Whether LWUs have hardship policy and an associated PAS is a decision for local councils. The Commission is uncertain as to how many of LWUs currently have a hardship policy. Where they do, NSW Government does not provide funding for LWUs for hardship purposes.

### 3.3 Customer revenue varies significantly across LWUs

As discussed in **section 3.2**, customer revenue is the most important funding source for LWUs and is relatively stable over time. That said, the extent to which customer revenue are sufficient to recover costs varies significantly across LWUs, with the majority of LWUs currently unable to pay a dividend to their shareholder council.

#### 3.3.1 Customer revenues vary significantly between LWUs

LWU customer revenue ranges from just under \$1.4 million to almost \$95 million per annum.<sup>19</sup> The 20 LWUs with the lowest customer revenue make up 4.1 per cent of total LWU customer revenue.<sup>20</sup>

On average, these 20 LWUs with the lowest customer revenue generate around \$2.8 million per annum from their water and sewerage businesses, contrasting with the top 20 LWUs by customer revenue whose average customer revenue stands at approximately \$46.4 million.

Table 4: Average annual revenue from customers over the past 5 years by percentile

Percentile	Revenue from customers per annum (\$m) <sup>21</sup>
Bottom 20 per cent	3,889
40 per cent	7,404
60 per cent	11,849
Top 20 per cent	32,463

Note: Excludes sewerage only councils, e.g. councils where Riverina County Council provides water supply.  
Source: DCCEEW, NSW Productivity and Equality Commission analysis 2024.

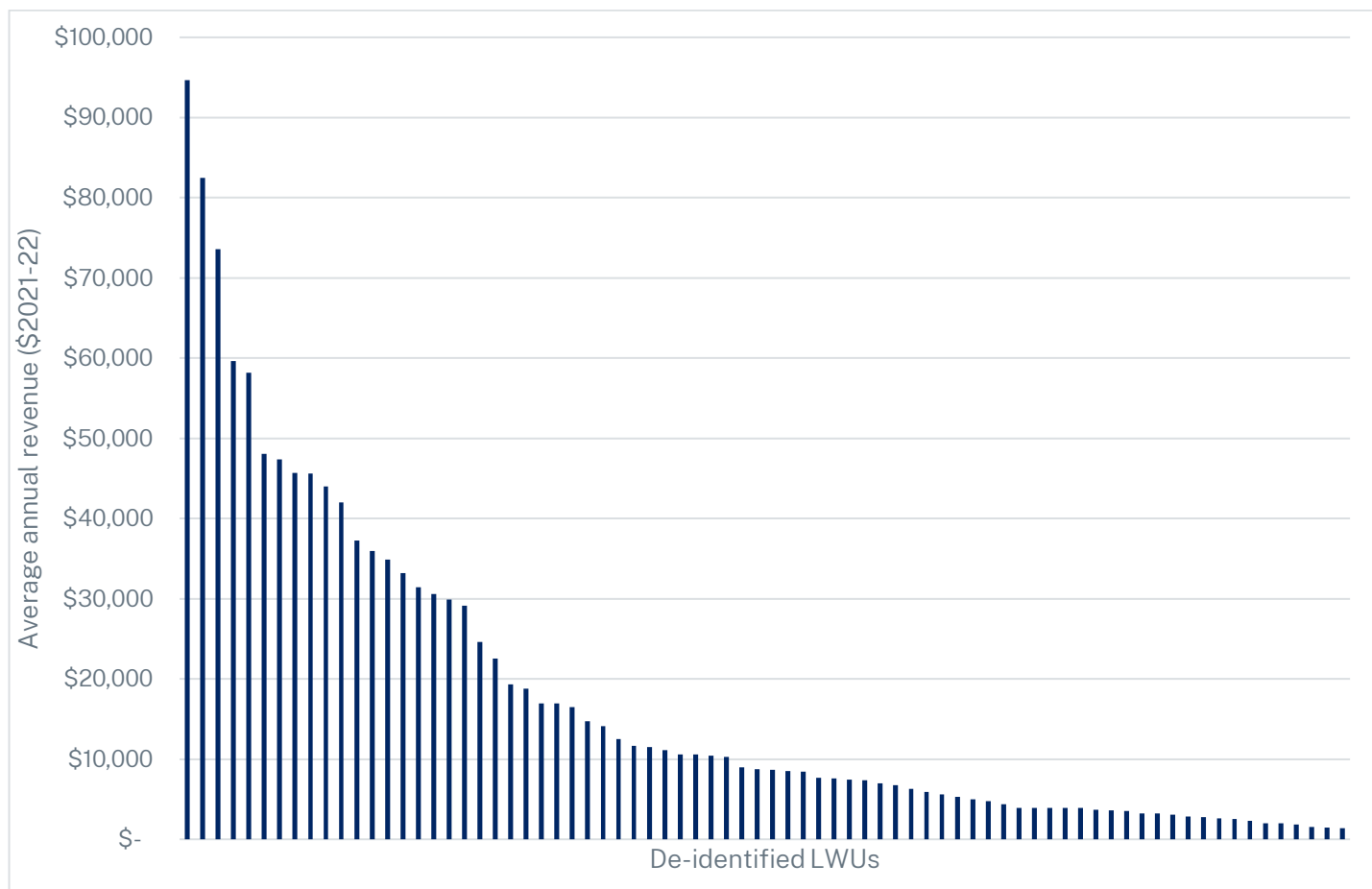
**Figure 7** shows the range of total customer revenues of LWUs. Annual customer revenue ranges from just over \$1.3 million to about \$95 million per year, with a median value of \$8.7 million.

<sup>19</sup> Excluding Central Coast Council.

<sup>20</sup> In \$2021-22. Based on average annual revenue over five years to 2021-22 financial year.

<sup>21</sup> In \$2021-22. Based on average annual revenue over five years to 2021-22 financial year.

Figure 7: Local water utility annual revenue by utility (\$2021-22)



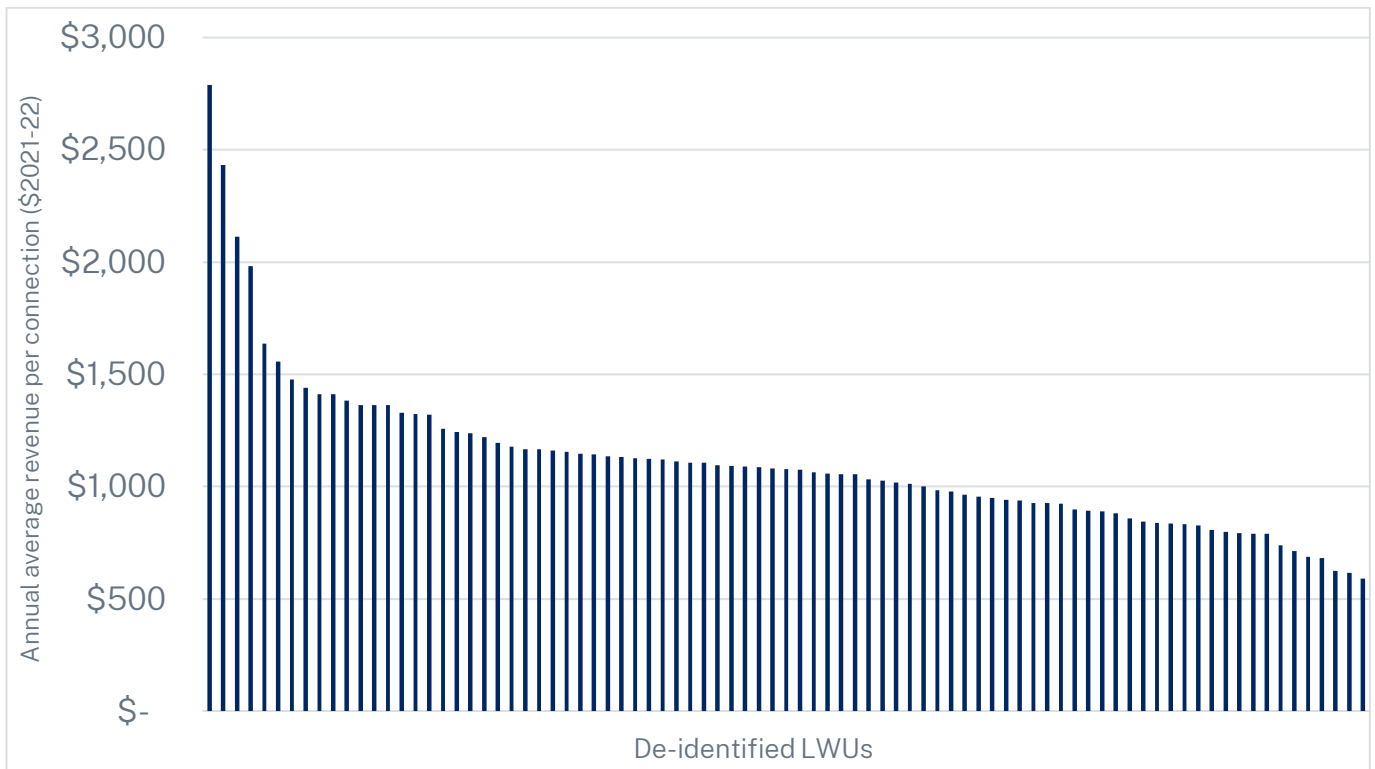
Source: DCCEEW, NSW Productivity and Equality Commission analysis 2024.

**Figure 8** shows estimated customer revenue per connection for each utility in 2021-22.<sup>22</sup> Revenues ranged from over \$2,700 per customer to less than \$800 per customer across the LWUs with water and sewerage connections. The median value was \$1,090 per connection.<sup>23</sup>

<sup>22</sup> Based on average customer revenue and average number of connections in the five years to 2022.

<sup>23</sup> Uses five-year average to the 2021-22 financial year, across 1,259,784 water and sewerage connections.

Figure 8: Customer revenue per connection for 85 utilities (\$2021-22)



Note: The analysis treats each residential and non-residential customer counts as a single connection. Includes sewerage only utilities, which generally have a lower customer revenue per connection than LWUs providing water and sewerage services.

Source: DCCEEW, NSW Productivity and Equality Commission analysis 2024.

### 3.3.2 Many LWUs struggle to cover their costs from user charges

While all LWUs generate enough cash flow from customer revenue to cover operating costs, across LWUs the average ratio of customer revenues to operating costs, the coverage ratio, is low relative to the national average for all utilities with more than 10,000 customers (see **Table 5**). When all expenses including depreciation and interest repayments (if any) are included, many LWUs, especially those that are small and very small, struggle to cover costs through customer revenue alone.

Table 5: Assessment of expenses versus user charges by LWU size, 2016-2022 financial years

LWU size	Per cent of operating to total expenses	Per cent of operating expenses covered by user charges	Per cent of total expenses covered by user charges
Very Small	65	137	90
Small	63	154	97
Medium	63	159	101
Large	56	185	104

Source: DCCEEW, Frontier Economics analysis, NSW Productivity and Equality Commission analysis 2024.

Note: Large (20,000-50,000 connections), Medium (10,000-20,000 connections), Small (2,000-10,000 connections) and Very Small (Less than 2,000 connections).

### 3.3.3 LWUs face different costs structures

LWUs face different costs structures. **Table 6** shows operating costs per connection for small and remote LWUs are almost 70 per cent more than those of large LWUs. This means there are higher operating costs per connection and less customers to pay.

Table 6: Operating costs per connection, by LWU size, 2016-2022 financial years

LWU size	Operating costs per connection	
	Regional	Remote
Very Small	\$656	\$868
Small	\$634	\$794
Medium	\$686	n.a
Large	\$511	n.a

Source: DCCEEW, NSW Productivity and Equality Commission analysis 2024.

Notes: Operating costs do not include borrowings, asset disposals or depreciation. n.a – no utilities fit this category. Large (20,000-50,000 connections), Medium (10,000-20,000 connections), Small (2,000-10,000 connections) and Very Small (Less than 2,000 connections).

Operating costs per connection is derived from the maximum operating costs and maximum number of connection between 2016 and 2022 financial years.

Smaller LWUs generally have a larger number of staff per connection (see **Table 7**). This is due to the large geographic footprint and low economies of scale of smaller LWUs. A base level of labour force is required to operate and maintain assets that may be disproportionate to the number of customers serviced that are widely dispersed.

Table 7: Rate of full-time equivalent staff members, by LWU size, 2016-2020 financial years

LWU size	FTEs per 1,000 connections		Average number of FTEs per LWU	
	Regional	Remote	Regional	Remote
Very Small	6.8	7.6	19	14
Small	4.4	7.2	41	41
Medium	3.3	NA	88	n.a
Large	3.7	NA	198	n.a

Source: DCCEEW, Frontier Economics Analysis, NSW Productivity and Equality Commission analysis.

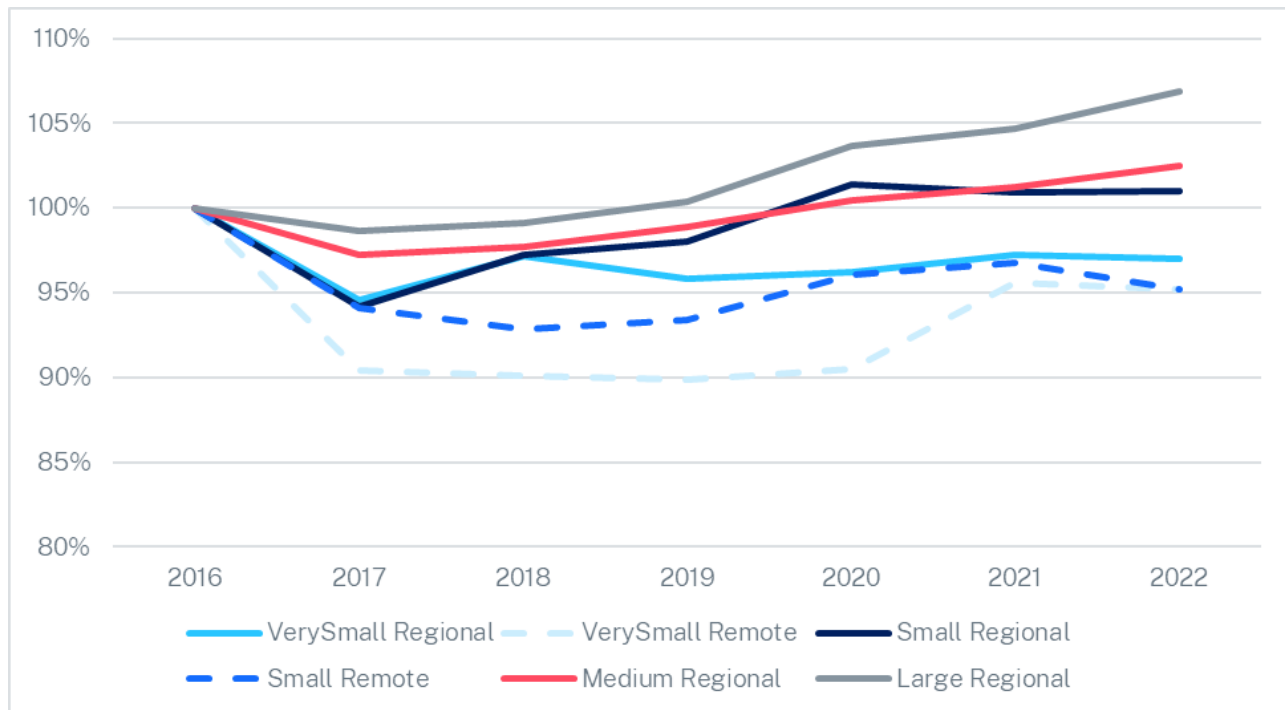
Notes: n.a means no utilities fit this category; Large (20,000-50,000 connections), Medium (10,000-20,000 connections), Small (2,000-10,000 connections) and Very Small (Less than 2,000 connections). FTE numbers are based on the highest reported by the utilities between 2016 and 2020 financial years.

Over time, several factors drive changes in the costs faced by LWUs. Of these factors changes in population is perhaps the most significant. Increased population can drive additional connections resulting in economies of scale and hence lower costs per customer. On the hand, population decline results in diseconomies of scale and higher costs per customer.

Larger regional centres and coastal areas have generally experienced sustained population growth, while smaller remote towns have typically had stagnant or declining populations. Accordingly, LWUs that serve large regional centres have experienced growth in the number of new connections and falling costs per connection. By comparison, some very small LWUs face increased costs per connection due to population decline and a reduction in the number of connections (see **Figure 9**).



Figure 9: Change in number of connections (compared to 2015-16 financial year)



Source: NSW Department of Planning Population Projections (2022).

Note: Large (20,000-50,000 connections), Medium (10,000-20,000 connections), Small (2,000-10,000 connections) and Very Small (Less than 2,000 connections).

### 3.3.4 Some LWUs are unable to achieve cost recovery

Most LWUs adopt lower-bound pricing strategies to set end-user charges. While cost recovery for LWUs with more than 10,000 connections is high, for smaller and remote LWUs this is not the case. In fact, some LWUs are currently recovering as little as 80 per cent of their costs from customer revenues (see **Table 8** and **Figure 10**).

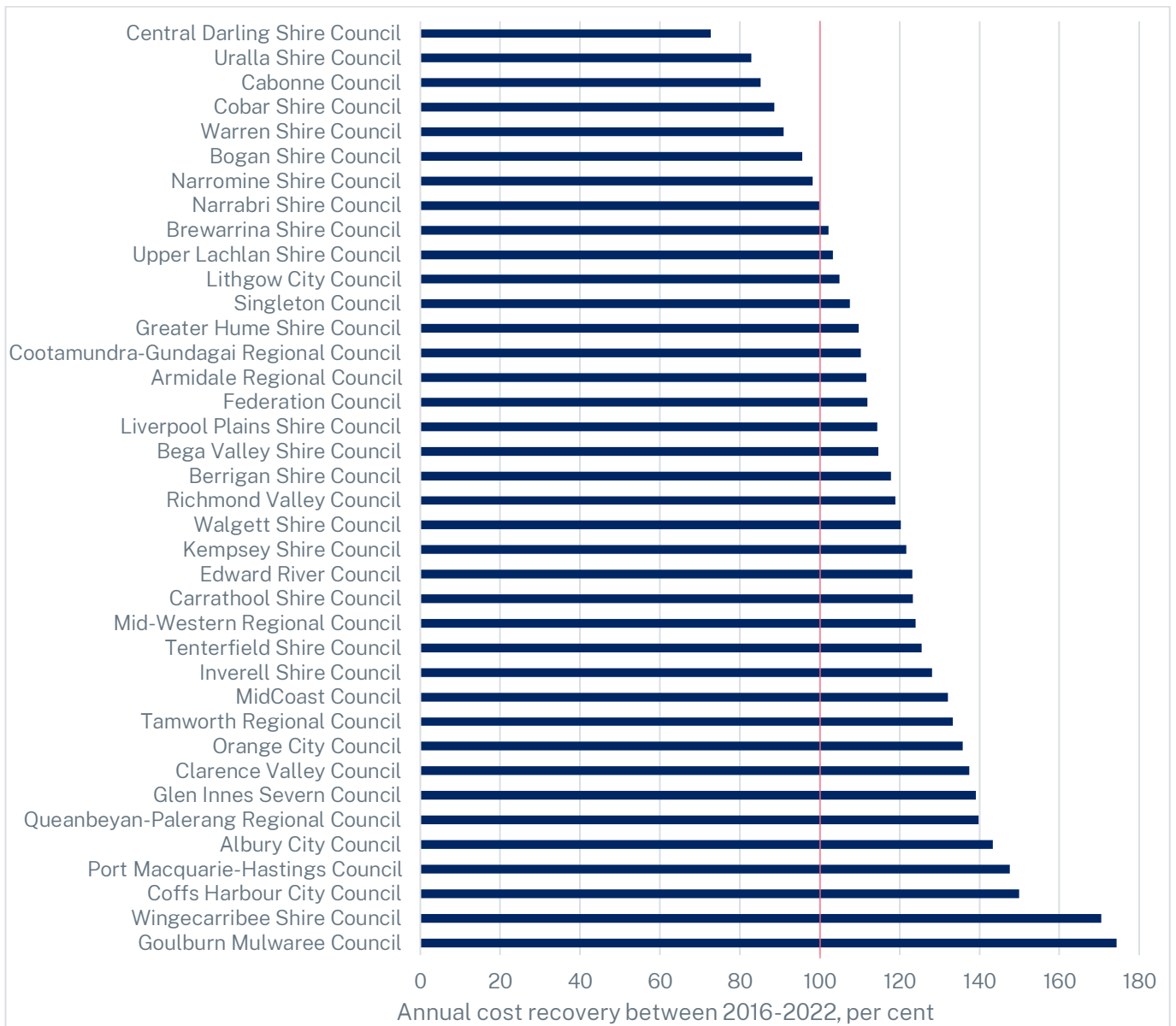
Table 8: Proportion of utilities achieving cost-recovery between 2016 and 2022 financial years, by LWU size

LWU size	Regional		Remote	
	Number of utilities	Proportion achieving cost recovery 2016-2022	Number of utilities	Proportion achieving cost recovery 2016-2022
Very Small	11	43%	8	50%
Small	34	90%	8	50%
Medium	10	100%	0	n.a
Large	14	100%	0	n.a
Total	69		16	

Source: DCCEEW, Frontier Economics analysis, NSW Productivity and Equality Commission analysis.

Notes: We considered a utility achieved cost recovery if its annual ratio of revenue to expenses was greater than one on average over the years 2016 to 2022. Large (20,000-50,000 connections), Medium (10,000-20,000 connections), Small (2,000-10,000 connections) and Very Small (Less than 2,000 connections).

Figure 10: Average percent of cost recovery between 2016-22 financial years



Note: Sample councils only, every second result displayed where data exists. Cost recovery (lower bound) = (Total revenue excluding capital works grants and interest income) divided by (sum of opex and depreciation).  
 Source: DCCEEW, Frontier Economics analysis, NSW Productivity and Equality Commission analysis.

Most LWUs are unable to generate a return on capital. For the 2022-23 period, only five LWUs paid a dividend from their water business totalling \$3 million, and six paid a dividend from their sewerage business totalling \$3.5 million (NSW Government n.d.).

Our analysis has shown that there is a significant cost recovery issues facing smaller and remote LWUs.

## 4 Future challenges will have significant cost and price implications for local communities

### Findings – Future challenges will have significant cost and price implications for local communities

- **Several challenges will impact LWUs in the future** – these include responding to changes in regulatory standards, managing population shifts, managing water security and climate change risks, replacing ageing infrastructure, changing customer expectations, and increasing construction and labour costs.
- **The challenges will impact LWUs in different ways** - while LWUs will be impacted differently, these challenges are likely to place significant upward pressure on both capital and operating costs for all LWUs.
- **The financial sustainability of LWUs necessitates increases in customer revenues** – in the face of expected higher capital and operating costs LWUs must generate higher own source funding to ensure their ongoing financial viability.
- **LWUs that have the capacity to increase user charges can improve their financial viability** – comparison of current prices and revenues suggests that most LWUs have the capacity to increase customer revenues. Financial modelling shows that if LWUs that face increasing costs lift prices to align with higher prices currently paid by customers in higher charging LWUs, it will allow most, but not all, LWUs to recover their costs.
- **The LWU sector as a whole has significant revenue generating capacity to respond to challenges.**

### 4.1 LWUs will need to adapt to changing regulatory standards

LWUs have several regulatory requirements they must manage including:

- ensuring drinking water quality under the *Public Health Act 2010*
- managing sewerage discharges to the environment under the *Protection of the Environment Operations Act 1997*
- holding appropriate water licences and works approvals under the *Water Management Act 2000*
- ensuring safe and effective fluoridation of their drinking water under the *Fluoridation of Public Water Supplies Act 1957*
- managing risks to public safety from council owned dams under the *Dam Safety Act 2015*.

LWUs also have approval requirements for water treatment and sewerage plants under the *Local Government Act 1993* (generally referred to as section 60 approvals). This process is designed to ensure that an LWU's plants meet regulatory standards and are fit-for-purpose. DCCEEW also periodically inspects the safety, operation and maintenance of water treatment works and sewage treatment works.

Complying with regulatory standards drives significant cost for LWUs, especially water and sewerage standards. These requirements are an essential part of an LWU's 'core business' and cannot be easily avoided (Water Directorate 2024). Health and environmental regulators also expect LWUs to improve their performance over time where they are not supporting policy objectives. Some examples of this include:

- The NSW EPA may require LWUs with poorly performing sewer plants to reduce their impact in the medium to long-term through a Pollution Reduction Program (Environmental Protection Authority 2003). When LWUs upgrade or replace sewer plants they are often expected to meet higher performance expectations through tighter licencing conditions.
- NSW Health is currently rolling out a set of health-based microbiological targets for LWUs. This may require significant new investments in water treatment technology in some areas, which LWUs may struggle to fund (Central NSW Joint Organisation 2024).

Submissions indicated that regulation, in particular ongoing changes to the regulations, are a significant driver of both capital and operational costs for LWUs. The Central NSW Joint Organisation (2024) said the pace of regulatory change has meant existing infrastructure and, in some cases, newly approved infrastructure still under construction, has been unable to keep pace with the higher regulatory standards.

While obviously drinking water must meet the Australian Drinking Water Guidelines and be safe to drink, in some communities the costs associated with the ever-increasing standards expected by regulators may not be able to be funded by the community.

(Central NSW Joint Organisation 2024, 7)

Similarly, The NSW Water Directorate (2024) highlighted how a change in a regulator's risk appetite results in a significant cost burden for an LWU. Moreover, a blanket approach to infrastructure fails to achieve a desirable outcome.

Significant cost burdens can accrue on an LWU due to a change in risk appetite from any regulator. A one-size fits all approach to infrastructure provision must be avoided to achieve fit-for-purpose, more cost-effective and sustainable local solutions.

(Water Directorate 2024, 4)

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## 4.2 Population changes have a significant impact on LWUs

Over the past decade, regional NSW has experienced split growth rates, depending on location:

- Larger regional centres and coastal areas have generally experienced sustained population growth.
- Smaller remote towns however have typically had stagnant or declining populations (Australian Bureau of Statistics 2024) (NSW Productivity Commission 2024).

These demographic changes can have significant cost and revenue implications for LWUs.

In areas of regional NSW with rapidly growing populations – like the North Coast and some inland cities – providing new water and sewer infrastructure will be a major challenge. It requires LWUs to construct new mains, pump stations, reservoirs, bores, pipelines, and even entirely new treatment plants for large increases in population. For example, Tamworth's 2018 Development Servicing Plan identified more than \$10 million of future water infrastructure and over \$20 million of future sewerage infrastructure attributable to new developments over the ten years from 2018 to 2028 (Tamworth Regional Council n.d.).

Some costs can be recovered from new connections through developer charges, although they don't capture the full cost of population growth, with LWUs required to fund the difference from other sources. Also, the revenue from developer charges can be sporadic, given uncertainty about when development will occur (Tweed Shire Council 2024).

On the other hand, in smaller communities with declining populations, LWUs still need to provide a service using the same assets, with the same fixed costs. This results in spiralling costs and increasing difficulty in funding asset renewals and replacements (Central NSW Joint Organisation 2024). For example, Goldenfields Water (2024) noted that a declining population presents challenges as it exacerbates issues of economies of scale and willingness to invest.

Other communities experience fluctuating population size. For example, Clarence Valley Council (2024) stated populations in some of its town increase by up to 50 per cent during peak holiday periods, meaning its network and treatment facilities are designed for these peak temporary loads rather than its permanent population.

Changing costs due to population change must be reflected in LWU's strategic plans and pricing strategies. Faced with increasing costs per customer connection LWUs should consider increasing prices to ensure ongoing financial sustainability. Likewise, for those LWUs that anticipate infrastructure upgrades or capacity augmentation to meet higher future demand from a larger population base, consideration should be given to how such projects should be funded (i.e. from debt or grants) and whether end-user charges need to increase in the first instance.

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## 4.3 LWUs need to manage water security and climate change risks

Water security is a major risk for LWUs across NSW, but the level of risk varies considerably by community. It is crucial that LWUs plan for water security impacts from demand growth, drought, and other causes.

Each community's water security is determined by a range of factors including rainfall and evaporation patterns, customer demand, proximity to water sources, the needs of other water users, and water quality issues like groundwater contamination. This means some LWUs may have secure supplies even in a severe drought, while others may struggle to supply their communities during normal rainfall periods.

Water supplies in many areas of NSW are already stretched, with available water resources fully allocated and there are low prospects of expanding surface water storages. Some major inland cities are long distances from large dams and may require expansive new infrastructure to manage additional population growth. Similarly, coastal areas may require desalination in the future to ensure their water security.

Several reviews have highlighted the critical impact a changing climate may have on water and sewerage systems. For example, the Australian Government Productivity Commission noted that "increased average temperatures, higher-intensity rainfall and other extreme weather events" were likely to lead to declines in water availability across Australia, threatening long-term water security in regional and remote Australia (Productivity Commission 2021, 38).

Climate change is projected to significantly impact water availability in New South Wales, especially in the Murray Darling Basin. The Commonwealth Scientific and Industrial Research Organisation (CSIRO) projects with high confidence that temperatures will continue to rise leading to higher water demand and greater evaporation rates across the state (CSIRO n.d.). Winter rainfall is expected to fall across inland New South Wales over the coming decades which will likely continue the already existing trend of falling streamflow into major inland rivers (CSIRO and The Bureau of Meteorology 2022). All these factors will impact water security going forward.

Climate change can also impact utilities asset management, for example increased extreme flooding and bushfires put assets at physical risk. Lower water availability and water restrictions will also reduce water sales and impact LWUs financial sustainability (Central NSW Joint Organisation 2024).

Stakeholders also emphasised how extended periods of drought and increased frequency of flooding were affecting the sustainability of their operations (Bellingen Shire Council 2024). Richmond Valley Council (2024) noted its \$50 million investment required to repair and improve the resilience of its wastewater network following flooding in 2022. The Council further noted that LWUs are unable to insure against this level of damage. These risks to operational sustainability are reinforced by the fact that disaster relief funding arrangements have traditionally not been available to repair the water and wastewater infrastructure of LWUs.

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## 4.4 LWUs will need to replace ageing infrastructure

Much of the water and sewerage infrastructure in regional NSW was built by the state government during the mid to late 20<sup>th</sup> Century. Stakeholders have observed that many of these assets, such as water mains and treatment plants, are now coming to the end of their lives, with limited funding available for renewals. Without a clear funding stream, LWUs are incentivised to operate aging infrastructure with growing operating and maintenance costs and high risks of failure.

An ‘infrastructure cliff’ is looming where a town was previously serviced with donated assets that reach the end of their useful life all at the one time, and asset renewal has not been progressively undertaken in advance.

(Water Directorate 2024, 3)

Consistent with the principle that LWUs should be responsible for the efficient and effective management of their water businesses, utilities should recover enough revenue to provide for the replacement and/or refurbishment of their assets. This has been NSW Government policy since at least 2004.<sup>24</sup>

The Australian Productivity Commission found that, in some areas, particularly with ageing infrastructure, LWUs may need to make significant investments to deliver ‘the same levels of service and minimise the risk of water supply or quality issues’ (Productivity Commission 2021, 15). Several stakeholders supported this finding (Cobar Shire Council 2024) (Tweed Shire Council 2024). For example, Cobar Shire Council indicated that much of its water and wastewater infrastructure was at the ‘end of life’ (Cobar Shire Council 2024, 1). Tweed Shire Council noted many LWUs face an ‘infrastructure cliff’, where the current user charges are inadequate to account for an imminent peak in renewals to replace aging assets (Tweed Shire Council 2024, 8).

Replacing water and sewerage infrastructure will be adversely impacted by the higher cost of construction in regional and remote NSW and the ongoing growth in these costs. It was noted in some submissions that contractors often place large premiums on capital works projects in remote areas to reflect the difficulty of getting labour and transporting materials long distances. For example, an official from Bourke Shire Council during the consultations referred to what they call “the Bourke Tax”, a 20 per cent or greater increase in costs compared to similar projects in the city (Alliance of Western Councils 2024). Construction costs have also grown considerably in recent years across NSW because of post-pandemic inflation.

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## 4.5 LWUs will need to manage increasing customer expectations

Customers’ expectations for their water and sewerage services are increasing and it is becoming harder for councillors to justify having different levels of service within their LWUs. During one consultation session, a LWU Water Manager noted that the growth of community social media groups means issues, like discoloured water, which might once have gone unnoticed are quickly shared and LWUs are held accountable for fixing them.

At the same time, outlying communities that had previously received untreated water or a septic service are increasingly expecting drinking water and sewerage to be provided at affordable prices. This is being accelerated with “sea changers” and “tree changers” relocating from larger cities and towns and expecting similar services to what they are used to.

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<sup>24</sup> Under the National Water Initiative, the NSW Government agreed that: “to be viable, a water business should recover, at least, the operational, maintenance and administrative costs, externalities, taxes or TERs (not including income tax), the interest cost on debt, dividends (if any) and make provision for future assets refurbishment/ replacement” (Commonwealth of Australia and the Governments of New South Wales, Victoria, Queensland, South Australia, the Australian Capital Territory and the Northern Territory 2004).



Unfortunately, these changing customer and community expectations are often disconnected from an understanding of the associated infrastructure requirements or costs. Customers having an understanding about how improved service quality or expanded service availability impacts user charges and customer bills may go some way to managing customer expectations. However, this must be initiated by LWUs as part of meaningful customer and community engagement.

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## 4.6 The financial sustainability of LWUs necessitates increases in customer revenues

The issues identified in sections 4.1 to 4.5 are expected to drive additional costs in the future. LWUs will have to manage these issues to minimise future costs. It is, however, unrealistic to expect that the cost implications of issues can be fully mitigated.

Ensuring the financial sustainability of LWUs necessitates that increased costs be met with increased revenue streams. Given that the NWI aims for full cost recovery from customer revenues and the fact that customer revenues are the most significant source of funding for LWUs it is not controversial that increases in end-user charges and developer fees should be considered in the first instance to meet increases in future costs.

Failure to increase customer revenues will exacerbate the already significant under recovery of costs by LWUs (see **section 3.3**). Hence, LWUs must initiate strategies to sustainably increase end-user charges and developer fees as well as to educate customers and the community as to why increased customer bills for water are necessary.

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## 4.7 LWUs have capacity to increase user charges to meet increased future costs

An examination of projected customer revenues as a percentage of capital and operating costs over 20 years shows that the level of cost recovery will decline over time. Without some level of State or Commonwealth contribution only four LWUs will achieve full cost recovery. There are:

- 15 utilities recover between 90 per cent and 100 per cent of total costs;
- 26 utilities recover between 80 per cent and 90 per cent;
- 22 utilities recover between 70 per cent and 80 per cent and
- 18 utilities below recover 70 per cent.

The present value of the total under-recovery of costs over 20 years is about \$5 billion, or about \$250 million per year on average.<sup>25</sup>

To explore the capacity of LWUs to meet this shortfall scenario, we considered the following three scenarios:

1. Base case scenario – *costs increasing to replace existing asset base*. Increasing customer revenue per connection to recover costs or to a cap of \$1,411 per annum.<sup>26</sup> This is to simulate the ability

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<sup>25</sup> The model relies on simplifying assumptions to calculate base case values. In the absence of reliable data on likely capital costs over the period, the model uses an approximation of the annual capital allowance using the '50-year method'. Capital costs were estimated by taking the total value of assets from financial accounts and dividing by an assumed average remaining life of 50 years. Amounts are in \$2024-25.

<sup>26</sup> We have used \$1,411 revenue per connection (in \$2021-22) as a benchmark because this is the 90<sup>th</sup> percentile. This assumes assume bills can increase to achieve 100 per cent cost recovery or alternatively up to a cap at the 90<sup>th</sup> percentile of revenue per connection.

for utilities to meet an assumed base level of expenditure without raising prices above the 90<sup>th</sup> percentile.

2. Standardised revenue benchmark scenario – costs from base case with a *standardised revenue benchmark* - in which all revenue per connection is increased to \$1,411 regardless of cost recovery. This is to simulate potential revenue raising capacity to either provide returns on assets or meet future challenges identified in this chapter.
3. An alternative scenario - increased user charges to meet costs driven by *meeting service standards* over the next 20 years - in this scenario additional costs are assumed over scenarios 1 and 2 to meet water quality, water security and environmental standards. This scenario does not restrict how much prices rise.

### 4.7.1 Base case scenario

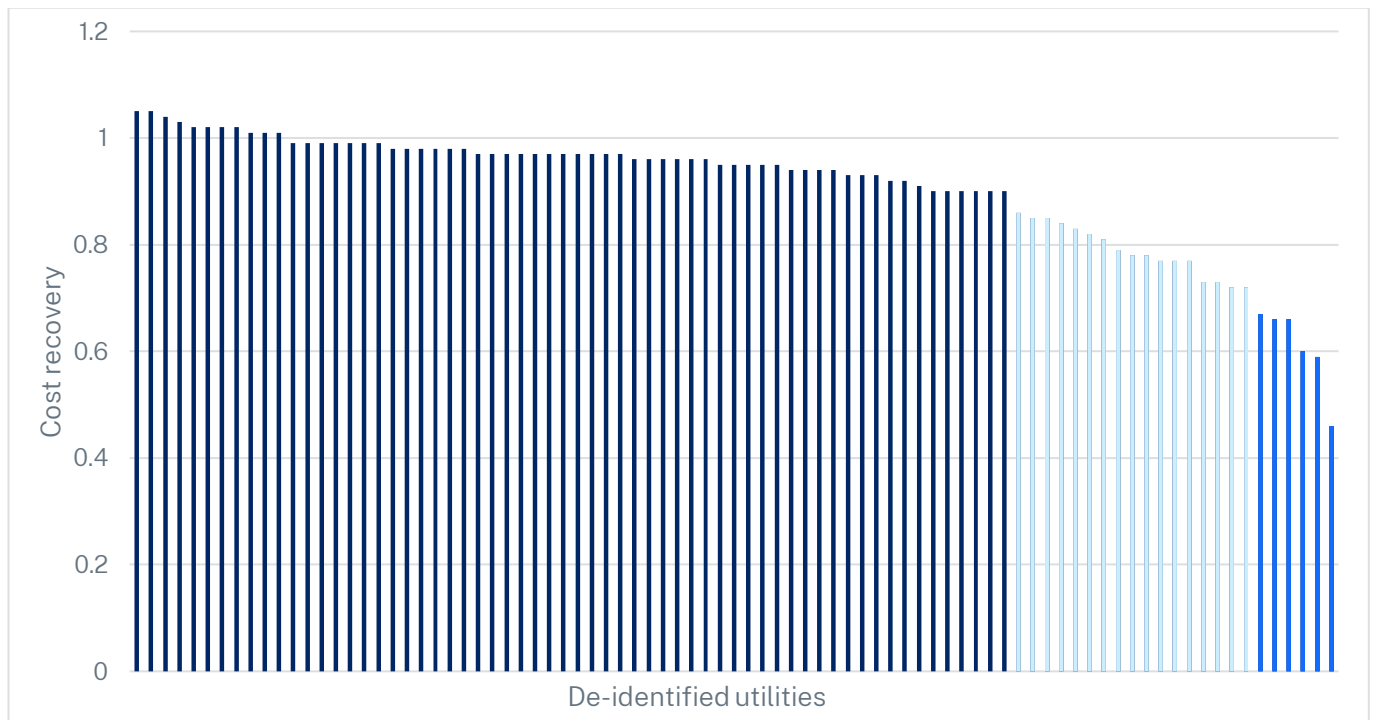
In this scenario, all LWUS that currently earn below \$1,411 of revenue per connection would increase prices to either achieve cost recovery or at least generate earn the \$1,411 of revenue per customer connection (note \$1,411 per connection (\$2021-22) is the 90<sup>th</sup> percentile of the current revenue per connection across all LWUs).

As shown in **Figure 11**, the percentage of cost recovery improves markedly if all LWU that should increase prices do so to this illustrative 90<sup>th</sup> percentile benchmark.<sup>27</sup>

This would result in additional revenue of about \$4.2 billion over 20 years (\$2024-25). Despite this, the sector would continue to face significant financial challenges and under-recovery of costs (remaining shortfall of around 800 million over 20 years):

- 62 of the 85 utilities would achieve a cost recovery percentage of greater than 90 per cent in the benchmark scenario (navy)
- There would be 17 utilities recovering between 70 per cent and 90 per cent of costs (light blue)
- Six utilities would not recover 70 per cent of their costs (blue).

Figure 11: Cost recovery levels using a benchmark 90<sup>th</sup> percentile of revenues per connection



Source: DCCEEW, NSW Productivity and Equality Commission analysis.

<sup>27</sup> The remaining utilities above \$1,411 are assumed to receive their current level of customer revenue per connection.

## 4.7.2 Standardised revenue benchmark scenario

It is not a simple matter to estimate the potential for increased revenue generation across the sector. This is because each LWU is an independent business and, irrespective of average water charges across the sector it only has to increase its own prices to meet its own projected costs.

Using the benchmark approach when charges are increased to the 90<sup>th</sup> percentile regardless of achieving cost recovery (or maintain current charge if above 90<sup>th</sup> percentile), LWUs can raise additional revenue of over \$6.5 billion over 20 years (\$2024-25).

However, this is a simplistic assessment because it assumes current customer revenue per connection and that increased customer charges are introduced in in the next year. In practice this scenario would likely result in bill shock with a corresponding reduction in demand. A more realistic scenario is a glidepath of price increases over time - for example a 10 per cent increase per year over several years.

This scenario also reveals there are many LWUs that have the capacity to raise revenue. For example, there are 67 LWUs that provide water and sewerage services that have revenue per connection of less than \$1,411 per annum<sup>28</sup> and therefore may have capacity to increase charges. These 67 LWUs account for just over 1.2 million connections. This suggests the extent that LWUs have capacity to lift charges affects a large proportion of total customer connections.

## 4.7.3 Meeting service standards into the future

Modelling suggests that both the capital and operational costs to LWUs of meeting current water security, water quality and environmental standards will be significant over the next 20 years. That said, these costs will impact LWUs differently, with the most adversely impacted LWUs being those with the least connections.

To lift water security and meet health standards across the sector, it is estimated that at least 27 councils would need to raise revenue per connection by at least 50 per cent while 5 LWUs would need to at least double their revenue per connection.

In addition to water security and quality standards, LWUs would further incur additional costs to comply with environmental standards. These additional costs would necessitate increased customer charges and customer revenue. For example, around 44 LWUs would need to increase revenue per connection by at least 50 per cent, while 14 LWUs would need to more than double their revenue per connection.

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<sup>28</sup> \$2021-22

# 5 The role of NSW Government and its funding

## Findings

- **The NSW Government funds LWU through grants** – the NSW Government has played a significant role in providing funding to the LWU sector. Over the last 10 years, the NSW Government has announced over \$1 billion in funding for LWUs under various grant programs.
- **It is difficult to assess the effectiveness of grant programs** – A lack of comprehensive funding data makes it difficult to assess the effectiveness of these grant programs and how well they are targeted to LWUs that are most in financial need.
- **Grant programs can distort LWU incentives** – unless they are well-targeted, providing grants as the main funding mechanism for LWUs can distort how LWUs operate.
- **Guiding principles can help ensure government funding is well designed.** These include ensuring that funding is aligned with NSW Government objectives, consistent, targeted and transparent, predictable and stable, linked to performance improvements, and easy to administer.

## Recommendations – The role of NSW Government and its funding

**Recommendation: Assess the design of any future funding approach against LWU funding principles identified by the Commission.**

- The guiding principles ensure:
  - funding aligns with explicit NSW Government objectives,
  - there is consistent treatment of LWUs in line with well-defined eligibility rules for funding,
  - funding is targeted and transparent,
  - funding provides a predictable and stable source of financial support,
  - funding is linked to measurable performance improvements, and
  - administration costs are minimised where feasible.

Targeting will mean that an LWU should not receive funding unless it demonstrates they it is providing a basic level of service efficiently and that it is unable to increase own-source revenues in the first instance (see **Chapters 6, 7, and 8** for more detail on a new funding approach to LWUs).

**Recommendation: Use the LWU funding principles to review Safe and Secure Water Program funding that has been earmarked but not formally allocated.**

DCCEEW should utilise the findings of this Review to ensure that its approach to targeting is fit for purpose and addresses affordability issues. This should identify opportunities to allocate funding to councils with less capacity to fund or finance new capital investment through user charges and capital structure reform.

## 5.1 The NSW Government plays a significant role in funding LWUs through grants

In addition to its regulatory role (outlined in **Chapter 2**), historically, the NSW Government has played a significant role in funding LWUs. Many of the programs have aimed to overcome a lack of scale to fund major works in remote and regional communities.

‘All water supply and sewerage programs have had a core objective of overcoming the lack of economies of scale. This is most important in small regional and remote communities.’

(Stephen Palmer Consulting 2024, 4)

‘In communities with low socio-economic characteristics, capacity to pay increased charges removes the option of debt as an alternative funding source.’

Lachlan Shire Council is currently considering how it can fund an estimated contribution of \$18-20 million toward the cost of replacing the Condobolin Water Treatment and Sewer Treatment Plants. If the contribution is funded through debt, this will increase the average water bill by approximately \$400 per year and the average sewer bill by approximately \$260 per year.’

(Lachlan Shire Council 2024, 4)

‘With much of the labour in these remote areas being of a casual nature the ability to pay higher rates for water becomes impossible and can render the towns unliveable, a situation we all find unacceptable and intolerable.’

(Alliance of Western Councils 2024, 2)

‘The scale of cost for capital renewals and upgrades in regional areas relative to the customer base utilising the infrastructure means many of the projects simply aren’t feasible without some level of external financial support.’

(Bega Valley Shire Council 2024, 2)

Government funding mechanisms generally fall into one of two categories – grants tied to a specific project or CSO payments (see **Table 9**). Currently, the NSW Government uses grants to fund LWUs.

Table 9: Comparison of grants and CSOs

Criteria	Grants	CSOs
Funding allocation	Allocation of funding from a pool	Series of payments to deliver services at below cost to customers
Time period	Funding is allocated over a defined project timeframe	Payments can be made over a defined timeframe or without an end-date
Funding linked	Funding typically linked to investment in a specific project. Project subject to business case approval processes.	Payments typically untied to specific investments or operational decisions.
Contractual basis	Typically, an agreement with milestones and payment schedule.	Documented in a service level agreement with a focus on outcomes and partnership to improve performance.

Implementation of relevant parts of the National Water Initiative (NWI) by the NSW Government reflects its commitment to 'provide healthy, safe and reliable water supplies' in regional and remote communities. It does this in partnership with the LWU sector. In 2020, the Australian Productivity Commission called for a renewed NWI to include principles for:

- Regional and remote urban water planning, including ensuring alignment between utility system planning, contingency planning, and water resource planning.
- Defining and ensuring access to a basic level of service, including guidelines for government subsidies for high-cost regional and remote water services.
- Governance of regional and remote providers, including financial separation and a commitment to light-touch economic oversight for small urban water providers.
- Performance monitoring and reporting of regional and remote water service outcomes, especially in remote Aboriginal and Torres Strait Islander communities.

The Commission has reviewed the NSW grant funding approach against these principles and found that there are areas of improvement that could be made to meet these principles. The approach proposed by the Commission in **chapters 6, 7 and 8** are designed to meet these principles. In particular, the proposed approach (see **chapters 7 and 8**) sets a basic level of service which limits government funding to where the provision of such services is not commercially viable, and where other options (such as self-supply) are not feasible.

### 5.1.1 Since 2014 over \$1.8 billion in grants has been announced for LWUs

Historically, NSW Government has been involved with LWUs via a range of programs. For example, between 1994 and 2018, the NSW Government administered a Country Towns Water Supply and Sewerage Program (CTWSSP) which provided over \$1.27 billion of funding to LWUs.

Since 2014, the NSW Government has announced over \$1.8 billion in funding for LWUs. It has made these funding commitments under several grant programs, including:

- **Safe and Secure Water** – grants for LWUs to develop and deliver projects to resolve water security, water quality or environmental risks (NSW Government n.d.). Since 2017, the NSW Government committed \$408 million to construct the Broken Hill to Murray River pipeline, as well \$317 million to around 200 projects across regional NSW. An additional \$288 million is earmarked for high risk LWUs and awaiting project proposals from LWUs (as at January 2024) (NSW Productivity Commission 2024, 23).
- **Regional Water and Wastewater Backlog** – grants for LWUs to clear a backlog of projects in regional areas affected by ongoing water quality and wastewater problems (NSW Government n.d.). The program also aimed to meet the NSW Government's targets for access to quality potable water through new infrastructure builds and infrastructure upgrades. The NSW Government announced \$110 million for this program over the period 2015 to 2017.
- **Drought Funding Programs** – Funding from various sources including Drought Stimulus Package, Critical Drought Initiative, and Regional Water (or Capital Grants) Stimulus Program. Funding was provided to around 40 LWUs as well as other agencies like Water NSW to improve their water security and some emergency water carting. The NSW Government provided over \$280 million through these programs. Many of these projects are still to be delivered.
- **Fluoride Capital Works** – Since 2004, NSW Health has offered LWUs a 100 per cent subsidy for works approved under the program to cover the capital and associated costs of constructing drinking water fluoridation systems (NSW Health Water Unit 2015).
- **Water Security for Regions** – grants for LWUs to improve their water security and prepare for future drought conditions (NSW Government n.d.). The NSW Government announced \$366 million in funding for this program over the period 2014 to 2016.

Actual expenditure over the same period has been around \$1.2 billion made up of expenditure in part from a previously announced program (i.e., Water Security for Regions).



Analysis of the announced expenditure indicated that the actual annual expenditure over past decade is in the order \$118 million. If we assess all committed funding, out to 2028 the annual funds provided by the NSW Government is in the order of \$122 million.

If we exclude the fund provided for the Broken Hill to Murray River pipeline, these numbers are \$78 million and \$94 million respectively.

### 5.1.2 It is difficult to assess the effectiveness of grant programs

When examining the NSW Government's funding commitments over the last 10 years, the Commission was unable to accurately determine how much funding LWUs received each year from the grant programs. This information was not readily available either publicly or within the agencies that administer the grants programs. This lack of transparency around grant funding is problematic given the significant funding commitments involved. Without comprehensive funding data, it is difficult to assess the effectiveness of grant programs and how well they are targeted to LWUs that are most in financial need.

The design of the most recent grant program – Safe and Secure Water program (version 2) – has improved the degree of targeting and requires a co-contribution from LWUs.<sup>29</sup> However, based on the funding data available, the Commission's analysis indicates there is not a clear relationship between the grant amount received by an LWU under this program and its ability to address service risks from its own-source revenue.

Further, the program prioritises access to grants to LWUs with higher service risks. This can create incentives for LWUs to delay investment to secure grant funding. As noted in the NSW Water Strategy, using grants to target high priority risk can discourage LWUs from acting until risks become critical enough to be eligible for funding (Department of Planning, Industry and Environment 2021, 114).

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## 5.2 Grants can undermine incentives for LWUs to efficiently manage their operations

Unless well-targeted, providing grants as the main funding mechanism for LWUs can distort how LWUs operate by creating perverse incentives to not plan/invest as a grant is expected, which over the longer term lets risks become worse:

[G]rant funding has rewarded bad behaviour. This is where a [Local Water Utility] may have neglected maintenance, investment or failed to adequately plan for long term provisions and has then essentially been 'bailed out'. High performing utilities that invest in long-term provisions and meet criteria of best practice tend to miss out on funding.

(Goldenfields Water 2024, 4)

Several limitations with grant funding have been highlighted by multiple reviews, as well as by stakeholders in their submissions. For example:

- **Grants are an uncertain and volatile funding source.** Grant programs provide different funding levels and have different eligibility criteria. This means that LWUs often undertake upgrades and renewals on an ad hoc basis, driven by funding availability rather than what is needed (Berrigan Shire Council 2024) (Richmond Valley Council 2024) (Cobar Shire Council 2024) (Water Services Association of Australia 2024). This can undermine longer-term strategic planning by LWUs (Productivity Commission 2021).

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<sup>29</sup> The Safe and Secure Water program was established in 2017 (version 1) and relaunched in 2018 (version 2) (NSW Government n.d.).

- **Grants are focused primarily on capital costs.** There is little consideration given to ongoing operating costs, compared with upfront construction costs (Tamworth Regional Council 2024). This can leave recipients with high life-cycle costs for assets (Productivity Commission 2021).
- **Grants have often been historically poorly targeted.** They often do not factor in a LWU's capacity to obtain funding from other mechanisms (Albury City Council 2024) (Alliance of Western Councils 2024). The NSW Water Strategy noted grant programs typically do not fully account for differences in capacity of LWUs to fund solutions themselves through service charges (Department of Planning, Industry and Environment 2021). Further, grant funding may not be prioritised for those very small and remote communities in most financial need.
- **Grants create a bias towards capital solutions.** They provide incentives for a LWU to replace or upgrade its infrastructure (Department of Planning, Industry and Environment 2021) (Productivity Commission 2021). However, it may be more efficient for the LWU to improve the way it operates existing infrastructure (which may not attract a subsidy).
- **Grants weaken price signals.** Using grants to fund infrastructure rather than user charges, may mean the prices set by LWUs are not cost-reflective. This weakens the signal that customers receive from prices about the costs of their water and sewerage services. There are several reasons why it is preferable for customers to be charged prices that reflect the costs of providing these services (see **Box 2**).

Box 2: There are several benefits from ensuring water prices are cost-reflective

User pays is the 'practice of charging consumers in such a way that the prices they face reflect the costs of providing the goods or services.' (The House of Representatives Standing Committee on Finance and Public Administration 1991, 103). User pays is already used for many types of economic infrastructure including electricity, telecommunications, gas, and water (Productivity Commission 2014).

Benefits of a user pays system include (Productivity Commission 2001) (Department of Finance 2023) (The Centre for International Economics 2021):

- **Efficiency** – User pays can lead to a more efficient allocation of water resources. Efficiency covers:
  - Allocative efficiency – User pays promote an optimal distribution of water resources as charges 'serve to ration output to those who are willing to pay for the good or service, and they act as a signal to suppliers (local governments) that indicates the quantity and quality of output desired' (McQueen 1998, 16).
  - Technical efficiency – User pays improves the efficiency of LWUs as they instil cost consciousness.
  - Dynamic efficiency – With clear price signals, there is greater incentive for technological innovation and the adoption of water-saving technologies and practices, fostering a more modern and resilient LWU sector.
- **Equity** – User pays promotes horizontal equity by ensuring the users of water who benefit from its provision pay for it, rather than the public through taxation revenue. While a user pays system does not promote vertical equity – as users pay the same amount regardless of their income – this could be counteracted by giving subsidies to specific groups.
- **Cost-recovery** – User pays ensures the full cost of water supply, including maintenance and infrastructure, is recovered. This leads to more sustainable financial management within the water sector, reducing the reliance on government subsidies and fostering financial independence for LWUs.
- **Transparency and accountability** – User pays increases transparency in pricing and service delivery. Consumers are more aware of the costs associated with water provision, leading to greater accountability for LWUs in terms of service quality and efficiency.

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## 5.3 Before seeking government funding, LWUs should take steps to manage revenue shortfalls

Ideally, each LWU would manage its operations to achieve cost recovery from customer revenues and not require funding from the NSW Government to provide services to its community.

Under this scenario, a LWU would:

- Operate a user pays system and set cost-reflective prices. This means prices for water and sewerage services would match the efficient costs of providing these services.
- Achieve lower-bound pricing targets under the NWI as a minimum. This would ensure own-source revenue could be used to fund operational and maintenance activities, as well as the costs of renewing, replacing, and upgrading assets over time (Department of Climate Change, Energy, the Environment and Water n.d., 18).
- Optimise use of other funding sources. For example, obtaining debt finance to manage any cash-flow concerns. Further, setting developer charges to pass some of the costs of servicing new connections onto developers.

In practice, a sub-set of LWUs will likely find it difficult to be self-sufficient. The Commission is of the view that any NSW Government funding for the LWU sector should be limited to those instances where there is material revenue shortfall. In assessing the shortfall, the LWU must show how it has:

- maximised own-source revenues from user charges, and
- minimised costs of service delivery.

LWUs should demonstrate that they are not able to increase customer revenue, reduce costs or obtain debt finance to smooth cash flows before seeking NSW Government funding. This approach ensures LWUs remain accountable for their operations.

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## 5.4 Government funding should be assessed against six funding principles

The Commission has developed six principles to assess and guide the program design for any future funding provided by the NSW Government to LWUs (see **Figure 12**). These principles could be applied to grant programs or CSO payments.

The principles are based on established policy guidance on the design and review of existing and new regulatory measures. This includes the NSW Government Guide to Better Regulation and the NSW Treasury's 2022 Policy and Guidelines: Evaluation (NSW Treasury 2019) (NSW Treasury 2023).

Figure 12: Funding should be assessed against six key funding principles



## **Principle 1: Alignment of funding program with explicit Government objective**

Funding programs to support LWUs should demonstrate a strategic fit with Government's high-level objectives, typically shown through alignment with NSW Outcomes.

NSW Outcomes represent the primary purpose for which NSW Government invests public resources. They articulate the goals and priorities that the NSW Government aims to achieve across all its activities. Rather than focusing solely on spending or solutions, the emphasis of NSW Outcomes is on achieving results and maximising the use of scarce public resources.

In the case of the NSW LWU sector, it is important that this objective clearly outlines the targeting of funding support to ensure effective service delivery for those LWUs who cannot deliver against the sector objectives.

## **Principle 2: Consistent treatment of LWUs in line with well-defined eligibility rules**

Funding arrangements benefit from certainty of eligibility rules. Consistency provides clarity and predictability for both Government and LWUs. Specific benefits include:

- Greater consistency supports efficient planning and resource allocation by government and government departments. It promotes greater transparency of government decision making and achieves greater alignment of funding programs with NSW Outcomes and government policy objectives.
- LWUs benefit from greater certainty of Government funding programs which in turn drive improvements and efficiencies in their business planning and investment activities. It also lowers the risk of unpredictable or unforeseen changes in Government funding programs which in turn may lower other business risks, such as the LWU's cost of capital.
- For customers of LWUs and the wider community, greater consistency of funding eligibility rules promotes confidence that affordable and reliable water will be available to meet their current and future requirements.

## **Principle 3: Targeted and transparent funding**

In general, NSW Government funding is only justified in the following circumstances:

- where there is market failure,
- in response to social and public policy issues, or
- to provide social benefits to a targeted group in the community.

Accordingly, NSW Government funding programs should be designed to be both targeted and transparent (see **Box 3**).

### **Targeted funding**

Government funding programs that are targeted ensure resources are allocated to specific areas where they are most needed, or to the provision of services that are essential. It also ensures that there is an alignment between the allocation of scarce resources and NSW Outcomes.

Additionally, government funding programs which are targeted promote economic efficiency and social equity. Efficiency is promoted because the targeted nature of any resource allocation minimises waste or the inefficiency. Additionally, government funding programs can be targeted to specific communities or recipients to reduce inequality, and promote social equity and equal access to services.

The NSW Government's Aboriginal Communities Water and Sewerage Program is an example of a targeted program that aims ensure the level of water and sewerage services provided to eligible Aboriginal communities are of equivalent standard to nearby non-indigenous towns (NSW Government n.d.).

Under any future funding program, LWUs should first demonstrate that they are not able to increase own-source revenue or reduce costs. This ensures NSW Government funding is tightly targeted to those LWUs and communities in financial need. It may mean there is a role for NSW Government funding for the following purposes:

- Supporting LWUs with high-cost services and small customer bases to meet the operating costs of service provision, primarily in remote and very remote communities.
- Providing transitional (say up to five years) support for LWUs where price pathways to meet the economic cost of water and sewerage service delivery result in significant price increases.
- Cost or revenue smoothing where these are lumpy investments for reasons beyond LWU control or planning.
- Transitioning LWUs to debt financing arrangements.

### Transparent funding

Transparency of government funding programs builds public trust and promotes certainty. Public trust in government and government departments results from visibility, and an understanding of how public resources are allocated and for what purpose. By contrast, public trust in government is undermined when there is a lack of understanding about how resources are allocated or if there is a perception that resources are allocated based on political decisions, as opposed to policy priorities.

Similarly, transparency of government decision making signals to the users of services, which are delivered subject to a CSO or grant program, that the government is committed to supporting the affordable and reliable provision of those services consistent with community's needs and expectations.

Transparency of government funding programs also supports the efficient and effective design and operation of funding programs. For example, transparency in respect of the objectives for providing government funding to LWUs will better enable the evaluation of the efficiency and effectiveness of that program and to measure the economic and social benefits that recipient LWUs generate. Over time, this supports ongoing improvements in government policy with respect to LWUs and may inform future government funding decisions.

### Principle 4: A predictable and stable source of financial support

Predictable and stable government funding arrangements are essential for policy continuity, operational efficiency, and positive community outcomes. Funding arrangements that are predictable and stable over time:

- **Promote and support long-term strategic planning by LWUs** – allowing LWUs to plan for the long term, which in turn promotes efficient investment in, and use of, infrastructure.
- **Reduce uncertainty and risk** – reducing the risk that LWUs will need to reduce service levels or delay infrastructure maintenance or capital improvement programs. By contrast, unpredictable funding can disrupt service delivery, which undermines public and consumer confidence in the ability of the LWUs to provide reliable water services as needed.
- **Support policy and operational continuity** – ensuring LWUs remain focused on their core purpose, which is the efficient and equitable delivery of local water services, without needing to engage in unnecessary advocacy or rent seeking activities.

The requirement that funding programs be predictable and stable over time does not mean that such programs should not evolve or change in response to changing market dynamics, customer needs, or community expectations. To the contrary, all government policies should be reviewed from time to time to ensure that they continue to align with State Outcomes and community expectations.



## **Principle 5: Funding linked to measurable performance improvements**

Government funding of LWUs should seek to promote improved outcomes for consumers and the community over time. Improved outcomes could take the form of lower cost of service provisions (including reduced reliance on government funding over time) or improved service quality.

Linking government funding to measurable performance improvements provides recipient LWUs with strong incentives to operate efficiently, thereby reducing the cost of supply, improving the quality of services which consumers receive, and minimising any negative externalities.

Importantly, any link between funding and improved performance outcomes by the LWUs must be measurable and subject to an agreed governance and accountability framework. SLAs between the recipient LWU and the relevant government department could be negotiated for CSO payments. This establishes a framework for reviewing performance outcomes on a periodic basis and relevant key performance indicators (KPIs) that will be used to measure performance improvements.

## **Principle 6: Minimise administration costs where feasible**

Government funding programs in respect of LWUs should be easy to administer and not give rise to significant compliance costs. Key benefits include (NSW Treasury 2019):

- Minimising the complexity and compliance burden of government funding programs promote economic efficiency. This allows government and government departments to minimise the resources needed to administer the programs. Likewise, recipient LWUs can minimise the resources needed to participate in, and demonstrate compliance with, the program.
- Promotes participation by LWUs. When funding programs are easy to administer, more LWUs are likely to participate. This broadens the reach of essential water services and benefits communities.

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## **5.5 Meeting the funding principles requires a new approach**

To implement the guiding principles, the NSW Government should adopt a strategic approach to the LWU sector and explore using a new funding option - CSO payment - as an alternative to grant programs.

### **5.5.1 Funding under the Safe and Secure Water Program should meet these principles**

As noted above, the current Safe and Secure Water Program has improved the degree of targeting, requiring a co-contribution from LWUs. Future funding under SSWP that has been earmarked for a council but not yet formally allocated, should be reviewed against these principles. This should include an updated targeting to approach, including future pricing pathways and a council's capacity to provide additional contributions through debt financing.

DCCEEW should utilise the findings of this review to identify opportunities to reallocate funding to councils with less capacity to fund or finance new capital investment through user charges and capital structure reform.

### **5.5.2 Establishing a strategic approach, including a basic level of service**

DCCEEW is responsible for overseeing LWUs to ensure they are delivering safe, secure, sustainable, and affordable services, as well as managing service risks (Department of Planning and Environment 2022). The design of any future funding by the NSW Government can provide strong incentives around how LWUs deliver these services and manage these risks.

To underpin the approach, the NSW Government needs to establish an accepted basic level of water service provision. It should be founded on a clearly-specified rationale, clearly define a basic service that can be measurable and be subject to review.



Any funding program should then prioritise resources according to risk and associated benefit as outlined in the current RAF. Importantly, this benefit should focus on hardship and assisting those who require funding to ensure financial sustainability. **Chapter 6** provides more information on these items.

### 5.5.3 Introducing CSO payments

One of the guiding principles is that any NSW Government funding should provide a predictable and stable source of financial support for eligible LWUs.

However, grants should not be expected to provide a predictable, reliable source of funding for those LWUs that cannot meet lower bound pricing targets under the NWI. Therefore, the NSW Government should broaden the current funding arrangements to introduce CSO payments as an option for LWUs. These payments are discussed in more detail in **Chapter 7**.

## 6 Using a strategic approach to better target funding

### Findings – The approach to funding and targeting support

- **Strategic planning should guide prioritisation of funding and resourcing for water and sewerage services through identifying key challenges, opportunities, strategic priorities and actions.** There have been recent improvements in state-wide, regional and local strategic planning with the development of the NSW Water Strategy, 13 Regional Water Strategies, and the implementation of council strategic planning and integrated water cycle management.
- **Local strategic LWU planning is not yet comprehensive or well-integrated into state and regional planning.** Strategic planning under the Regulatory and Assurance Framework is currently voluntary. Councils often view higher-level planning processes as opaque and struggle relating local planning to state priorities, resulting in a lack of alignment and fragmented decision making.
- **Current strategies and plans do not provide a sufficiently robust basis for articulating funding prioritisation to address sector challenges.** There is no comprehensive policy that identifies the mechanism for prioritising investment and outcomes within the sector, or how NSW Government agencies will engage with councils to assess needs and prioritise funding.
- **Integrating key elements of the RAF into the Community Strategic Planning framework could streamline and improve Councils' governance of LWUs.** The *Local Government Act 1993* provides an existing strategic planning framework with statutory force covering community planning, long-term financial planning, and asset management that should be used by Councils to plan for their water businesses.
- **A new investment framework should build on the Town Water Risk Reduction Program's progress,** providing a more explicit focus on facilitating and building local and county council capacity for efficient service delivery, performance improvement, and risk management as owners of water and sewer assets. This should be supported by DCCEEW facilitating or leading the development of solutions to state-wide and regional challenges.
- **This evolution will require better integrated strategic planning from state to regional to local levels.** This should support a shared sector overview that informs a new Sector Priorities Plan, building on the current Regional Water Strategies and local planning.
- **Given the significant quantum of resourcing involved, whether from customer charges or NSW Government funding, all future programs must be informed by effective strategic planning by the NSW Government and LWUs to ensure effective targeting.** A transparent framework should reduce *ad hoc* approaches and inefficiencies while targeting assistance to meeting service standards.

### Recommendations – Using a strategic approach to better allocate funding

**Recommendation: Prepare a stocktake of existing strategic planning for LWU sector, including state, regional and local plans, and develop a preliminary Sector Overview outlining future challenges, expenditure, and potential funding shortfalls to support a new funding approach.**

- Collate all existing planning documents, including strategic planning and business cases of proposed projects, as inputs to ensure that a new approach to strategic planning and funding is aligned with strategic planning of LWUs and NSW Government.

## Recommendations – Using a strategic approach to better allocate funding

- A preliminary Sector Overview should incorporate any council-led work through the IP&R process, strategic planning under the RAF or the previous Integrated Water Cycle Management plans (regardless of status), and NSW Government led planning.
- This Sector Overview should also provide a more comprehensive insight into the usefulness of existing strategic planning, and the alignment between NSW Government and LWU strategic planning. As a preliminary Sector Overview, it should also identify gaps that the NSW Government and councils will need to address to implement a strategic funding framework.

**Recommendation: Develop a LWU Investment Framework to ensure funding to LWU sector is well targeted and minimises overall cost to NSW Government.**

- The Framework should:
  - include a LWU Funding Policy and a Sector Priorities Plan
  - improve alignment between the objectives of the NSW Water Strategy, regional water strategies, and NSW Government funding programs
  - provide clear policy and pathways to enable councils to approach the NSW Government to express interest in entering into long term partnership agreements
  - focus on facilitating Councils' capacity to improve LWU performance, risk management, operational efficiency, value for money, and addressing hardship where required
  - specify that an assured LWU strategic plan is a mandatory requirement of future NSW Government funding.
- The NSW Government should not agree new significant funding programs for the LWU sector prior to the adoption of this Framework.

**Recommendation: Prepare a draft LWU Funding Policy, with release for sector consultation prior to finalisation.**

- A draft Policy should be released by the end of 2024 for discussion with LWUs, with a first formal Policy to be finalised by mid-2025. DCCEEW should review and report on the operation of the Policy in the Annual Report and update, in collaboration with the LWU sector.
- The LWU Funding Policy should include:
  - Sector objectives, NSW Government agency roles, role of NSW Government funding,
  - LWU sector resourcing hierarchy, local council expectations and program eligibility,
  - Funding pathways on critical sector issues,
  - Requirements for funding assessment and cost benefit analyses,
  - Guidance on how local councils may enter into funding arrangements, including CSO agreements, with the NSW Government, and
  - Governance and reporting requirements.

**Recommendation: Work with LWUs and other NSW Government agencies to develop a Sector Priorities Plan**

- The Plan should set out the NSW Government's priorities for the LWU sector over the short to medium-term (2 to 4 years).
- DCCEEW should develop an Interim Plan, based on existing water strategic planning, as soon as practicable, and revise the Plan by the middle of 2025, with any updated water strategic planning available. The Plan should then be updated on an annual rolling basis.

**Recommendation: Make strategic planning for water supply and sewerage services an explicit requirement for all councils in regional NSW, with key elements of the Regulatory Assurance Framework to be incorporated into the Integrated Planning and Reporting Framework (IPRF).**

- DCCEEW and OLG to work together to integrate key elements of the RAF into the IPRF with respect to long term financial planning and asset management regarding water.

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## 6.1 Strategic planning should inform funding from NSW Government to LWUs

Strategic planning should be used to guide the delivery of water and sewerage services at the individual LWU, regional and whole of NSW levels. It involves identifying the key challenges, opportunities, strategic priorities, and actions to deliver these services (NSW Government n.d.).

Strategic planning is crucial to managing risks to a LWU's water security, water quality, environmental impacts, infrastructure, customers, and financial sustainability (Department of Planning and Environment 2022). LWUs' strategic planning contributes not only to the water security of their regions, but also the entire state.

Over the next decade the challenges confronting the LWU Sector will be felt most by those LWUs with a low revenue base and facing costly solutions. The challenge for funding programs is to incentivise efficient responses and investments while protecting those who need it most. Considering the significant funding involved, it is critical that **all** future funding programs are informed by fit-for-purpose strategic planning and the NSW Government uses this strategic planning undertaken for the LWU sector to determine where it should prioritise funding support.

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## 6.2 While strategic planning is occurring, it is currently voluntary and fragmented

Strategic planning is occurring at the state and regional levels, and for individual LWUs. Effective strategic planning enables customers to understand the level of services, risks to these services, and future investments and financial plans (including prices). These plans are the foundation of customer consultation and the basis for planning across regions and with the NSW Government.

There is currently no mandatory requirement for councils to complete effective strategic planning for water supply and sewerage services, nor a mechanism for testing/assuring this effectiveness. Instead, the provisions set out in s3 of the Regulatory and Assurance Framework are voluntary, except in a limited number of circumstances.

The strategic planning processes are also not integrated into a comprehensive strategic overview for the LWU sector. It is unclear whether and how the NSW Government considers LWU strategic planning when identifying and prioritising need for funding support.

### 6.2.1 Strategic planning is improving but is not comprehensive or well-integrated

In recent years there has been significant improvement in state-wide strategic planning, with the NSW Government developing the NSW Water Strategy and 12 Regional Water Strategies.<sup>30</sup>

- The **NSW Water Strategy** is a 20-year plan to address key challenges and opportunities for water management and service delivery across the state (NSW Government n.d.). It sets the strategic direction for the NSW water sector over the long-term.
- The **Regional Water Strategies** set out a long-term 'roadmap' of actions to address five objectives:
  1. deliver and manage water for local communities by improving water security, water quality and flood management,
  2. enable economic prosperity, by enabling water access reliability for regional industries,
  3. recognise and protect Aboriginal water rights, interests, and access to water,

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<sup>30</sup> The NSW Government is currently developing an additional Regional Water Strategy.

4. protect and enhance the environment, and
5. affordability, by identifying least cost policy and infrastructure options (NSW Government n.d.).

These strategic plans provide the opportunity to identify state-wide and regional issues for LWUs in each region. The strategies are supported by implementation plans.

The NSW Government also has a new Regulatory and Assurance Framework (RAF) in place which applies to LWUs in regional NSW (Department of Planning and Environment 2022). This framework's objectives for the LWU sector are to continue to ensure:

- safe and secure drinking water supply to protect public health and the environment, and to support economic development and liveability,
- effective sewerage services to protect public health and the environment, and to support economic development and liveability,
- services that meet customer and community needs, expectations, and preferences, and
- financially sustainable water utilities with efficient and affordable pricing for services.

The RAF is administered by DCCEEW. It includes a process for DCCEEW to provide assurance as to whether a LWU has effective, evidence-based strategic planning. As noted in the RAF, DCCEEW's assessment and assurance of the effectiveness of strategic planning done by LWU is important to informing funding to the sector (Department of Planning and Environment 2022). DCCEEW's assurance process is described in more detail in **Chapter 7**.

In its 2020 *Support for regional town water infrastructure* performance audit, the Audit Office of NSW found that DCCEEW had not 'articulated a clear approach for ensuring the ongoing integration of town water issues over the lifecycle of its regional water strategies' (Audit Office of New South Wales 2020, 37). Further, there was no clear funding pathway to resolve cross-LWU boundary or catchment-scale risks. (Audit Office of New South Wales 2020).

DCCEEW has made progress on addressing the findings and recommendations of the Audit Office report, including through the implementation of the RAF, the revised Town Water Risk Reduction Program, and the Safe and Secure Water Stage 2. For example, the RAF outlines NSW Government LWU sector objectives, roles, and responsibilities, including the role of NSW Government and LWUs.

DCCEEW has also committed to working in partnership with LWUs to support integration of state, regional and LWU strategic planning (Department of Planning and Environment 2022).

The Commission found that strategic planning for water and sewerage services in regional NSW is fragmented. There is no formal process for integrating strategic planning by LWUs into regional and state strategic planning, nor is there a clear articulation of how the NSW Government should prioritise funding to support sustained performance improvement at a local service delivery level, informed by demonstrable need for support.

There is no explicit requirement for all LWUs to undertake strategic planning and seek assurance of its effectiveness.<sup>31</sup> The IP&R provisions of the *Local Government Act 1993* requires councils to undertake strategic planning for all their functions and activities, this includes water supply and sewerage services. However, there is currently no mandatory requirement regarding the effectiveness of strategic planning for water supply and sewerage service, nor a mechanism for assuring this effectiveness. Instead, these assurance provisions are set out in the s3 of the RAF, which remains voluntary except in a limited number of circumstances.

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<sup>31</sup> For councils seeking to take a dividend payment under s409(5) of the *Local Government Act (1995)*, its Local Water Utility must have in place effective, evidence-based strategic planning in accordance with the Regulatory and Assurance Framework (NSW Government, Regulatory and assurance framework for local water utilities, July 2022, p 19).



As a result, to date, only 10 per cent of LWUs have opted to participate in this assurance process. This means just eight LWUs are considered to have effective strategic planning in place under the Regulatory and Assurance Framework. Of these:

- Only two have been assessed by DCCEEW using its assurance process.
- The remaining six were deemed to have effective strategic planning in place when the RAF was introduced in 2022.<sup>32</sup>

Many councils have completed some strategic planning for utilities through previous Integrated Water Cycle Management planning or the Community Strategic Planning provisions of the *Local Government Act (1995)*.

It is also unclear the assurance will ensure that the planning clearly identifies risks in a consistent manner.

## **6.2.2 This makes it difficult for the NSW Government to use existing strategic planning to prioritise funding**

With strategic planning taking place at three levels – LWU, regional, and state – there is insufficient alignment between the objectives of the NSW Water Strategy, state level actions, priorities identified in the Regional Water Strategies, and critical priorities identified in LWU plans under the RAF.

Under current arrangements, whether through the RAF or the IPR, it is unclear how LWUs can identify a need for NSW Government involvement in planning or funding water and sewerage service delivery, and how this can then be communicated to the NSW Government. There is also no explicit mechanism articulating how DCCEEW has or will incorporate LWU strategic planning into state and regional strategies.

This lack of alignment limits the NSW Government’s ability to focus on improving LWU capacity and performance, as well as ensuring a more strategic allocation of sector funding. As a result, it is unclear how the NSW Government will develop its future priorities for funding support in this sector in a way that is aligned with the strategic planning of LWUs.

To address this gap in the understanding of strategic planning at the LWU level, DCCEEW should, in the first instance, collate:

- any relevant existing community strategy planning (including long term financial plans) developed as part of the 2021-22 Community Strategic Planning process and any supporting Council documentation including Asset Management Plans
- existing Integrated Water Cycle Management Plans considered ‘current’,
- recent Integrated Water Cycle Management work currently being completed,
- strategic planning funded under the Safe and Secure Water Program Stage 2, and
- options assessments and business cases for projects under the Safe and Secure Water Program Stage 2.<sup>33</sup>

As an example, the Safe and Secure Water Program has recently funded 48 LWUs to develop strategic planning (Planning and Environment 2022). Even though they have not been assured through RAF process, this provides an opportunity for DCCEEW to identify any implications for future NSW Government funding through the strategic planning process. Once issues and strategic

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<sup>32</sup> It has also found effective strategic planning is in place for two county councils. NSW Government, [Water utility strategic planning](https://public.tableau.com/app/profile/lwu.performancereporting3219/viz/StrategicPlanningAssuranceDashboardv1/StrategicPlanningDashboard), accessed 20 June 2024. The complete data set can be viewed using this here: <https://public.tableau.com/app/profile/lwu.performancereporting3219/viz/StrategicPlanningAssuranceDashboardv1/StrategicPlanningDashboard>.



responses are determined to be current, DCCEEW can then assess where the strategic planning identifies a role for the NSW Government in resourcing, collaboration, or requests for funding.

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## 6.3 The NSW Government should develop an LWU sector investment framework

The NSW Government should develop an investment framework to ensure its funding to the LWU sector is well targeted and designed to lower the overall cost of NSW Government's contribution to the LWU sector.

### 6.3.1 There is currently no overarching strategic approach to funding LWUs

There is no overarching, long term strategic approach to the NSW Government providing funding support. There is also no comprehensive document or statement that identifies how the NSW Government will interact with the LWU sector to assess needs, establish a common set of expectations, and prioritise NSW Government funding.

Without a sector (future) outlook, it is difficult for the NSW Government to develop a longer-term plan for the sector and design potential funding options to address costs challenges.

Furthermore, the introduction of new funding programs without an overarching framework is more likely to result in poorly targeted funding, with insufficient reference to the capacity of a LWU to fund its operations and capital investment from own-source revenue.

### 6.3.2 Developing an investment framework can facilitate a more targeted approach to supporting LWUs

The approach developed through the Town Water Risk Reduction Program Phase 2 should continue to evolve. There should be a more explicit focus on facilitating and building local and county council capacity to efficiently deliver water and sewerage services, improve performance, and manage risk, as the owners of their local water and sewerage businesses. This should be supported by DCCEEW Water leading and, where appropriate, implementing solutions to state-wide and regional water challenges.

This evolution will need to be built on better integrated strategic planning from the state level through regional plans and LWU planning. In addition, this evolution will need to be supported by an investment framework that focuses on collaboration and lifting performance.

While LWUs are responsible for providing services and raising revenue to fund those services, there are circumstances in which the NSW Government should provide funding support to LWUs. The LWU Investment Framework should make it clear when and why this is the case, and the processes to assess each circumstance or proposed program. The reform imperative is greatest for those LWUs that will struggle to meet the needs of their communities.

Having a transparent LWU Investment Framework in place should therefore reduce:

- the likelihood of governments taking an *ad hoc* approach, which can be ineffective, excessive, or misdirected,
- inefficient administration and failure to target assistance to where it is needed to meet service standards, and
- moral hazard creating incentives for LWU to not properly plan for manage long term capital and operational requirements.

### 6.3.3 An investment framework should have long-term foundations that support shorter- to medium-term priorities

The Commission recommends the NSW Government develop an investment framework that comprises:

- A **LWU Funding Policy**, which embeds the long-term foundations for sector funding, setting out clear NSW Government objectives for the LWU sector (see **section 6.4**).
- A **Sector Priorities Plan**, which has a short- to medium-term focus, setting out the NSW Government’s priorities for providing funding to LWUs over the next one to three years (see **section 6.5**).

As outlined in **Figure 13**, these elements of the investment framework would be informed by the strategic planning outlined in **section 6.12** above.

Figure 13: Elements of an investment framework



## 6.4 The LWU Funding Policy should set out clear NSW Government objectives for LWU sector funding

A LWU Funding Policy is needed to provide long-term certainty on the approach to funding roles and responsibilities, and to clarify expectations of LWUs. It should outline a clear set of principles to guide NSW Government involvement and support in the LWU sector.

Existing strategies and programs have tended to focus on risk reduction and affordability. Future NSW Government funding programs should focus on improving performance, operational efficiency, value for money, and addressing genuine hardship where required. Specifically, the LWU Funding Policy should:

- ensure alignment between the objectives of the NSW Water Strategy and funding programs and demonstrate value for money. These objectives need to clearly outline the role of the NSW Government in the LWU sector and emphasise the consideration of affordability and hardship when determining the appropriate level of funding and support.

- specify how various challenges across the sector may be funded and the information requirements for consideration of each. For example, there may be different approaches to extension of services to existing townships and funding new developments.

Further, the NSW Government should focus funding on those LWUs that cannot supply a basic level of service to their customers from own-source revenue without causing sustained and unreasonable affordability issues.

All future funding streams for the LWU sector should be developed and incorporated into the Framework as approved by NSW Cabinet.

### 6.4.1 The LWU Funding Policy would set out sector objectives, the NSW Government’s funding role and critical sector issues

The Commission recommends that the LWU Funding Policy should include the elements in **Table 10**.

Table 10: Options for LWU Funding Policy

Elements	Proposed approach
Sector objectives	Articulate whole of sector objectives, largely reflecting the current NSW Water Strategy and Regional Water Strategies, and the RAF with updates as appropriate.
LWU sector responsibilities and resourcing hierarchy	Identify clear actions and roles and responsibilities to ensure clear accountability for the sector.  Clearly state that LWUs are primarily responsible for generating own-source revenue to deliver efficient water supply and sewerage services, and for ensuring capital structure reflects equivalent utility businesses.  The Funding Policy should provide an explicit hierarchy of LWU sector resourcing, with clear explanation for all sector participants on prioritisation of pricing pathway and capital structure optimisation, needs-based CSO payments, and targeted grants programs, in descending order.
NSW Government overall funding role	Provide a well-articulated rationale for ongoing NSW Government funding role in the LWU sector.  The Commission suggests that the NSW Government’s funding role should focus on: <ul style="list-style-type: none"> <li>• improving the capacity of councils to operate efficient water and sewerage businesses, consistent with community expectations and statutory requirements where they cannot fund this from their own revenue base.</li> <li>• development or implementation of solutions to regional or statewide issues, especially those which result from coordination failures or regulatory requirements, with a preference for facilitating and enabling council or regional led solutions.</li> </ul> Provide a statement identifying the respective roles and responsibilities of specific NSW Government agencies within the funding context.
Funding expectations and eligibility	Identify the following requirements, to ensure value for money for the NSW Government: <ul style="list-style-type: none"> <li>• <b>Current and future revenue capacity</b> - eligibility for future funding should consider in the first instance the capacity of a LWU to fund operations and capital investment, from own-source revenue.</li> </ul>

Elements	Proposed approach
	<ul style="list-style-type: none"> <li>• <b>Pricing pathways</b> - future funding eligibility should require LWUs to demonstrate a pricing pathway to achieve consistency with the NWI Pricing Principles within a reasonable timeframe.</li> <li>• <b>Transition to new capital structure</b> - explicitly identify expectations and support pathways for Councils to move LWUs to appropriate capital structures for water utilities.</li> <li>• <b>Strategic planning</b> - future funding eligibility should require LWU strategic planning to be assured by DCCEEW.</li> </ul>
Funding pathways on critical sector issues	<p>Identify clear funding pathways consistent with the six guiding principles, identified in <b>Chapter 4</b>. It should be clear what the arrangements are to include potential programs and for councils to understand the processes for seeking to access funds.</p> <p>Clear pathways by funding type and circumstance are critical to enabling consistent funding assessment, including strategic assessments and robust business cases.</p> <p>It is envisaged that the LWU Funding Policy will set out several approaches to funding to support LWU sector objectives, including:</p> <ol style="list-style-type: none"> <li>1. Community Service obligation funding for a LWU, with long term service agreement with NSW Government.</li> <li>2. A contribution to a regional project based on alignment with wider government objectives and cross LWU boundary issues.</li> <li>3. Sector-wide improvement programs.</li> <li>4. Sector-wide program where NSW Government funding will leverage collaboration benefits.</li> <li>5. Major projects that should be managed by the State.</li> </ol> <p>Future funding pathways should be supported by explicit allocation of different types and level of risk associated with the operation of LWUs between the NSW Government and local councils, and associated costs.</p>
Funding assessment and cost benefit analysis	<p>Clear requirements for assessment and prioritisation for future funding programs, including the role of risk analysis, funding need, affordability, and cost benefit analysis should be clear.</p> <p>The LWU Funding Policy should also ensure that any agreements or projects are assessed against consistent assessment criteria including cost benefit or cost effectiveness assessments. The LWU Funding Policy should explicitly outline a strategic business case approach to project assessment prior to full business case development.</p> <p>This should include funding for projects that are led by the NSW Government. The Commission's 2021 White Paper noted that options proposed in NSW's emerging water strategies should be evaluated through rigorous cost benefit analysis. All available options should be considered, including infrastructure and non-infrastructure options. In addition to options analysis, due diligence is needed to ensure significant individual <i>investment</i> decisions are based on high quality business cases.</p>
Agreement pathways guidelines	Outline a governance process for negotiating agreements between NSW Government and LWUs on structural CSO agreements, and sector wide improvement programs (see <b>section 6.4.2</b> )

Elements	Proposed approach
Sector Priorities Approach	A consistent, collaborative approach to developing and maintaining a Sector Priorities Plan (see <b>section 6.5</b> ).
Governance structure and reporting	Provide a governance structure for both the Investment Framework and specific programs as they are developed.  At a minimum, this should include processes for reporting to Cabinet or committees, the establishment of interagency steering committees, and collaboration on policy and program development with local and county councils.

A key element of the LWU Funding Policy is a description of a ‘basic level of service’ to be used as the benchmark service level when considering proposals for assistance, and developed in consultation with the LWU sector (see **Box 4**).

Box 4: Basic level of service for LWUs

The basic level of service should include:

- Regulatory requirements covering:
  - water quality standards – as determined by NSW Health, and
  - environmental standards (including in relation wastewater discharges to the environment) – as determined in environmental legislation/regulation and by the NSW Environment Protection Authority (EPA).
- Water security (for example, in relation to the expected frequency, duration and severity of water restrictions) as set out by the DCCEEW water security targets.
- Policy and guidance on the minimum threshold for the provision of water and sewerage services (i.e., extending services to customers and potentially withdrawing services).
- Policy on the circumstances where developer charges and expenditures on amenity may be funded by exception.

**Chapter 8** provides information on the basic level of service in relation to the basic standard, and combined with the assessment of risks and capacity to pay, can serve as the basis of an approach to funding.

## 6.4.2 The LWU Funding Policy should include guidelines to support long term agreement pathways

The new approach to funding relies on mutual obligations of the NSW Government and councils:

- NSW Government should shift more of its focus and effort to building collaborative approaches with LWUs to address sector, regional, and local water issues.
- Equally, councils need to take greater responsibility for lifting the performance of their LWUs and for specifying any support required from the NSW Government, including CSO funding and regional water solutions, consistent with user pays principles in the first instance.

To underpin this shift, the new Funding Policy should include a clear CSO Funding Policy and an Agreements Pathway Guidelines to enable councils to approach the NSW Government seeking CSO funding support under long-term service level agreements.

The preferred approach is to adopt the key elements of the existing NSW Treasury *Commercial Policy Framework* to provide for service level agreements that include a CSO payment or other funding arrangements. The agreements should provide a sufficient length, likely to be 10 to 15 years, to facilitate long term certainty for councils for their LWUs, with funding envelopes approved for



four- or five-year blocks, with review to occur on a regular basis and reported to an appropriate subcommittee of Cabinet.

Councils seeking NSW Government support would need to ensure they are prepared to enter negotiations and participate in a long-term partnership under the investment framework, and should be able to provide an evidence base for financial assistance. This evidence base should be supported by strategic planning, including any business planning, pricing strategies, water planning, long term financial planning, and asset management planning.

Applications for NSW Government funding should be reviewed:

- By DCCEEW and relevant NSW Government agencies, potentially including Treasury, to provide advice and assistance to Councils to support readiness of long-term funding agreement applications. DCCEEW Water should also facilitate input from other regulatory agencies.
- Through a formal review and advice process to be undertaken by an independent panel or advisors, potentially through NSW Treasury or Infrastructure NSW, to advise the Minister for Water and the NSW Treasurer on the necessary funding, pricing, and performance provisions of any agreement.

The first set of agreements should be developed with councils in the Far West and Western NSW as a pilot and considered by Cabinet within 18 months.

While councils should be responsible for approaching the NSW Government with agreement requests. DCCEEW and NSW Treasury should consider a prioritisation approach for councils, such as:

- other councils (outside of the Western NSW region) that have both a significant identified water risk and significant demonstrable pricing challenges,
- councils that self-nominate as regional groupings of LWUs, with a commitment to regional level coordination, or
- councils that have identified a need to move towards NWI consistent pricing and greater use of debt financing, and are seeking only transitional pricing and capital structure reform assistance.

There should also be scope for multi-council or regional agreement pathways, especially where actions have been identified by joint organisations or other regional bodies, or in regional water strategies. This reflects the recognition in previous State Infrastructure Strategies for ‘the need to develop bespoke packages of policy, regulatory, technology and infrastructure solutions for each catchment.’ (Infrastructure NSW 2022, 112).

### **6.4.3 Using the LWU Funding Policy to assess funding programs**

The LWU Funding Policy should guide future funding decisions by the NSW Government, including on:

- levels of subsidies required under CSO agreements,
- transition to new pricing and capital structure regimes,
- prioritisation of any future capital investment identified in local and regional water strategies, and
- allocation of costs and risks between NSW Government and local councils.

Importantly the Policy should not rule out any type of investment across the sector, although proposals should meet policy requirements and stated objectives. Improved strategic planning may be funded for LWUs that would not be able to meet future costs without becoming financially unsustainable.

There may be situations, for example major investments in dam upgrades or pipelines to address water security in a region, where a project agreement between the NSW Government and one or more councils may be more appropriate than a service level agreement and CSO funding.



In these circumstances, any proposed agreement and funding arrangements should be developed within the context of the LWU Funding Policy. This should ensure that funding is consistent with the NSW Government's overall funding role, funding expectations, and eligibility for LWUs, including pricing and capital structure, and all other elements of the Policy.

Other challenges—like regional planning collaboration, disaster recovery, climate change adaptation, staff recruitment, retention, and training—may be funded if they meet the policy's stated principles and are clearly aligned with NSW LWU objectives.

#### **6.4.4 Implementing the LWU Funding Policy**

A draft LWU Funding Policy should be prepared and released for consultation with LWUs in early 2025, with an initial Policy to be finalised by mid-2025. The Policy should be developed on an ongoing basis, incorporating future work on regulatory impacts and costs, and reviewed and updated on an annual basis, in collaboration with the LWU sector.

The NSW Government should not agree new funding programs for the LWU sector prior to the adoption of this Framework.

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## **6.5 The Sector Priorities Plan should outline how the NSW Government will prioritise its funding to LWUs**

A review of issues combined with an assessment of projects against the LWU Investment Framework should identify priorities for funding. NSW Government should set clear objectives and use the Funding Policy to prioritise its funding to LWUs.

Key government agencies should work with LWUs to develop a Sector Priorities Plan, based on the state-wide, regional, and LWU-level strategic planning. This document will set out the NSW Government's priorities for the LWU sector over the short- to medium-term (one to three years). The Sector Priorities Plan will list the individual projects and programs the NSW Government plans to fund or otherwise support during this period to address challenges such as water security, water quality, environmental impacts, climate change, and population growth.

It should ensure the next tranche of NSW Government funding aligns with overarching principles in the LWU Investment Framework. These include that any future funding program in the Sector Priorities Plan:

- is tightly targeted to LWU's financial need, and
- provides funding up to an accepted basic level of water service provision.

### **6.5.1 Currently, NSW Government funding is prioritised using risk-based measures rather than using strategic planning to lift performance**

The NSW Government's main funding program—the Safe and Secure Water Program—allocates funding to projects in identified higher risk water systems to address water quality, water security, and environmental impacts. LWUs receive 'Eligible Risks and Issues List' (ERIL) scores to represent their system risks. The strength of the ERIL approach is that it identifies solutions to the highest risk issues identified by government agencies, such as NSW Health and NSW Environment Protection Authority.

The NSW Water Strategy, however, notes that using risk to prioritise capital investment funding can discourage LWUs from acting until risks become critical enough to be eligible for funding (NSW Government n.d.). Furthermore, the risk-based approach does not have direct regard to a LWU's own capacity to fund capital and other initiatives through own-source revenue, nor is it informed by councils' and regional organisations' strategic planning.

The Commission's consultations highlighted that LWUs do not understand how the NSW Government's priorities are established. In their submission, Goldenfields supported the Audit Office's finding from the 2020 review of the Safe and Secure Water Program:

‘Most projects in the program were reviewed by a technical panel but there was limited evidence available about regional and local priorities to inform strategic project assessments. About a third of funded SSWP projects were recommended via various alternative processes that were not transparent.’

(Audit Office of New South Wales 2020, 2)

In moving to an Investment Framework which has a primary objective of lifting councils’ own capacities to improve performance and manage risk, the existing ERIL approach does not provide a sufficiently robust strategic justification for NSW Government funding prioritisation as a standalone assessment. ERIL should be utilised as an input into the Sector Priorities Plan and should be used to assess NSW Government and council strategic planning and studies, in a more transparent strategic planning-based approach.

### **6.5.2 The NSW Government should conduct a transparent process to develop a list of sector priorities based on strategic planning and sector consultation**

DCCEEW, Office of Local Government (OLG), and NSW Treasury should work with LWUs to develop the Sector Priorities Plan by December 2024. It should then be revised by mid-2025 based on updated water strategic planning.

To ensure any funding provided is effective and efficient, the prioritisation list in the Sector Priorities Plan should be based on:

- the NSW Water Strategy and Regional Water Strategies and implementation plans
- a review of all LWU strategic planning supplied to either DCCEEW or OLG, through previous IWCMs, strategic planning under the RAF or the IPR processes, or work undertaken to support grant applications under the Safe and Secure Water Program or other grants programs.

While **section 6.2.1** notes that gaps exist in strategic planning, the Sector Priorities Plan can still be developed based on available information. It can then be updated on a rolling basis as more comprehensive strategic planning becomes available.

### **6.5.3 CSO payments should be a key tool used to address funding priorities**

The Commission considers the NSW Government should establish CSO payments as one of the main mechanisms to deliver funding priorities under the Sector Operational Plan. These payments can:

- promote long-term planning by LWUs by providing a predictable and stable funding source of financial support (which is not provided by grants)
- enable better targeting of funds to LWUs in financial need, and
- lift the performance of LWUs.

CSO payments are discussed further in **Chapter 7**.

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## **6.6 The NSW Government should ensure the new approach is built on well-integrated and robust strategic planning**

The new LWU Investment Framework should be founded on evidence-based strategic planning carried out at an LWU level, which is both transparent and coordinated with NSW Government plans. The current requirements for planning are not suitable for this role as they are voluntary.

This has been a long-standing challenge. The Armstrong and Gellatly Review (2008) identified the need to make strategic planning a requirement for LWUs, on the basis that ‘strategic plans would significantly strengthen the process of promoting efficiency within utilities and hence the prices at which services are delivered.’ (Armstrong and Gellatly 2008, 83).

The NSW Government could use several mechanisms to require councils to complete more effective strategic planning, including:

1. Requiring effective and evidence based strategic planning by LWUs as a mandatory eligibility requirement of future funding, specified in the LWU Funding Policy.
2. Integrating key elements of the RAF related to the expectation of effective and evidence based strategic planning into the Integrated Planning and Report Framework (see **Box 5**) to improve long term strategic planning for LWUs.
3. Incorporating elements of the RAF as OLG Chief Executive's Guidelines for councils.

The Commission recommends that the NSW Government should pursue the first and second mechanisms in sequence, for the following reasons:

- Placing a condition on funding that meets the RAF assurance process can be undertaken as part of the design of the LWU investment framework and incorporated into future funding programs immediately.
- Enhancing the Integrated Planning and Report Framework is necessary given the significance of LWUs as a business within councils and the impact that water and sewerage services have on the communities they serve.
- Adding assurance of strategic planning to eligibility criteria for a CSO or any significant grant process would address the current lack of enforceability in respect of requiring LWUs to develop effective strategic plans. To focus assurance on councils seeking a CSO, the framework could require LWUs to identify projects that may require government funding, and outline the explicit alignment between LWU commercial decisions and long-term funding priorities.

#### Box 5: Integrated Planning and Reporting framework

The Integrated Planning and Reporting (IP&R) framework enables councils to engage with their communities and identify service levels, funding options, and other long-term priorities. This framework supports the decisions councils need to make about the services they provide and what resources they allocate to them. The *Local Government Act 1993* outlines the steps councils need to take to comply with their planning and reporting activities under the IP&R framework.

The IP&R framework allows NSW councils to draw their various plans together, to understand how they interact and inform each another, and to get the maximum benefit from their efforts by planning holistically for the future.

(Office of Local Government 2021)

Relevant IP&R documents include:

- **Community Strategic Plan** – identifies the community's main priorities and aspirations for the future, and plans strategies for achieving these goals. In doing this, the planning process considers the issues and pressures that may affect the community and the level of resources that will realistically be available to achieve the community's aims and aspirations. This is the highest level of strategic planning a council undertakes and covers a 10-year plus timeframe. All other plans must support achieving the objectives of the Community Strategic Plan.
- **Resourcing Strategy** – details how a council will resource its strategic priorities, identified through the IP&R process and includes three inter-related elements: Long-Term Financial Planning, Workforce Management Planning, and Asset Management Planning.
- **Delivery Program** – outlines the council's commitment to the community about what it will deliver during its term in office to achieve the Community Strategic Plan objectives.
- **Operational Plan** – details the individual projects and activities a council will undertake in a specific year.

Source: (Office of Local Government 2021)

# 7 Establishing CSO payments

## Findings

- CSO arrangements are varied and in the urban water sector, generally relate to the payments for agreed non-commercial operations with SOCs. They are generally longer term in nature than grants, are based on agreed levels of service, and identify the degree of subsidy required across the business.
- The NSW Government has provided subsidies of over \$1 billion to the LWU sector over the last decade through a mix of grant programs and direct project investment. CSOs have not been used for making payments directly to LWUs in NSW.
- CSO payments:
  - can give greater funding certainty to LWUs, while providing incentives for them to improve cost recovery and performance, compared to grants.
  - are preferable to grants when addressing LWUs which have an enduring shortfall between their efficient costs of service delivery and maximum recoverable revenues.
- CSO arrangements could be entered into between the NSW Government and individual LWUs, a sub-set of LWUs or the entire sector, and any relevant SOCs.

## Recommendations – Establishing CSO payments

### **Recommendation: Introduce a CSO payment as a new funding approach for the LWU sector.**

- The CSO payments should focus on LWUs which are unable to achieve full cost recovery from their user charges without creating undue hardship within their communities. They should be designed to target several types of financial need.
- CSO payments should be structured under individual SLAs to provide incentives for LWUs to:
  - move to cost-reflective pricing (i.e. lower bound pricing under the NWI),
  - consult with regulators and customers on levels of service,
  - undertake long-term capital and operational planning under the RAF,
  - optimise other financing/funding sources, such as debt financing or developer charges,
  - engage in regional collaboration with other LWUs, and
  - improve operational performance (e.g. reducing service risks, bringing costs into line with an efficient level of operations).
- The NSW Government should build on existing arrangements to introduce CSO payments. These include NSW Treasury's guidelines for providing CSOs and DCCEEW's Regulatory and Assurance Framework for assessing applications for CSOs.

### **Recommendation: Develop a CSO Policy as part of the *LWU Funding Policy* in consultation with the sector over the next 12 months.**

- The CSO policy should include guidance on the:
  - eligibility and information requirements, including the appropriate level of strategic planning for a LWU
  - assessment processes, including roles and responsibilities
  - elements of the service level agreement
  - negotiation processes and funding arrangement

## Recommendations – Establishing CSO payments

- periodic review and triggers
- approach to any specific reporting requirements
- administration.

**Recommendation: Provide a report to the NSW Productivity & Equality Commissioner on the implementation of the CSO policy after 12 and 24 months.**

- When reviewing the CSO policy, the NSW Productivity and Equality Commissioner should consult sector participants to determine whether the proposed CSO policy should be revised.

## 7.1 CSO payments can provide greater funding certainty to LWUs

CSO payments are payments by government for services to be delivered to customers at prices that are below cost-recovery levels. As they can be set up to operate for the long-term, these payments can give funding certainty to LWUs. They can also be designed to provide incentives for LWUs to improve cost recovery and performance.

### 7.1.1 CSO payments have benefits over and above grant funding for LWUs

Some stakeholders noted that the current funding model, which primarily uses grants, distorts investment decisions by LWUs. For instance, upgrades and renewals are undertaken on *ad hoc* basis, driven by grant funding availability rather than when they are needed (Cobar Shire Council 2024). Further, grants are an uncertain and volatile funding source. There have been fluctuations in funding levels and eligibility criteria for the different grant programs made available to LWUs in recent years (Berrigan Shire Council 2024) (Richmond Valley Council 2024).

In contrast, introducing CSOs under Service Level Agreements (SLAs):<sup>34</sup>

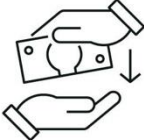

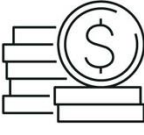





- Offers predictable and reliable funding for LWUs. This allows LWUs to be accountable for their operations. They can better plan for their business-as-usual services, as well managing long-term funding challenges, rather than seeking grants as an emergency response.
- Considers a LWU's capacity to fund services from its own operations. For example, by reducing costs to an efficient level or moving to more cost-reflective charges. This ensures the CSO payments preserve incentives for efficient service delivery, while being tightly targeted to those LWUs in financial need.
- Provides a flexible funding source, which can be used for operational, maintenance or capital spending. As noted by the Australian Government's Productivity Commission, providing this funding envelope, untied to any particular project,<sup>35</sup> allows LWUs to choose the most cost-effective way of improving their services (Productivity Commission 2017).
- Enables the NSW Government to adopt a consistent approach to providing any funds to LWUs. In particular, making funding contingent on LWUs taking steps to lift their performance. This includes them 'exploring all opportunities to improve the efficiency of their services, taking into account the future viability of services and alternative options' (Productivity Commission 2017, 13).

<sup>34</sup> Service level agreements should define service levels, Key Performance Indicators, CSO payment amount and terms (NSW Treasury 2019). They are discussed further in **section 5.4**.

<sup>35</sup> The NSW Government may want the flexibility to use CSO payments to make capital contributions to projects, as alternative to grants.



Figure 14: Benefits from funding under a CSO payment over a grant program

	<b>Predictable &amp; reliable funding source</b>		<b>Supports LWU accountability &amp; planning</b>
	<b>Considers capacity to pay from LWU's operations</b>		<b>Better targets funding to financial need</b>
	<b>Flexibility to fund operating or capital costs</b>		<b>Facilitates cost-effective solutions</b>
	<b>Consistent approach to NSW Government funding</b>		<b>Includes incentives to improve performance &amp; costs</b>

There was strong support for CSO payments among stakeholders as an alternative to grants (Lachlan Shire Council 2024) (Tamworth Regional Council 2024) (Cobar Shire Council 2024) (Berrigan Shire Council 2024) (Richmond Valley Council 2024). Some noted that grants have historically focused on capital and pre-construction costs, with little consideration given to ongoing operating costs. Others considered more flexible funding options were needed to plan for inter-generational investment in water and wastewater assets (Richmond Valley Council 2024).

### 7.1.2 For commercially unviable water systems, CSO payments are preferable to grants

CSO payments are preferable to grants when addressing LWUs which have water systems that are commercially unviable. This occurs where there is an enduring shortfall between their efficient costs of service delivery and maximum revenues that can feasibly be recovered from their communities.

The NWI provides that full cost recovery should be the objective for all rural surface and groundwater-based systems. It recognises however that ‘there will be some small community services that will never be economically viable but need to be maintained to meet social and public health obligations’ (Commonwealth of Australia and the Governments of New South Wales, Victoria, Queensland, South Australia, the Australian Capital Territory and the Northern Territory 2004, 14).

In these circumstances, several reviews have found that CSO payments may be a better option than grants to assist these LWUs. For example:

- The Australian Productivity Commission recommended using transparent, untied CSO payments than grants, as the latter are often poorly targeted to where needed (Productivity Commission 2021).
- Furthermore, the Joint Select Committee on Protecting Local Water Utilities from Privatisation recommended a funding model that uses CSO payments could be made available to LWUs where cost recovery is not economically viable (Joint Select Committee on Protecting Local Water Utilities from Privatisation 2024).

Stakeholders also considered that CSO payments would be preferable for those LWUs which do not have the capacity to recoup operational costs from their limited customer base (Tamworth Regional Council 2024) (Richmond Valley Council 2024). We discuss the potential for these payments being made to a grouping of western NSW LWUs in **Chapter 9**.



There may be a case for capital grants in instances where LWUs are unable to fully fund the costs of substantial, one-off investments in major assets. Any program that uses CSO or grant funding should be designed to meet the best practice principles outlined in **Chapter 5**.

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## 7.2 CSO payments enable better targeting of funds to LWUs

The NSW Government should introduce CSO payments as the foundation for a new funding option for the LWU sector. This will provide a commercial approach to funding LWUs and enable targeting of those communities that have challenges in providing services to customers and generating the revenue required to fund these services.

### 7.2.1 CSO payments should be tightly targeted to financial need

Many stakeholders expressed views on how eligibility for and the amount of CSO payments could be structured. For example, they could consider a LWU's size, remoteness, and socio-economic disadvantage.<sup>36</sup> Similarly, the Issues Paper canvassed potential eligibility based on these characteristics (NSW Productivity Commission 2024).

After further analysis and consultation, the Commission considers eligibility for CSO payments should not be preset based on these criteria. Rather, any LWU may be eligible to enter a SLA to receive these payments. This does not however automatically mean that all LWUs would receive CSO payments. These payments should be tightly targeted to LWUs in financial need. Therefore, the key is to demonstrate that, based on its strategic planning developed through DCCEEW's Regulatory and Assurance Framework (RAF) process:

- the LWU has a financial need, and
- this financial need would continue to exist despite the LWU taking all feasible steps to improve the financial sustainability of its operations.

This would allow the LWU to apply for a CSO payment. The payment would typically comprise the difference between the efficient cost of delivering the water and sewerage service, and the community's ability to pay for that service (Productivity Commission 2017). Any application for a payment would be subject to an assessment process like that outlined in **section 5.4**.

Given the significant quantum of subsidies the NSW Government provides under existing grant programs and the principle that CSO payments should be tightly targeted. The Australian Government's Productivity Commission considers this would be likely to reduce the overall quantum of funding that the NSW Government provides to LWUs (Productivity Commission 2017). The new approach to LWU funding requires better strategic planning of priorities, provides a mechanism to agree mutual obligations to make LWUs operations more efficient, and will ensure that LWUs recover costs from the customers where possible. If targeted the approach will reduce the overall expenditure to address issues facing the sector and reduce the reliance on the NSW taxpayer.

### 7.2.2 There may be several types of financial need

Under a SLA, the NSW Government could design a CSO payment to target several types of financial need comprising:

- **Structural payments** – long-term funding for those LWUs where it is not viable to provide a basic level of service at full cost recovery (see **Chapter 8** for more detail on the concept of basic level of service), and

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<sup>36</sup> Bega Valley Shire Council, Goldenfields, Canberra JO, Tweed Shire Council, Singleton Council, Bega Valley Shire Council, Leeton Shire Council, Goldenfields, Central NSW JO, Canberra JO, Water Directorate, Orana Water Utilities Alliance, Riverina and Murray JO, Berrigan Shire Council, WSAA.

- **Transitional pricing payments** – temporary funding for LWUs who are transitioning to full cost recovery over a period, while managing bill impacts on their customers.

### 7.2.2.1 Structural payments

Long-term CSO payments could be made available to LWUs in circumstances where it is commercially unviable for them to provide basic water and sewerage services to customers. Structural payments should be guided by the following principles:

- Eligible LWUs are unable to achieve lower-bound pricing under NWI pricing principles. That is, they cannot sustainably fund operating costs and asset renewals through their user charges.
- Previous reviews have identified that some LWUs will always have higher costs, even if their water services are run very efficiently. Further, some communities will have lower capacity to pay due to socio-economic factors (NSW Productivity Commission 2021).
- This type of CSO payment would represent the difference between a LWU’s efficient level of service costs and its community’s ability to pay for the service.

CSO payments could be made available to LWUs to cover both operating and capital costs which they are unable to fully fund, untied to specific projects. This might be a more administratively simple funding option to implement compared to grants where the LWU already has other CSO payments in place under an SLA. Technical and funding gateways could be built into the CSO payments, as they currently are with grants.

- Analysis by the Commission suggests only a small number of LWUs, located in Western New South Wales are likely to come within this category. This issue is discussed further in **Chapter 9**.

### 7.2.2.2 Transitional pricing payments

Some LWUs will be able to improve the viability of their operations by increasing their user charges to achieve lower bound pricing under NWI pricing principles. However, this may lead to large bill increases if it occurs immediately. Where this is the case, temporary CSO payments could be made available to LWUs to transition to cost-reflective prices. This would allow LWUs to transition over a period (e.g. five years) and use the CSO payment to cover the funding gap during this time.

Temporary CSO payments could take several forms, including applying for debt facilitation support. CSO payments could be made available to LWUs who can access debt finance (public or private) but are unable to service interest payments without leading to large bill increases for their communities. This may overcome one of the barriers to LWUs face using more debt financing in their operations.<sup>37</sup>

**Box 6** provides an illustrative example of how CSO payments could work in practice.

Box 6: Illustrative example of CSO payments

Introducing CSO payments would allow LWUs to better plan across all aspects of their operations, both short-term and long-term.

- As an example, a LWU has developed its strategic planning under DCCEEW’s Regulatory and Assurance Framework and identified that:
- User charges currently under-recover its efficient costs and it can transition to cost-reflective pricing over a 4-year period.
- Funding is needed in the earlier years for the LWU to upskill its staff and establish a model of greater regional collaboration. However, the LWU is unable to fully fund these initiatives without an excessive increase in bills.

<sup>37</sup> As outlined in **Chapter 3**, the Commission found that many LWUs met the key metrics to qualify for loans. However, debt funding is currently under-utilised. Around a quarter of LWUs have no debt at all. Many others only borrow relatively small amounts.

- In the later years, despite accessing debt financing, a funding gap exists to construct new infrastructure.

Subject to the assessment process outlined in section 5.4, the LWU enters a SLA with the NSW Government to receive a CSO payment for its operations, provided it complies with conditions around service levels and requirements to improve the financial sustainability of its operations. These conditions could include increasing water and sewerage charges to more cost-reflective levels or establishing cost efficiency against sector benchmarks.

### 7.2.3 Uses of the CSO mechanism for program funding

There is flexibility for the CSO mechanism to be used for specific issues that apply to individual LWUs, a group of LWUs or the entire LWU sector.

For example, during our consultation we heard many LWUs face a shortage of skilled workers to effectively manage water and sewerage operations. A CSO may be used to support training initiatives. This could be targeted to LWUs in need or provide sector-wide support, as appropriate. The CSO design could also ensure flexibility in funding training initiatives, including training 'on country' for First Nations water operators and ability to deliver training through a collection of councils.

Similarly, a recent example of a sector-wide CSO was the Dam Safety CSO to Water NSW from DCCEEW as part of the TWRRP.

The CSO approach proposed in this review could allow the flexibility to fund similar initiatives with the LWU sector. In some case a small grant program maybe a more effective funding instrument.

Regardless of whether the CSO payment is directed at individual LWUs, groups of LWUs or the entire sector, funding should align with the six principles of State Government funding in **Chapter 5**.

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## 7.3 CSO payments should be used to lift the performance of LWUs

The Terms of Reference requires the Commission to examine the extent to which alternative funding arrangements can lift the performance of the most poorly performing, smaller LWUs without creating disincentives to the efficient operation of good performers.

Several stakeholders recognised that any funding model needs to provide appropriate incentives for LWUs and for each LWU to specifically have 'responsibility to ensure its operations are as cost effective and efficient as possible before accepting subsidies' (Bega Valley Shire Council 2024) (Goldenfields Water 2024) (Riverina Water 2024) (Berrigan Shire Council 2024) (Council (Richmond Valley Council 2024). Furthermore, some stakeholders agreed with linking a component of funding to a LWU meeting specific performance indicators (Berrigan Shire Council 2024) (Tamworth Regional Council 2024).

The Australian Government Productivity Commission noted making CSO payments available risks reducing incentives for a LWU to improve their efficiency and charge cost-reflective prices. Therefore, the payments should be designed to ensure the LWU has clear incentives to provide effective and efficient water services to their communities. The payments should support improved operational and financial performance and 'not allow utilities to under-price their services in pursuit of affordability' (Productivity Commission 2021, 32).

Figure 15: Incentives possible under a CSO payment



CSO payments can be structured under SLAs to provide incentives for LWUs lift their performance. For example, payments could be made contingent upon LWUs:

- Moving to cost-reflective pricing (i.e. lower bound pricing under the NWI). Tamworth Regional Council (2024) noted that LWUs should be encouraged to set appropriate water and sewerage charges (taking into consideration the local socio-economic conditions) that can be used to fund or partly fund future capital investments.
- Consulting with regulators and customers on levels of service.
- Undertaking long-term capital and operational planning under the RAF.
- Optimising other financing/funding sources, such as debt financing or developer charges.
- Engaging in regional collaboration with other LWUs or SOCs. Several stakeholders supported LWUs using greater regional collaboration to help address the lack of economies of scale in their operations (Tamworth Regional Council 2024) (Berrigan Shire Council 2024) (Dubbo Regional Council 2024) (Goulburn Mulwaree Council 2024).<sup>38</sup>
- Improving performance around risks or costs. For example, reducing service risks to an agreed target or bringing costs into line with an efficient level of operations.

## 7.4 The NSW Government should build on existing arrangements and the new Investment Framework to introduce CSO payments

Currently, CSO payments are not used as alternatives to grants when funding LWUs. One way the NSW Government could introduce them as a funding option is through harnessing existing DCCEEW and NSW Treasury arrangements, as well as establishing a NSW Treasury advisory group.

<sup>38</sup> Priorities that may include the need for collaboration should be identified through the Strategic Priorities planning process.

## 7.4.1 CSO payments are not currently used to fund LWUs

Historically, the NSW Government has not used CSO payments to fund LWUs. Instead, it has provided funding for LWUs under grant programs.<sup>39</sup>

While not used to directly fund LWUs, the NSW Government has provided CSO payments to SOCs to assist the sector. In 2022, the Minister for Lands and Water announced Phase 2 of the Town Water Risk Reduction program. It included a new CSO payment of up to \$10 million over two years for WaterNSW. Under this arrangement, WaterNSW provided information and expert services to LWUs to reduce dam safety and drinking water quality risks (NSW Government n.d.).

The NSW Government has guidelines in place to provide CSO payments to government businesses across a range of services (NSW Treasury 2019). The guidelines specify that the CSO should:

- have a clearly defined objective
- relate to activities that support a clearly defined target group or resolve an exceptional circumstance
- be formalised through a SLA, and
- be monitored and reviewed on an ongoing basis.

## 7.4.2 The NSW Government should introduce CSO payments as part of the new Investment Framework and Funding Policy

Along with the development of the LWU Sector Overview and Sector Priorities Plan, DCCEEW should propose a funding envelope for LWU CSO Agreements via the annual budget process prior to negotiating a CSO with individual LWUs. The Budget proposal should:

- demonstrate the consistency of the funding proposal with the LWU Investment Framework,
- identify priority LWUs based on the Sector Overview and Sector Priorities Plan (noting however that other LWUs will still be eligible to seek a CSO agreement),
- quantify funding required for forward years for priority LWUs requiring a CSO, and
- confirm monitoring and reporting arrangements for CSO payments to individual LWUs.

Following this preliminary work, steps 1 to 3 should be undertaken in relation to each individual LWU funding request.

### Step 1: LWU applies to enter into a service level agreement with CSO funding

Based on its strategic planning, the LWU may identify a financial need it is unable to resolve from its own resources. For example, it is unable to increase user charges without causing undue bill shock, defer expenditure without adversely impacting on levels of service or risks, or access other funding sources such as debt finance.

In these circumstances, the LWU would apply to DCCEEW to seek a long-term service level agreement including CSO funding. This should be supported by submission of its strategic planning to DCCEEW.

The Australian Government's Productivity Commission has noted that clear and credible data is required to make estimates around the efficient costs of delivering services and the affordability of these services. High-quality information is needed to ensure any estimate of financial need is credible and that any resulting CSO payment is set at a prudent level (Productivity Commission 2021).

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<sup>39</sup> That said, the NSW Government does provide CSO payments in relation to pensioner rebates. Local councils are required under the *Local Government Act (1993)* to offer rebates to pensioners for their water and sewerage bills. The NSW Government covers 55 per cent of the cost through a CSO payment. Pensioner rebates are discussed further in **Chapter 10**.



## Step 2. DCCEEW assesses whether this strategic planning is effective and evidence-based

The RAF contains a process for DCCEEW to follow when assessing whether the strategic planning the LWU does is effective and evidence-based (Department of Planning and Environment 2022).<sup>40</sup> Its focus is on determining whether it achieves the outcomes outlined in step 1 to a reasonable standard. That is, the strategic planning:

- is underpinned by evidence-based analysis (e.g. uses expert advice, external accreditation or audited financial statements),
- draws on industry standard approaches and departmental guidance, and
- explores alternative interpretations of the evidence used to support its conclusions.

While DCCEEW sets expectations for the outcomes the strategic planning needs to achieve to be effective and evidence-based, the LWU can decide what approach to take to meet them. The process outlines information requirements and what will occur if DCCEEW needs additional information for its assessment. If DCCEEW assesses that the LWU's strategic planning information to be effective and evidence-based, it would provide this information to a NSW Treasury advisory group reviewing CSO payments, along with the application form.

## Step 3. CSO Working Group to evaluate the strategic planning information, scrutinising the financial need and alignment with the Sector Overview and Sector Priorities Plan

To ensure a consistent approach to CSO payments, a CSO Working Group should be established and led by DCCEEW, with membership including Office of Local Government, NSW Treasury and Infrastructure NSW. The Advisory Group would undertake a detailed evaluation of the strategic planning information (and accompanying application) to appropriately scrutinise the LWU's financial need (see **Figure 16** for possible governance arrangements for new CSO funding approach).

This may include undertaking price and cost benchmarking across LWUs with similar operations to understand opportunities to increase user charges or reduce costs to more efficient levels. The Working Group may also explore different servicing solutions, such as using different technologies or regional collaboration with other LWUs or SOC's.

It is proposed that a Specialist Advisor be appointed with LWU experience to provide expertise to the working group when considering CSO proposals and to provide final advice to the Ministers on the final service level agreements. It would examine the how the LWU has identified the financial need, as well as the steps it has taken to firstly manage it using its own resources.

The CSO Working Group would also evaluate alignment with the NSW Government's priorities for the LWU sector. As outlined in **Chapter 6**, any funding to support LWUs should demonstrate a strategic fit with the NSW Government's objectives for the sector. The objectives should be set out in its LWU Sector Overview. This includes assessing service delivery against the 'basic level of service'. As discussed in **Chapters 6 and 8**, this is the benchmark service level for NSW Government funding. Services above this level would not be eligible for CSO payments.

These detailed and strategic evaluations are similar to those required under the *NSW Treasury Policy and Guidelines: Guidelines for Community Service Obligations* (NSW Treasury 2019). If they indicate the financial need should be addressed using a CSO payment, the advisory group would then engage with the LWU in relation to the size of the payment, duration, and any conditions it is contingent on. The Australian Government's Productivity Commission considers any payments should be made conditional on operational improvements, such as pursuing regional collaboration (Productivity Commission 2021). **Section 5.4** also discusses how CSO payment should be designed to include conditions aimed at lifting performance.

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<sup>40</sup> It aims to provide an assessment result within 60 working days.



#### **Step 4. CSO Steering Committee to make recommendations about Service Level Agreement and level of CSO payment to Ministers.**

Following the evaluation, the CSO Steering Committee would make a recommendation to the Minister for Water and the Treasurer on service level agreement, and making of CSO payments to the applicant LWU. The recommendation would include the size of any payments and any conditions it is contingent on. It would also provide information on how well the CSO payment aligns with the NSW Government's objectives and priorities for the LWU sector, contained in its Sector Overview.

The recommendation should be accompanied by advice from the Specialist Advisor on the consistency of the final terms of the agreement and levels of CSO payments with the NSW Government's Sector Overview and Sector Priorities Plan. The Specialist Advisor can be used by the CSO Interagency Working Group during the process when liaising and negotiating with individual LWUs as to what is required. The Specialist Advisor will need to have LWU expertise which can be drawn upon.

The Minister for Water and the Treasurer would then decide whether to jointly approve funding available for the CSO payment.

#### **Step 5. DCCEEW formalises the SLA with the LWU**

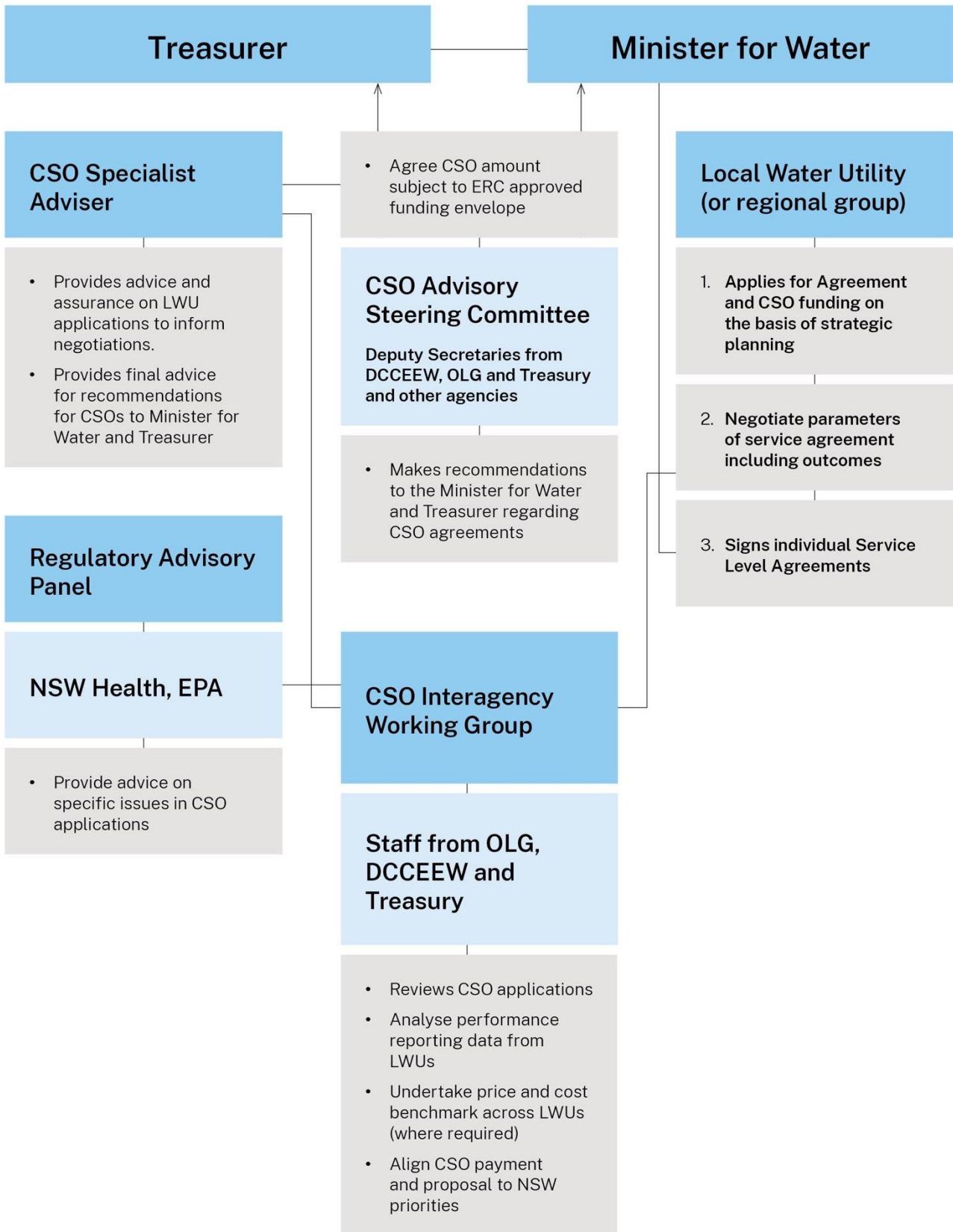
After funding approval has been provided, NSW Treasury guidelines indicate that a signed SLA must be in place before commencing the CSO payments (NSW Treasury 2019). As noted in the NSW Treasury guidelines, 'SLAs give clarity to the delivery and funding of CSOs and provide a framework to measure performance and review priorities' (NSW Treasury 2019, 21). Further, SLAs should ensure that there is alignment in understanding about its intended objectives, what service is needed, and the costs involved.

In this case, the SLA would be put in place between DCCEEW and the LWU. It would specify service levels and requirements the LWU would need to meet to continue receiving the CSO payments. These include requirements around maximising revenue from other sources (e.g. moving to more cost-reflective charges), engaging in regional collaboration, performance reporting, and meeting outcomes (see [section 5.4](#)).

#### **Step 6. CSO Working Group and Steering Committee monitor and evaluate service levels and CSO payments**

Consistent with the NSW Treasury guidelines, the CSO Advisory Group would regularly monitor and evaluate the CSO payments to ensure they are operating as intended (NSW Treasury 2019). The findings and reporting would be signed off by the Steering Committee (led by DCCEEW). This would be facilitated by including annual reporting by the LWU against performance indicators in its SLA. The Australian Government's Productivity Commission considered that CSO payments should be made conditional on LWUs undertaking this type of regular performance reporting. (Productivity Commission 2021).

Figure 16: Proposed governance for CSO Funding Approach



Source: NSW Productivity and Equality Commission 2024

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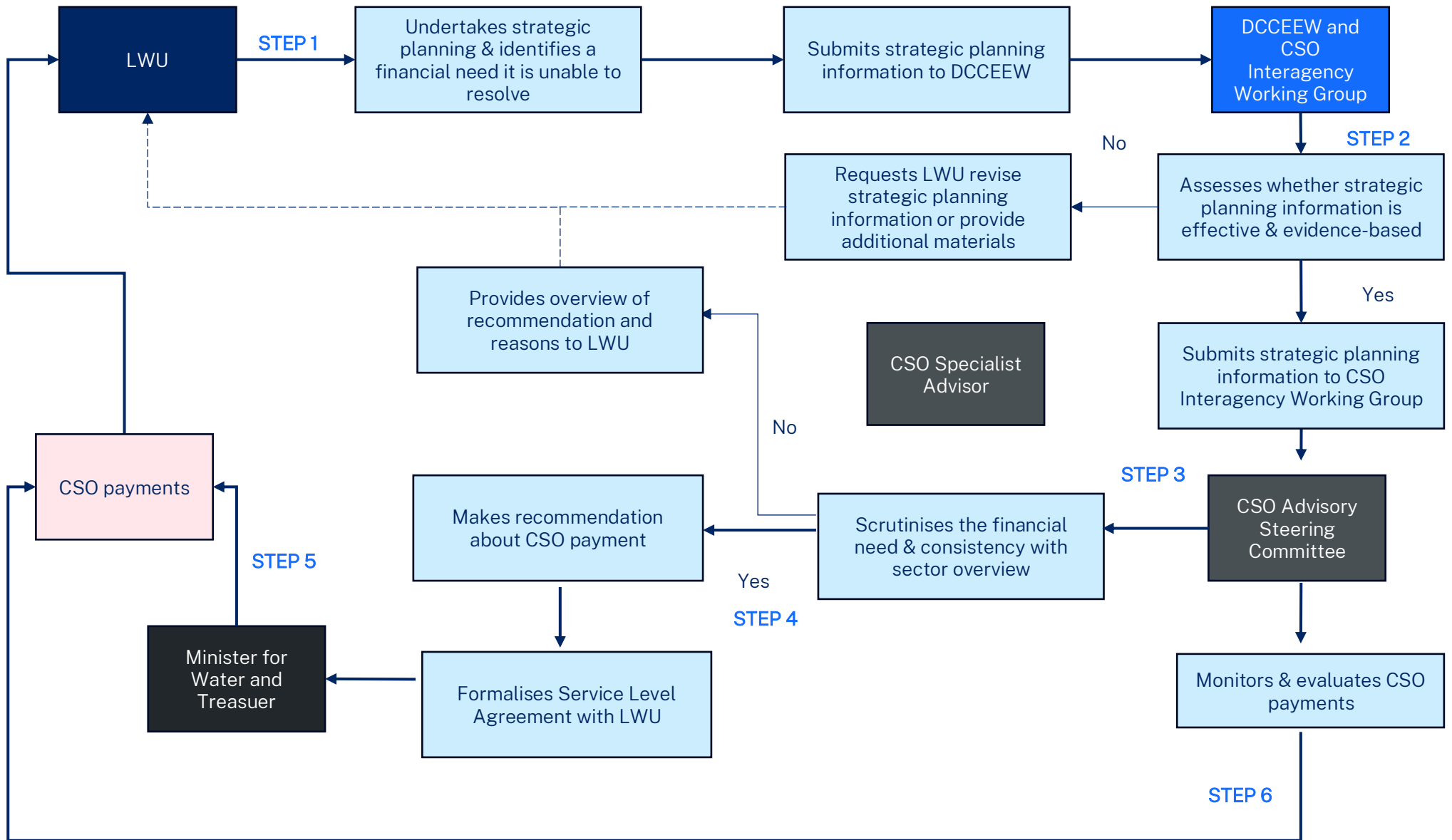
## 7.5 CSO approach should be designed over next 12 months

The Minister for Water should request the DCCEEW develop a CSO policy as part of the LWU Investment Framework. When undertaking this review the DCCEEW must consult with the sector. This policy should include guidance on the:

- eligibility and information requirements, as well as the appropriate level of community strategic planning for a LWU,
- assessment processes, including roles and responsibilities,
- a description of a standard CSO funding arrangement and form of funding agreement,
- a description of the negotiation process,
- a description of any specific reporting requirements,
- periodic review and triggers, and
- administrative and compliance requirements.

The policy should be provided to the NSW Productivity & Equality Commissioner no later than 12 months after the commencement of the review. When reviewing the policy, the NSW Productivity and Equality Commissioner should consult sector participants to determine whether changes need to be made.

Figure 17: CSO Funding Approach (by steps)



# 8 Service levels and minimum service standards

## Findings – Service levels and minimum standards

### A defined Basic Level of Service should inform a CSO funding approach

- A clearly defined Basic Level of Service (LoS) should inform the level of support that the NSW Government would contribute under a CSO scheme to an LWU that does not have the financial resources to provide adequate services for its customers. This should also inform what types of projects they would be funded under other mechanisms such as grants or any CSOs across the sector.
- The development of a Basic LoS would require the NSW Government to determine and communicate which services and the level of services it is willing to support in relation to drinking water supply, sewerage services and financial assistance programs.
- Consistent with the principle of local government ownership and accountability, defining a Basic LoS should not prescribe what set of services a LWU should provide.
- A Basic LoS should be consistent with relevant minimum standards. Inconsistency would give rise to uncertainty and regulatory risk for LWUs.

### Minimum standards must produce net benefits for the LWU sector

- While it is possible to set a minimum service standard in respect of any service characteristic, standards result in both costs and benefits. Any minimum service standards should produce clear demonstrable net benefits when applied.
- Currently the *Public Health Act 2010* and *Public Health Regulation 2022* require LWUs to have and comply with a drinking water management system. Apart from this requirement, there is no minimum water quality standard specified in regulation.
- LWUs are required to hold Environmental Protection Licences for wastewater treatment plants with processing capacity of 2,500 persons equivalent (or 75 kl per day) or more under the *Protection of the Environment Operations Act 1997* (POEO Act).
- Although minimum standards for water quality and wastewater discharges are established for the purposes of protecting human health and minimising environmental damage, the blanket application of these standards in different locations and circumstances provides a bias towards capital investment and inefficient spending.
- The current approach to assessing what is a reasonable service level for water security across LWUs is unclear and does not provide guidance on tolerable levels of risk from a NSW Government perspective. The NSW Water Strategy and NSW Regional Water Strategies do not clearly set out the acceptable level of service for water security for cities and towns.
- Objectives for levels of service for water security are required to assess risks consistently across the state and prioritise investment. The required level of service may vary between LWUs and indeed within LWUs, however it should be transparent.
- The implications of establishing an outcome-based service standard for system reliability risks imposing unwarranted costs. System reliability standards should not be included in a Basic LoS definition at this stage and Councils should continue to be responsible for setting system reliability service levels with customers.
- A voluntary customer retail service standard should be developed which outlines common approaches to customer service issues such as billing, hardship, privacy, and family violence

## Findings – Service levels and minimum standards

for the LWU sector. There are elements of this standard that may be made compulsory to receive Government funding.

### Efficiency

- It is difficult to assess the efficiency of current regulatory regimes because there is a lack of information regarding how regulatory obligations and associated standards are applied.
- Reforms are required to ensure regulatory standards for water quality, environmental protection and water security result in outcomes that have demonstrable community benefits (either economic, social or environmental).

## Recommendations – Service levels and minimum standards

### Recommendation: Ensure that implementation of minimum standards across the sector is efficient.

- To ensure that the implementation of water quality minimum standards is efficient, NSW Health should:
  - publish its current regulatory strategy for LWU drinking water quality consistent with the NSW Government Guide to Better Regulation,
  - develop a Regulatory Impact Statement (RIS) of any proposed change in water quality standards, such as the implementation of health-based targets,
  - develop a joint approach with DCCEEW on how to implement standards in LWUs where the cost of compliance is unacceptably high, as outlined in the new LWU Funding Framework, and
  - work with DCCEEW to contribute to the development of a *Sector Priorities Plan*, including scoping the aggregate cost and financial implications of relevant health standards and setting priorities for investment.
- To ensure that the implementation of minimum environmental standards is efficient, the NSW EPA should:
  - publish and implement a regulatory and enforcement strategy for LWU environmental standards consistent with the NSW Government Guide to Better Regulation,
  - conduct a Regulatory Impact Statement (RIS) of its regulatory and enforcement strategy,
  - develop a joint approach with DCCEEW on how to implement standards in LWUs where the cost of compliance is unacceptably high, as outlined in the new LWU Funding Framework, and
  - work with DCCEEW to contribute to the development of a Sector Priorities Plan, including scoping aggregate cost and financial implications of standards and setting priorities for investment.

### Recommendation: Review the role of regulators in planning processes undertaken prior to submission of an application for water treatment and sewage works under section 60 approval processes.

DCCEEW work with NSW Health and the NSW EPA to ensure regulatory objectives are clear at the commencement of approval processes relevant to section 60 of the *Local Government Act 1993* to ensure that responses are commensurate to risks.

### Recommendation: Establish an outcomes-focused standard for water security that outlines NSW-wide expectations while providing LWUs with flexibility to manage given local conditions.



## Recommendations – Service levels and minimum standards

- The NSW Government should prescribe methods and approaches for assessing the performance of an LWU in meeting water security objectives and enable the prioritisation of potential investment for the *LWU Sector Priorities Plan*.
- The Level of Service Objective for water security for LWUs should be set by the NSW Government based on acceptable risk. The acceptable level of risk should be determined from feedback from LWU customers and the broader system-based standard. An initial focus should be placed on LWUs that are facing high levels of risk and/or significant costs.
- DCCEEW should conduct a Regulatory Impact Statement (RIS) of the establishment of a outcomes-focused water security standard.

### **Recommendation: Develop a voluntary customer retail service standard for LWUs.**

- A voluntary customer retail service standard should be developed to outline procedures and practices to protect customers to be included in the Regulatory Assurance Framework.
- Elements of this guidance should be made mandatory for receiving funding for any revised state funded hardship payments to ensure implementation of critical state policies such as privacy protection and family violence prevention.

### **Recommendation: Develop and adopt a Basic Level of Service description under its LWU Funding Policy in consultation with the LWU sector.**

- The NSW Government's Basic Level of Service (LoS) should:
  - include drinking water supply, wastewater and financial assistance as basic services,
  - outline the role of minimum standards for services, and
  - describe the factors to consider when extending services to new areas.
- The LWU Funding Policy should outline how the Basic LoS concept will be used to consider LWU forecast expenditures under the CSO assessment process.
- What is a reasonable level of system reliability should be established at a local level as there is no minimum standard to refer to when defining a Basic LoS. If the cost of improving Reliability levels of service is a key driver of cost for an LWU requesting a CSO, the NSW Government should benchmark this level of service with similar businesses to assess whether the expenditure is reasonable.

Under the RAF, DCCEEW has a role in considering if any investment is prudent and offers value for money. We have recommended a set of funding principles and the introduction of a CSO for LWU funding.

To deliver this reform, the NSW Government needs to establish which services it will fund and the acceptable or reasonable level of service that is considered prudent.

In addition, through our analysis and engagement with stakeholders, we have identified significant concerns with the effectiveness and efficiency of existing regulatory minimum standards for drinking water quality, water security and environmental licencing.

This chapter addresses these two issues separately, though the concept of minimum standards and their impact on costs closely linked. In turn, this chapter considers:

- how the NSW Government should establish a Basic LoS to clearly communicate what it considers to be 'described' or 'level of service objective' which the Government is prepared to fund, and
- how the NSW Government can reform existing minimum standards for drinking water quality, environmental licencing, and water security to ensure regulation is effective and affordable.

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## 8.1 Establishing a basic level of service for funding

In **Chapter 7**, we outlined the Community Service Obligation funding option to assist those LWUs that do not have the financial resources to provide services for their customers. The development of this approach requires the NSW Government to define a Basic LoS that it is willing to consider funding.

Defining a Basic LoS will clearly communicate to LWUs, the sector as a whole and the wider community the level service that the NSW Government considers to be 'adequate' or 'a minimum acceptable level of service' which the Government is prepared to fund. As part of a well-designed CSO funding program, a Basic LoS will help the NSW Government provide consistent funding for LWUs even though water and sewerage services provided by LWUs vary significantly, both between LWUs and also within a service area.

Defining a Basic LoS would also be consistent with a key recommendation of the Commonwealth Productivity Commission's Review of Urban Water Services for Regional and Remote Communities (see **Box 7**).

Box 7: Basic level of service and the National Water Initiative

The Commonwealth Productivity Commission discussed the 'basic level of service' in its Review of Urban Water Services for Regional and Remote Communities (Commonwealth PC 2020 pg. 45).

Its approach to defining a basic level of service concentrated on using health standards for water quality and approaching setting reliability objectives based on local circumstances.

The Commonwealth Productivity Commission considered that each state should outline a basic level of service by providing guidance on system planning for regional and remote communities. It recommended that:

*"A renewed National Water Initiative should include the development of a definition of, and to ensure access to, a basic level of water services. At a minimum, this would include safe and reliable drinking water. The definition of 'safe' could be nationally consistent, while the definition of 'reliable' will vary according to local circumstances."*

The Basic LoS should be founded on a clear rationale of why particular services are included and on detailed definitions of a basic service, specified in the form of measurable user outcomes where possible. The definition should be subject to review.

The remainder of the section discusses in detail key issues that should be considered as part of defining a state-wide Basic LoS.

### 8.1.1 Which services and activities should be included in a Basic Level of Service

A necessary first step in establishing a Basic LoS is identifying the relevant services and activities which should be covered.

There are a range of services that are provided by LWUs (see **Table 11**). In addition to water and sewerage services, LWUs also carry out a range of related activities and ancillary services. These activities primarily relate to:

- Activities that support the provision of a final service – for example, activities such as water storage, treatment and distribution and also services such as consumption information or provision of rainwater rebates are carried out to support the provision of drinking water supply.
- Financial assistance programs and activities - the development and administration of programs for hardship and pensioner rebates are activities that aim to provide financial assistance targeted to those in need. These activities could be undertaken by other bodies or be substituted by other programs and are therefore an ancillary LWU activity.

Table 11: Outline of LWU Services and Activities

Water Supply Services	Wastewater Services	Ancillary Services
Drinking Water Supply Non-potable Water Supply Recycled Water Supply Bottled Water Refilling Stations Metered Standpipes Bulk Tanker Water Filling Stations	Wastewater Collection, Treatment, and Disposal (Sewerage) Trade Waste Management Human Waste Removal Services	Development services - processing sub-division and development applications Financial assistance services – hardship and pensioner rebates Liveability and amenity services
<b>Business Regulatory Requirements/Supporting Activities</b>		
Environmental Protection		
OH&S requirements		
Governance and reporting requirements		
Customer service and billing		

For the purposes of establishing a CSO funding program, the NSW Government should consider which of the above services and related activities it is prepared to fund.

The NSW Government should communicate its views on these issues as part of the CSO processes under the *LWU Funding Policy*.

The Commission’s view is that a basic level of service should encompass:

- drinking water supply to urban areas,
- non-potable supply to urban areas,
- recycled water to urban areas,
- wastewater services (residential and trade waste), and
- customer financial assistance programs that are state policy

Ancillary services, such as supporting development or improving amenity may be excluded from a basic a level of service and require further investigation if they are creating significant expenditures for the LWU resulting in affordability concerns. Further detail is provided below.

## 8.1.2 Determining basic levels of service

Any basic level of service should include a defined measurable outcomes or levels of service to assess what is a reasonable to use as a basis for funding. Key attributes or performance measures could include drinking water quality and security, the level of environmental protection and the access to payment assistance services.

Guidance on a basic level of service should describe the role and treatment of the following:

- regulatory requirements covering:
  - **water quality standards** – as determined by NSW Health
  - **environmental standards** (including in relation wastewater discharges to the environment) – as determined in environmental legislation/regulation and by the NSW Environment Protection Authority (EPA).

- water security requirements (for example, in relation to the expected frequency, duration and severity of water restrictions) as set out in new water security objectives.
- system reliability performance measures.
- any policy on the provision of water and sewerage services to areas that are un-serviced, i.e., extending services. This policy could also relate to withdrawal of services.
- The circumstances where developer charges may be funded by exception, and
- The circumstances where expenditures on amenity may be funded by exception.

Consistent with the principle of local government ownership and accountability, a basic level of service should not prescribe what services an LWU should provide. LWUs should retain the right to establish different service level targets provided this is based on appropriate consultation with customers, meets regulatory standards, and is funded by customers.

### **8.1.3 The agreed Basic Level of Service is the basis for a CSO service level agreement**

The establishment of a *LWU Funding Policy* and a CSO provide the administrative mechanism to consider basic levels of service when providing funding.

To demonstrate that a request for funding is tied to achieving the Basic LOS, any LWU requesting funding should have a suitable customer service plan describing its water and sewerage services and the associated levels of service.

There should be clear alignment between these services and a long-term capital and operating plans and forecast level of expenditure.

For any proposed expenditure the NSW Government will have to determine whether:

1. The LWU forecast expenditure is delivering a Basic LoS, for example:
  - a. Are cost drivers clear and aligned to basic services?
  - b. Is the coverage / extent of services considered as meeting sector level policies?
2. The LWU's level of service are appropriate for the circumstances they are facing, for example:
  - a. Is expenditure on water quality and environmental services required to cost-effectively meet minimum standards?
  - b. Is expenditure on water security meeting NSW Government expectations for risk?
  - c. Will the proposed long-term capital and operating plans deliver the services and manage identified risks and challenges?
3. The expenditure can be broadly considered as efficient, for example:
  - a. Has expenditure with regulatory standard cost drivers been through a suitable assurance process?
  - b. Is the forecast expenditure based on suitable business cases and evidence?

The Basic LoS should also be used to establish the agreed levels of service that forms part of a CSO service level agreement. Delivery on the agreed levels of service should also be one measure of LWU performance under a CSO agreement.

The Basic LoS enables an assessment of the LWU proposed funding strategy and any impacts on affordability which is the key reason for a CSO to be struck with an LWU.

The Basic LoS will be directly related to any minimum standards and the associated impacts on LWU, however the Basic Los is not simply be a mirror of a set of relevant minimum standards as the standards do not cover all services and are at times not related directly to a level of service objective. In addition, the Basic LoS should also consider the coverage of services provided which is a policy question.

## 8.2 Current minimum standards and basic level of service

### 8.2.1 The basic level of service will need to incorporate minimum standards

Minimum standards are regulated services an LWU is required to provide. A basic level of service would likely incorporate existing minimum standards in areas such as drinking water quality, water security, and the environment. The Basic LoS may also require the government to develop new minimum standards, such as for customer service.

Currently, LWU are affected by three sets of minimum standards. Some of these standards relate directly to services and others relate to business operations, for example protecting third parties from negative impacts such as environmental standards. Table 1 lists the minimum standards that currently apply to LWUs, of these, public health and environmental standards are the biggest driver of LWU expenditures.

Table 12: Current regulatory role and responsibilities relating to existing and potential minimum standards

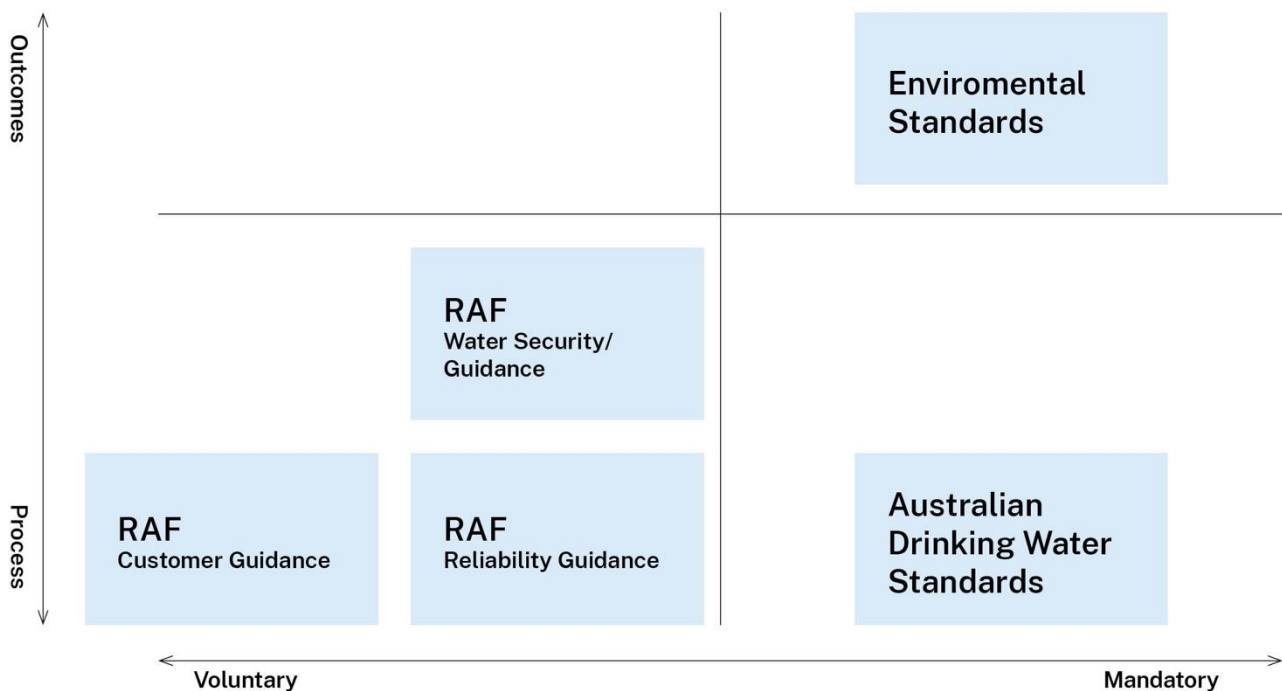
Service / activity	Responsible Regulator	Standard and Approach	Roles
<b>Existing</b>			
Water Quality Standards -	NSW Health <i>NSW Public Health Act 2010 and Public Health Regulation 2022.</i> <i>NSW Fluoridation of Public Water Supplies Act 1957.</i>	LWU must have and comply with a drinking water management system that addresses the Australian Drinking Water Guidelines (ADWG) Framework. NSW Health has powers to make directions with respect to unsafe water.  Fluoridation Code of Practice (specific standards relating to addition of fluoride).	Oversees the supply of safe drinking water and provides guidance on aesthetic quality of drinking water.  Issues alerts in response to water quality incidents.  Oversight of fluoridation.
Environmental Standards	NSW Environment Protection Authority (EPA) <i>Protection of the Environment Operations Act 1997</i>	Licensing of the quality of discharges from sewage treatment plants (STPs). Noting treatment levels can differ for each treatment plant based on the assessed environmental risks.  Licensing of dry and wet weather overflows from the sewerage network.	Manages licensing process of STPs.  Manages a system of notices relating to overflows, biosolids management, and odour.
Water Security	Water Group within DCCEEW <i>NSW Local Government Act 1993 and the NSW Water Management Act 2000.</i>	Currently there is no outcome regulation around water security for LWUs.  A “reasonable standards test” is applied to the sufficiency, appropriateness and robustness of a LWU’s planning process, under section 3 of the RAF.	Oversees the assessment of reasonable standards test in planning.

Service / activity	Responsible Regulator	Standard and Approach	Roles
<b>Potential</b>			
Service Reliability	Water Group within DCCEEW	There are no reliability outcomes standards that apply to LWUs.	Oversees the assessment of reasonable standards test in planning.
Customer Service	Water Group within DCCEEW	There are no customer service outcome standards that apply to LWUs.	Oversees the assessment of reasonable standards test in planning.

As detailed in **Figure 18** the current minimum standards that impact the LWU sector are a mix of:

- **Compulsory outcome-based service standards** – such as current environmental standards set by the EPA
- **Process-based service standards** – including drinking water minimum standards set by NSW Health
- **Voluntary process service standards** – for example water security under the Regulatory Assurance Framework.

Figure 18: Characteristics of existing LWU service standards



The Basic LoS should where appropriate reflect relevant regulatory standards. The concept will need to include other consideration such as the extent of coverage for services and how to establish a Basic LoS for aspects of service where there is no regulatory basis to service requirements.

### 8.2.2 Drinking water and water quality standards

Poor drinking water quality can have a range of adverse outcomes. It may contribute to the prevalence of diseases and, in rare cases, death. It can also have serious economic impacts on communities. There is a clear case for society to have a role in determining what is an acceptable level of health risk. This argument may have less applicability to aesthetic water quality issues, such as taste and odour. However, governments may wish to intervene to ensure people have equitable access to what is an essential service.



There are currently 264 Water Treatment Plants (WTPs) across 80 LWUs with water treatment facilities (CIE 2024).

NSW Health is the regulator for drinking water quality in NSW. It regulates water quality under the Public Health Act 2010, which requires LWUs have and comply with a drinking water management system (DWMS), setting out how they understand and manage water quality risks. The process requirements in the Act are designed to implement the national guidelines for drinking water, the Australian Drinking Water Guidelines (ADWG).

In its DWMS, an LWU must:

- identify existing water quality risks and current controls,
- assess if existing controls are sufficient to manage water quality risks in accordance with the ADWG. If additional controls are required to manage risks, the LWU should also identify improvement actions to manage those risks.
- set out performance, reporting and DWMS review requirements for LWUs.

It is important to note that NSW Health's DWMS guidance to LWUs focuses on achieving health outcomes and does not require consideration of costs and benefits of different approaches to managing water quality risk.

Other than supporting the development and implementation of DWMS, NSW Health also supports LWUs through the provision of free of charge water quality testing and reporting through the NSW Health Drinking Water Monitoring Program and water quality incidents. However, there is not an articulated strategy for how NSW Health implements these tools to enforce compliance with drinking water provisions of the Public Health Act 2010 and Public Health Regulation 2022.

LWUs must also follow procedure when adding fluoride including the fluoride concentration that must be maintained. Water utilities must undertake daily fluoride measurements, provide a monthly report of these results to NSW Health, submit monthly samples to a laboratory, and notify NSW Health of incidents including overdosing incidents, underdosing incidents, and when they are not able to fluoridate for more than 24 hours.

### **Proposed changes to drinking water health standards**

NSW Health is currently supporting two water quality initiatives. Firstly, NSW Health and DCCEEW have developed guidance on how health-based microbiological targets, as recommended in the ADWG, should be incorporated into drinking water management systems and Section 60 approvals. This includes NSW Health support to assess catchment risks and water treatment requirements, and what changes are required to achieve acceptable levels of pathogen risk. NSW Health recommends that LWUs work towards incorporating health-based targets into their drinking water management systems. However, other than DCCEEW's Section 60 approvals, no timeframe has been set. This higher standard of health-based targets could create significant additional costs, depending how it is implemented.

NSW Health has provided guidance on external auditing of LWU's DWMS in accordance with section 48 of the Public Health Regulation 2022. External audit provides opportunity for an independent third party (which may include a peer reviewer) to assess drinking water management system compliance and implementation, make recommendations and identify opportunities for improvement. These audits may identify risks that were previously overlooked in LWUs strategic planning.

### **Future cost considerations**

Our Issues Paper examined a range of implementation options for minimum service levels for Water Quality, which included extending a range of the current process service standards and the establishment of outcome service standards.

The type of water quality process standards that may be implemented in the future include:

- Drinking Water Management System (DWMS) updated and audited every 4 years.

- The requirement of a qualified water quality engineer for each LWU and/or requiring two accredited operators per WTP.
- Online monitoring - installing and operating online analysers to monitor, alarm and shutdown the WTP on detection of a water quality exceedance.

An outcome-based approach was analysed by estimating the costs of lifting the risk scores of WTPs and also ensuring that there is fluoridation across all WTPs.

This high-level scan revealed that the many of the councils facing the highest costs are small, with costs driven by the number of separate water systems requiring an upgrade.

### 8.2.3 Basic LOS and drinking water quality standards

The current and proposed minimum service standards for health outcomes have a clear rationale for protecting human health. They should be adopted as part of a Basic LoS for assessing proposed expenditure for possible funding support where an existing service exists.

However, the implementation of the standard across the state should be efficient. This requires an assessment for the cost implications for any LWU that is applying for a CSO.

An LWU should demonstrate that the proposed expenditure has been based on engagement with NSW Health and DCCEEW to ensure that responses to any water quality issues are fit for purpose and efficient.

#### Extending coverage to small communities

There are villages which are currently not serviced or received non-potable supply only across NSW. These are estimated to be in the order of 200-250 villages. It is not clear on what basis these are identified as candidates for service provision.

The *LWU Funding Policy* should describe the expectation for the NSW Government in any consideration of extending the service provision to smaller and/or remote communities. The Basic LoS concept should have appropriate flexibility to consider and fund alternatives such as tanks or a raw water supply.

The Basic LoS for drinking water should be based on state-wide consistent minimum standards and any relevant state policy on service coverage for townships and villages.

### 8.2.4 Sewerage services and environmental regulation

The operations of LWUs may have a range of environmental impacts, including the extraction of water from rivers or groundwater, land clearing to construct new assets, discharges from sewage treatment plants and greenhouse gas emissions from LWU operations.

The minimum service level options for the environment relate primarily to performance of wastewater management systems.

Minimum standards for environmental impacts reflect the intention of the NSW Government to protect third parties or externalities from the activities of an LWU. Environmental regulation of LWUs focuses mainly on limiting water pollution from treatment plants, but also addresses issues like odour and noise.

There are 452 STPs, either existing or potentially servicing unsewered communities across NSW LWUs.

The NSW Environment Protection Authority (EPA) regulates the quality of discharges from sewage treatment plants under the Protection of the Environment Operations Act 1997 (POEO Act). Under the Act, NSW EPA regulates the quality of discharges from sewage treatment plants with processing capacity of 2,500 persons equivalent (or 75 kl per day) through a licensing process. There are a range of smaller sewerage networks which are not licenced by the EPA but for which the EPA remains the appropriate regulatory authority where they are operated by a public authority (e.g. local councils).

Relevant treatment plants are required to hold Environment Protection Licences (EPLs) which typically include concentration and load-limits for certain pollutants. They also in some cases require controls for dry and wet weather overflows from the sewerage network.

When designing licence conditions, the EPA have to consider a number of requirements under section 45 of the POEO Act. This does not explicitly include a consideration of the costs of regulation.

Environmental licencing is designed to support agreed NSW Water Quality Objectives for each river system, which were developed in 1999. LWUs which release discharges into receiving water are required to complete a Water Pollution Discharge Assessment. This requires the LWU to consider the likely impact of their discharge on Water Quality Objectives and provide solutions to minimise impacts and where necessary, improve the quality of receiving waters towards achievement of Water Quality Objectives. The final step of this process is consideration and negotiation of discharge criteria in EPLs between the LWU and the EPA.

The POEO Act requires the EPA to review each EPL at least once every five years. Reviews or variations to licences can also take place when requested by a licence holder or on the initiative of the EPA, for example where monitoring provides new information. Reviews can also occur when upgrades or new plants are proposed.

Where LWUs are not compliant with their licence conditions the EPA can implement a series of regulatory actions, including fines, improvement plans, and potentially prosecution, as described in its *Regulatory Policy* and *Prosecutions Guidelines*. Non-compliance with EPL conditions is common, however typically it is minor in nature, as identified in a recent strategic audit (NSW EPA 2019).

Sometimes the EPA responds to high-risk non-compliance by requiring improved treatment technologies or new procedures through a Pollution Reduction Program. In other cases, the EPA has responded by adjusting certain licence conditions in negotiation with council.<sup>41</sup>

## Future costs considerations

We conducted a scan of the future costs arising from environmental standards.

Under the Eligible Risks and Issues List (ERIL) there are multiple risk categories for environmental impact for seweraged communities. For each STP a score from one to five was given based on factors such as whether an EPA mandated pollution reduction program (PRP) was in place or if it experienced sustained environmental performance or compliance issues.<sup>42</sup> Overall risks may be influenced by wastewater quality, load/capacity and condition/age of an STP.

Using an approach that examined inherent risk scores to determine whether upgrades are needed we found that the costs for meeting a possible lift in environment standards are more evenly distributed across LWUs than either improving water quality or security. The potential capital costs required to meet higher standards concentrated in a handful of LWUs which are generally large and have many separate schemes that each require upgrades.

### 8.2.5 Basic LoS – role of environmental standards

The current environmental service standards have a clear rationale for protecting waterway health and other third-party impacts, such as downstream drinking water supplies.

The objectives for environmental standards are not an explicit basic level of service provided to LWU customers. However, they do form part of the assessment of the costs of doing business.

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<sup>41</sup> For example, following reoccurring EEPL non-compliances in one of wastewater treatment plants, Albury City Council met with the EPA in 2020 and negotiated to increase the concentration limit for a pollutant.

<sup>42</sup> NSW Environment Protection Authority 2014, Pollution reduction programs operating procedure, 140733-pollution-programs.pdf (nsw.gov.au)

There is a clear rationale for incorporating costs that are driven by meeting environmental standards as part of a Basic LOS for assessing proposed expenditure for possible funding support where an existing service exists.

## **Extending coverage to communities in NSW**

The *LWU Funding Policy* should describe the expectation for the NSW Government in any consideration of extending the sewerage systems to smaller and/or remote communities. The Basic LOS concept should have appropriate flexibility to consider and fund alternatives or incorporate payments from a group of customers to be connected to the sewerage system as it can provide a significant lift to property values and there may be a willingness to pay to receive services earlier than may be the case without a co-contribution.

The Basic LoS should include costs that are consistent with meeting environmental minimum standards and any relevant state policy on service coverage for townships and villages.

### **8.2.6 Water security**

Water security analysis assesses the long-term risk a regional city, town, or community faces in accessing a reliable water source. Assessing the risk considers the availability of water, operating conditions, and service levels that meet customer and community needs, values, and preferences.

The water sources and water supply systems differ across regional NSW. They range from regulated river systems (serviced by significant storages/dams) to LWUs that use a mix of water sources for their water supply systems to some that are highly reliant on unregulated streams (with little storage capacity).

The risk to water security may be less clear to LWU customers until there is a drought or other extreme event. Unreliable water supplies can result in frequent water restrictions or a reliance on high-cost or poor-quality alternative sources. These events can impose a range of costs on communities, including reduced amenity and green open space, and poorer health and wellbeing outcomes and elevated costs.

#### **Roles and responsibilities**

Although LWUs are primarily responsible for understanding and managing risks in their communities, the NSW Government maintains an important strategic role in identifying and managing water security risks.

The NSW Government's RAF identifies that managing water security risk is a shared responsibility between the state and local government.

The NSW Government also has a clear interest in ensuring effective water security planning is in place for LWUs because:

- the NSW government is responsible for setting rules on how to share limited water resources between town water, irrigators, industry, and the environment,
- rivers and aquifers often extend across multiple local government areas and require a coordinated management approach,
- LWUs often rely on state-government owned bulk water assets like dams and pipelines, and
- the NSW government is often required to step-in to cover emergency water security issues in small communities.

The 2017-19 drought was one of the most severe in NSW's recorded history. It exposed serious issues with water security planning in many LWUs. Both coastal and inland communities faced the serious possibility of running out of water (MidCoast Council 2021, Karp 2019), and serious emergency actions were required – spending around \$300 million (NSW Government 2018).

## Existing water security standards

There is currently a process-based standard for LWUs to assessing their water security risks through strategic planning. Under the RAF, LWUs should have an understanding of their water security risks that is sufficient, appropriate, and robust. The RAF identifies two specific considerations for DCCEEW when assessing LWU strategic planning:

- What is the local water utility's access to current and potential water supply sources?
- How will the local water utility address current and future risks around continuity and reliability of access to water supply sources?

Without clear guidance on how to measure the effectiveness of these plans the water security standard does not provide a consistent assessment of risks.

The supporting documentation for this planning outcome, *Guidance on strategic planning outcome - Understanding water security*, sets out a set of factors for a LWU to consider but does not define a process the utility should follow. The advice does not provide LWUs with a clear guidance on:

- what the NSW Government considers an appropriate level of service for water security, nor does it set out a process for estimating this other than recommending LWUs engage with their customers on levels of service, and
- the appropriate level of evidence required to establish current or future water security risk. The guidance provides a menu of acceptable modelling approaches of variable quality but does not define where different models are appropriate.

## The current standard for water security in the RAF does not ensure consistent assessment of water security risks.

It is the Commission's view that in addition to providing a clear and consistent assessment of water security risks LWU strategic planning should also clearly identify where the State Government has a role in the management of these risks.

## Future cost considerations

Our Issues Paper examined options for an enhanced water security standard. This included an assessment of costs to meet a water security risk target based on long term yield calculations.

The assessment highlighted that the costs to meet water security targets are likely to be distributed very unevenly across LWUs. Over half of the potential total cost is borne by only eight LWUs. These utilities are generally medium or large, with relatively large volumes of water and significant works required to supply water. This assessment highlights the need to examine the cost implications of a standard in detail for a particular location.

### 8.2.7 Basic LoS – water security

Water security is a key concern for stakeholders and should be included in any definition of a Basic LoS for the provision of drinking water. A clear and agreed objective for this level of service is required for assessing the prudence of any proposed expenditure for possible funding support.

Many of our communities including the larger regional centres of Orange and Bathurst remain at risk of running out of water.

Central NSW JO 2024, 3

The implementation of any water security standard across the state needs to be efficient and deliver fit-for-purpose solutions. Based on common expectation and guidance around water security an agreed target for water security should be made in conjunction with each LWU and the communities affected after the risk is established using a consistent approach and options are addressed for their costs.

The NSW Government should define a **clear** approach and methods for assessing the forecast performance of LWU in meeting water security targets. Given the significant scale of many water



security projects it is important that the prioritisation of significant projects across the state should be factored into any agreement when considering a CSO and associated service level agreement with an LWU.

### 8.2.8 The NSW Government should develop a new water security standard

Currently the NSW Government does not have a documented view on what level of water security is appropriate for different communities across different areas of the state. Although DCCEEW has attempted to harmonise approaches to water security planning, it is not clear if the planning undertaken in these documents is sufficient to establish water security assessments that could create a clear statewide picture of water security risks.

An absence of NSW Government water security objectives for regional NSW creates difficulties for effective water security planning and it is not clear where the government should be making strategic investments to improve water security.

There are also some LWUs do not know what they should be aiming to achieve with their water planning, and what solutions would be viewed as fit-for-purpose.

The NSW government has already begun setting levels of service for water security in some communities through its Regional Water Strategies. For example, in the Namoi Regional Water Strategy the government proposes for regional cities to move to an “Enduring Level of Supply”, based on providing a guaranteed minimal volume of water in all circumstances. This is a step in the right direction in establishing an outcome-based expectation to guide planning.

DCCEEW should develop a set of outcome performance metrics and a set of strategic expectations for water security planning. These expectations should vary by location to reflect the costs and benefits of different levels of water security and the state government’s risk appetite.

These could include elements such as:

- **Water demand** - ensure that the water supply system will be able to supply the expected average volume of water that will be used by the community into the future,
- **Water restrictions** - the acceptable maximum frequency, severity, and duration of restrictions for a community, and
- **Emergency measures** - the acceptable likelihood for a community to require emergency measures when demands cannot be met by the local supply sources due to climatic conditions (i.e. when a supply shortfall occurs due to drought).<sup>43</sup>

These should be established for priority areas as part of a process to identify water security projects in the *LWU Priority Plan* or for LWUs that apply for a CSO with water security as a key cost driver.

Regardless of the simplicity of the “NSW Security of Supply” method, and its widespread use by LWUs, it would be problematic to use as a minimum standard across NSW because the method does not precisely estimate risk and is in essence an arbitrary level of service which would be unreasonably high in some places.

At the same time, the Enduring Level of Supply may result in constructing infrastructure to ensure water supply in all circumstances that is infeasibly expensive.

These methods can only be the first step in establishing the need for actions to enhance water security. However, consistent methods and approaches are critical to enable the assessment of risks and priorities across the state.

To ensure NSW government funding is targeted, the NSW guidance on water security planning should outline a reasonable range of water security objectives in different types of communities, based on an assessment of the costs and benefits of different levels of service. Where LWUs

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<sup>43</sup> Based on Queensland water security level of service objectives: Guidelines for development, April 2018. These types of level of service objectives are prescribed in regulation for the SEQ region of Queensland.



propose objectives outside of this range they should justify why this is appropriate, based on engagement with their community.

The Basic LoS for water security should be based on clear NSW Government service level objectives water security based on acceptable risk. The acceptable level of risk may be determined from feedback from LWU customers and a broader system-based standard.

Box 8: Developing state level of service objectives for water security

To develop a clear minimum level of service for water security, DCCEEW should outline the acceptable range of level of service objectives for LWUs based on their size, available water sources, or other criteria.

Levels of service objectives are essential for effective water security planning. They define what the acceptable level of risk the community and decision makers are willing to accept. It also provides a way of comparing the costs and benefits of different levels of risk reduction.

DCCEEW’s *Guidance on strategic planning outcome -Understanding water security* sets out the department’s expectations are for understanding water security to a reasonable standard and also optional guidance and case-studies and tools on how some of these expectations could be met. A key requirement is that the LWU should apply ‘sound’ water security criteria and service levels.

As documented in the *Guidance* there are many different water security criteria and service levels and that a LWU should consult with customers and community to determine the level of service and/or risk appropriate for its supply systems, including appropriate water restriction levels.

**Example level of service objectives**

Yield based objectives-calculates the size for storage required to achieve a given set of criteria. Many LWUs have applied a yield-based approach called the “X/Y/Z” rule which assesses if an LWU has sufficient water security to meet three objectives:

1. time spent in restrictions does not exceed X per cent of the time,
2. there is no need to apply restrictions in more than Y per cent of years, and
3. systems should meet (1-Z) per cent of the unrestricted dry year water demand through a simulation of the worst recorded drought commencing at the time restrictions are introduced.

Risk-based objectives- uses hydrology to estimate the rainfall, storage, and demand characteristics of a water system and then use statistical models to estimate the probability certain outcomes like water restrictions and supply failure. This approach can simulate various supply and demand changes, such as implementing new water sources.

Enduring level of supply objectives-Sets a minimum amount of water the LWU could provide in a very severe drought. For example, in Queensland, the government’s level of service objectives state that Brisbane’s water supply system should be able to deliver 100 litres per person per day in a 1-in-10,000 year drought (Queensland Government 2024).

**Establishing a reasonable range of levels of service objectives**

sets out an example for how the NSW government could identify a reasonable range of water security objectives. This is indicative only.

Table 13: Indicative example of a potential range of level of service objectives for different types of communities.

Type of Utility	Potential lower risk objectives	Potential higher risk objective
Large coastal city or inland city on a regulated river	Enduring level of supply providing X L/day/person in a 1 in 10,000 drought	Risk of supply failure should not exceed 1 in 10,000 years

Inland City on an unregulated river	Yield based objective based on a 5/10/10 estimate <i>or</i> risk of supply failure should not exceed 1 in 10,000 years	Risk of supply failure should not exceed 1 in 5,000 years
Regional town	Yield based objective based on a 5/10/20 estimate <i>or</i> risk of supply failure should not exceed 1 in 5,000 years	Risk of supply failure should not exceed 1 in 1,000 years
Small community where water carting is available	Risk of supply failure should not exceed 1 in 100 years	No level of service, but with estimate of how frequently water carting will be needed.

## 8.2.9 System reliability

Service reliability relates to the performance of the urban water network in terms of the management of assets and the level of service provided to customers.

Under the RAF, DCCEEW has an assurance role to establish what outcomes it expects for effective, evidence-based strategic planning and assess if a utility’s strategic planning achieves these outcomes to a reasonable standard.

The RAF include a set of guidance documents that relate to the planning for a business, including the following which are relevant for setting system performance targets:

- Guidance on strategic planning outcome -Understanding service needs (DPE 2022)
- Guidance on strategic planning outcome – Understanding system capacity, capability and efficiency (DPE 2022).

The Guidance also identifies typical service levels specified by the department or other regulators, for example about:

- supply failures or interruptions
- response times to supply failures/system faults
- water pressure
- customer complaints and inquiries
- services to special customers, such as those with critical health needs
- impact of sewage treatment works on surrounding residents
- effluent and biosolids management.

There are also reporting requirements around system performance in relation to service levels. There are 24 indicators in this area including Community (2), Complaints (15), Service Restrictions (2) and Interruptions (5).<sup>44</sup>

Sydney Water and Hunter Water, as well as many utilities in other jurisdictions, have defined minimum levels of service. Examples include the water pressure a customer can expect to receive, the length and frequency of unplanned interruptions, and how quickly the utility will respond to incidents.<sup>45</sup>

A key factor informing decisions around change in the reliability of a service at a local level is cost. Establishing a robust cost for strengthening network reliability across local water utilities is not

<sup>44</sup> <https://water.dpie.nsw.gov.au/our-work/local-water-utilities/local-water-utility-performance>

<sup>45</sup> Service standards for Sydney Water and Hunter Water are outlined in their operating licences, which are issued under the *Sydney Water Act 1994* and *Hunter Water Act 1991* respectively.

feasible as reliability is driven by a range of factors including many which are outside the control of LWUs.

### **Is there a need for a stronger standard?**

We have taken a consistent approach to assessing the need to establish a stronger regulatory regime in relation to minimum standards and their role in funding.

The broad options considered for reforming standards for system reliability include:

- **Option 1** - no change – retention of current approach under the RAF,
- **Option 2** - enhancement of reporting requirements for a set of common reliability standards, or
- **Option 3** - establish a service reliability standard for service elements that directly impact customers (e.g., water continuity, pressure and flow standards).

The Commission considers that defining system reliability levels of service is a process that can be managed by an LWU and its customers at a local level relying on guidance for engagement and representative structures of local government.

Selecting an approach with higher minimum service levels could result in higher costs across LWUs where customers do not support investments to achieve an outcome. The impact of establishing a set of outcome minimum standards in this area is unknown and risks imposing unwarranted costs. At this stage it is considered acceptable that councils should be primarily responsible for setting service levels with customers.

### **8.2.10 Basic LoS – system reliability**

The approach to assessing reliability as a Basic LoS should be to first identify if a change in the current service reliability is a key cost driver. DCCEEW in its feedback on a CSO application and during its assurance process should articulate an approach to establishing a reasonable level of reliability if it is a key cost driver for an LWU expenditure, consistency with published guidance.

Meeting system reliability improvements could be a consideration in the assessment of providing funding. However, LWUs proposed reliability standards should not be considered excessive, to avoid creating unreasonable costs. Funding requests for system reliability levels of service should be in line with industry norms for similar LWUs.

In some cases, meeting a particular standard may be assessed as best paid for by customers that are the beneficiaries of a level of service.

The Basic LoS for reliability should be established at a local level with reference to relevant industry benchmarks for the purposes of assessing funding requests.

### **8.2.11 A retail customer standard**

Customer retail service standards relate to the service that LWUs (and their agents) should comply with in providing retail services in delivering water and sewerage services.

Each LWU has a number of the customer-related interactions that may have specific procedures and practices. These can vary depending on the customer base and decisions over time.

Issues that should be included in a retail Basic Level of Service description include billing, payments, payment assistance or hardship plans, a customer support policy, family violence assistance and pensioner rebates.

There may also be benefit from consistency resulting from developing a standard treatment of non-payment and policies for charging interest, format of bills and communications around issues such as efficiency.

These issues could be included in a standard or a customer charter which outlines:

- How an LWU will consult with customer in strategic planning and on its customer services plan

- The agreed level of service as a result of community planning for a period
- All rights and responsibilities of the LWU to its customers
- A description and explanation of the water business's practices and processes including:
  - complaints handling
  - customer assistance (including joint account holders) affected by family violence, including the handling of customer information, billing and debt management.

### **There are no existing standards for customers retail services**

Currently there is little guidance on customer service standards in NSW. The NSW Water Directorate has provided Customer Service Plan Guidelines (Water Directorate, 2017). This includes and approach to Performance Measures and Customer Service Standards for the essential service aspects of the citywide water and sewerage systems or network.

There is a case for a set of minimum process customer retail service standards to ensure that procedures and practices that are funded by the NSW Government are consistent across the state.

The Commission has found that there is merit in developing a common Retail Customer Service Standard which may include common approaches to billing, hardship and privacy.

## **8.3 Ensuring expenditure is efficient**

### **8.3.1 Reform is required**

There have been several studies that have examined key future drivers of cost increases and decreases in the urban water sector.

Underlying cost drivers such as population growth, ageing assets, climate change and rising standards will necessitate significant investment in infrastructure augmentation, renewals, and asset maintenance. Our examination of cost and the scan of the impact of increasing standards also indicates there will be upwards pressure on costs and prices in the future.

Regulatory reforms are required to ensure regulatory standards result in outcomes that are demonstrably value for money.

No one would disagree that all potential risks to drinking water should be managed but the major issue, aside from the security of water in the first place, is the revenue source. Who is going pay?

Central NSW JO 2024, 3

### **8.3.2 The holistic impact of standards on the LWU is unquantified**

The regulatory arrangements for water quality and environmental licencing have been in place for a decade or more. Yet, it is not clear there has been a meaningful review of these regulations to see if they are working as intended. We have also found that the potential cost implications of these standards are unknown.

We are aware that there is a potential change in the existing water quality regulation practice. The Commission has also recommended that the NSW Government design and implement a Water Security standard in this review.

LWUs will need to comply with three major regulatory requirements:

- Water quality standards managed by NSW Health,
- Environmental licencing managed by the NSW EPA, and
- A new water security standard managed by DCCEEW.

Complying with regulation is the main driver of their capital and operating costs. To avoid inefficient or ineffective expenditure, it is important an optimised regulatory framework is in place. This assessment should be made in a holistic manner across all three regulatory drivers of cost.

The NSW Government Guide to Better Regulation states that regulations should be required, reasonable and responsive to the economic, social, and environmental needs of NSW. When creating or amending regulations, the government is required to produce a Better Regulation Statement (BRS) or Regulatory Impact Statement (RIS). The process for constructing a BRS or RIS should ensure the government has a clear rationale for regulation, considers a number of options including de-regulatory options, and considers the cost, benefits, and impacts of regulation.

DCCEEW, NSW Health, and the EPA should prepare detailed BRSs for each of the three area of regulation, based on the NSW Government Better Regulation principles (see **Box 9**) and the Australian Government's Guide to Regulatory Impact Analysis.

As a key step in commencing a BRS:

1. The EPA and NSW Health should publish their regulatory and enforcement strategies for LWUs.
2. NSW Health should conduct a review of its current legislation with a focus on defining a minimum standard for water quality and addressing compliance and enforcement limitations for regulating LWU drinking water quality.

After the review, which should include public consultation, the regulatory framework should be reformed to ensure that they are effective and result in efficient outcomes.

At least one option in the RIS should be non-infrastructure option and the BRS should also consider the implication of any regulation on the profile of infrastructure works across the LWU sector and ways to prioritise expenditure.

Box 9: Better Regulation Principles

**The NSW Government Guide to Better Regulation** sets out seven principles to consider when developing new regulation. It also provides supporting guidance on how to address each of these principles when developing a BRS.

- |              |                                                                                                                                                              |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Principle 1: | The need for government action should be established.                                                                                                        |
| Principle 2: | The objective of government action should be clear.                                                                                                          |
| Principle 3: | The impact of government action should be properly understood by considering the costs and benefits of a range of options, including non-regulatory options. |
| Principle 4: | Government action should be effective and proportional.                                                                                                      |
| Principle 5: | Consultation with business and the community should inform regulatory development.                                                                           |
| Principle 6: | The simplification, repeal, reform, or consolidation of existing regulation should be considered.                                                            |
| Principle 7: | Regulation should be periodically reviewed, and if necessary reformed to ensure its continued efficiency and effectiveness.                                  |

### 8.3.3 All three regulators should be involved in sector prioritisation

The RIS process should assist DCCEEW, NSW and the EPA ensure that the implementation of standards across the state is efficient and targeted.

The costs of failing a particular standard in a particular location should be described, documented and made public as part of any planning process.

NSW Health and the EPA should provide contribution to a DCCEEW-led **Sector Priorities Plan**. This will involve NSW Health and the EPA understanding priorities for investments that affect the risks from a water quality as well as an environmental perspective across the state.



This will also necessitate a joint approach with DCCEEW on how to implement standards in LWUs where the cost of compliance is unacceptably high, to be outlined in the new LWU Funding Framework.

### 8.3.4 The blanket implementation of regulatory standards may result in high costs

When regulatory standards change it is often expected that utilities should address water quality issues through capital upgrades to treatment plants. Some stakeholders considered this is, in part, driven by risk-averse regulators (Water Directorate 2024, 4), as well as the approach taken by engineering consultants and Public Works Advisory (Alliance of Western Councils 2024).

There is also concern these approaches do not consider the costs and benefits of proposed response to the issue identified via the regulation.

Significant cost burdens can accrue on an LWU due to a change in risk appetite from any regulator. A one-size fits all approach to infrastructure provision must be avoided to achieve fit-for-purpose, more cost-effective and sustainable local solutions. NSW Water directorate p 4.

This focus on capital solutions discourages LWUs from working with regulators to develop alternative approaches to achieve regulatory objectives at a lower cost. There has been some improvement in this area through the Advanced Operational Support Program, where DCCEEW provides LWUs with a variety of operational support to addresses risks with their existing infrastructure (DCCEEW n.d.).

It is important that LWUs are supported to develop and implement fit-for-purpose regulatory solutions that are cost effective and achieve regulatory objectives (see **Box 10**).

Box 10: Fit-for-purpose water quality regulation in New Zealand

Like in regional NSW, water services in New Zealand are generally provided by local councils but regulated by the central government. Following a major public health incident in the town of Havelock North, a new water service regulator, Taumata Arowai, was established in 2021 with a mandate to improve water safety.

The new regulatory framework requires local councils to assure the water they supply is safe. However, the regulator understood the capacity for councils to identify and manage risks was variable, and attempting to apply a single regulatory approach would not be effective, given their very different starting points.

The regulatory framework includes some important features to support fit-for-purpose regulatory solutions:

- **Consistent standards but tiered rules** - all water suppliers are required to comply with water quality standards related to pathogen and contaminant concentrations. However, the regulator sets a tiered set of Drinking Water Assurance Rules. Under these rules small suppliers are required to comply with a core set of proscriptive requirements to lift them up to a minimum standard. Larger utilities need to comply with the basic requirements plus additional process requirements to further reduce risk, with greater options to provide solutions.
- **Building technical expectations into rules** - to assist utilities to identify the fit-for-purpose approach to treatment and source water control, the rules include specific expectations for how utilities should achieve compliance. For example, the rules set out specific catchment monitoring requirements, treatment process requirements, and monitoring requirements the utility needs to meet.
- **Ready-made Acceptable Solutions** - for very small low risk communities the regulator prepares a set of Acceptable Solutions. These are ready-made treatment options a supplier can implement in a highly prescribed manner. If implemented correctly, the supplier has a simplified regulatory process.



Our review of the processes that are triggered by a failure in a health or environmental standards has not identified a clear process for how LWUs should identify and implement fit-for-purpose solutions to water quality regulatory issues.

Rather, once an LWU has identified a water quality risk through its DWMS it is their responsibility to improve management of the risk through their DWMS or develop a solution through their strategic planning. We have heard that current pre-assurance processes are informal and inconsistent. We have also heard that a change in regulator personnel in a strategic options stage can result in significant shifts in directions and requirements.

The NSW Guidelines for DWMS recommend that NSW Health and DCCEEW are consulted during the risk assessment process used to identify and address water quality risks in their DWMS. LWUs should be identifying improvement actions as part of the improvement plan in their DWMS required to adequately manage risks.

DCCEEW and regulators also formally review a LWU's approach to addressing water quality or environmental risk when they request approval for a new or upgraded treatment plant under section 60 of the *Local Government Act 1993*. Although section 60 approval is an important requirement, it comes too late in the process to assure that the utility has undertaken appropriate planning to determine if a new plant is the best option to address an identified risk.

### 8.3.5 Improving planning and assurance processes

The implementation of regulatory standards across the state should be demonstrably efficient. The costs of failing a particular standard in a particular location should be described, documented, and made public as part of any planning and assurance process.

The EPA and NSW Health should work with DCCEEW to ensure that the solutions proposed by LWUs to meet minimum standards are both fit-for-purpose and cost effective. This requires a clear process where the assessment of costs and benefits of options are considered.

In particular, the NSW Government should set clear objectives that are outcomes based and suited to meet the different risks posed for a given location. This should include developing a set of regulatory principles that ensure that responses are efficient. Regulatory processes must clearly and publicly incorporate assessments of the costs and benefits where their imposition creates significant expenditure. The cost of the response should not be greater than the costs avoided through regulation.

If environmental standards or water quality is a key cost driver, assurance should be provided by the relevant regulators that the proposed option is fit-for-purpose, aligns with regulatory objectives, is deliverable, and is in the long-term best interest of customers.

The implementation of the standards should also consider the cost and benefits of different approaches at different scales. This has been effective in New Zealand for developing fit-for-purpose approaches for water quality (see **Box 10**). This may involve regulators committing to a structure engagement process. This may include:

- Establishing a formal process between an LWU and relevant regulators,
- Identify a set of feasible objectives for review, and
- The NSW Government providing advice on the relevant minimum standard and associated level of service as an outcome of this process.

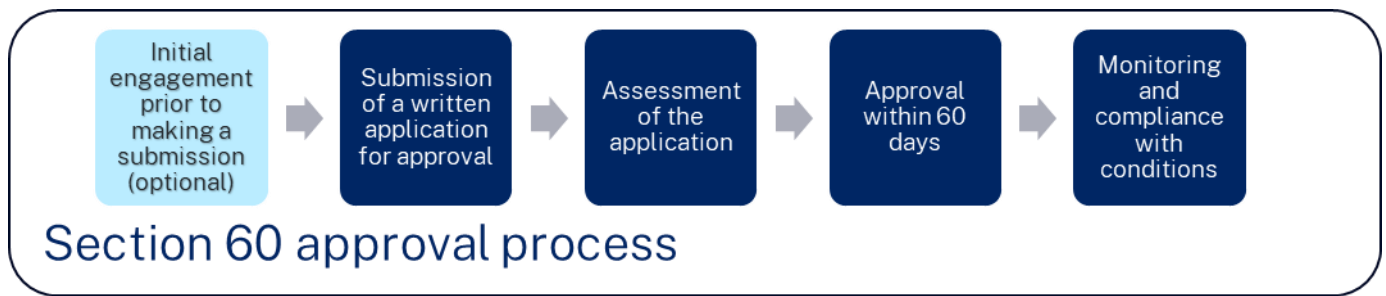
The Commission recommends that DCCEEW work with NSW Health and the EPA to review the current processes undertaken in the 'initial engagement prior to submission' under the approval processes relevant to section 60 of the *Local Government Act 1993* to ensure that the relevant regulatory objectives are clear and commensurate to risks.

#### Improving clarity

To obtain approval for water and sewerage works under section 60 of the *Local Government Act 1993*, LWUs need to complete a formal application as described in section 5 of the RAF (see Figure 19 below). Part of the approval process is for DCCEEW to assure a proposed work is fit-for-purpose.

When planning for and implementing solutions to achieve regulatory minimum standards it is important that LWUs have clear objectives based on appropriate and consistent advice from regulators.

Figure 19: Current section 60 approval process



Currently the RAF encourages LWUs to undertake initial engagement with DCCEEW prior to submitting a section 60 application to consider the strategic context of proposed solutions.

However, the initial engagement step is currently optional, and we understand there is no formal or structured process to establish the regulatory objective is appropriate. The clear documentation and assessment that an objective is fit-for-purpose should occur in Step 1 in **Figure 19**.

The Commission considers DCCEEW should formalise the initial engagement step as a way to ensure that implications of a minimum standards can be reviewed in consultation with the relevant LWU and regulator prior to the section 60 approval process commencing.

This may involve regulators committing to a structure engagement process. This may include:

- Establishing a formal process between an LWU and relevant regulators.
- Identify a set of feasible objectives for review.
- The NSW Government providing advice on the relevant minimum standard and associated level of service as an outcome of this process.

# 9 Provision of services in western NSW

## Findings – LWUs in western NSW

- There are a set of councils in western NSW that are unlikely to be able to operate LWUs on a commercial basis without ongoing external support. Therefore, this should be the priority group of LWUs considered under the new funding approach. This work should be undertaken simultaneously to establish the new approach to strategic planning and funding for LWUs.
- There is no clear and obvious grouping for organising these Councils into a structure that may enhance efficient and effective service delivery.
- The challenges these LWUs face include low revenues, difficulties in retaining skilled staff, accessing appropriate training and increasing costs due to water quality and security issues. Even though they face common challenges, the LWUs are not homogeneous.
- These LWUs service a large area and there may be diseconomies of scale from some groupings because the distances are great and some have differences in circumstances, including different water sources.
- These challenges have been long standing and are likely to increase without climate change mitigation. Increasing costs and the shift to a CSO funding model represents the opportunity to establish a sustainable solution.
- There is scope to implement structural reforms across western NSW LWUs that improve the ability to deliver strategic planning, conduct operations, share resources and provide certainty of funding for western NSW councils.
- In general, local Councils in western NSW are willing to be involved in a process that reviews a wide range of delivery options for water and sewerage service provision. The principle of co-design is a key concern of western council representatives.
- The consideration of reforms should be consistent with the expectations and guidance for LWU strategic planning as outlined in section 3 of the RAF. Relevant principles include consideration of service needs, risks and resources, customers engagement in decision-making and long-term financial sustainability.
- If structural reform and provision of a regional CSO is not considered efficient by a western NSW council, the council should provide clear evidence of financial sustainability for its LWU under alternative arrangements.

## Recommendations – Service Provision in western NSW

**Recommendation: Immediately establish a reform process to identify and implement the most efficient and effective structure for providing water and sewerage services in western NSW.**

- The reform process should be conducted by an independent appointed Chair and a working group consisting of stakeholders from government and relevant councils, supported by the NSW Government and completed by February 2026.
- The reform process should involve:
  - Developing, assessing, and consulting on possible definitions or groupings of western NSW to be part of structural reform process.
  - Establishing appropriate working groups and reviewing governance to ensure councils and customers retain responsibility for any decision made in the process pertaining to their council's involvement in any future business structure.

## Recommendations – Service Provision in western NSW

- Identifying the efficient and effective structure for providing water and sewerage services in western NSW with a focus on an enduring solution.
- The reform process should be conducted on an opt-in basis and the final decision should be based on formal positions made by the candidate LWUs. It should consider a range of ownership and service delivery options, including:
  - a formal alliance with a shared executive and strategic support
  - a joint organisation or county council arrangement
  - corporatisation with joint ownership between councils and the State Government
  - corporation with State Government ownership such as Essential Energy or WaterNSW in providing on-going services and/or ownership of assets, such as pipelines and weirs.

### **Recommendation: Develop a Strategic Business Case (SBC) for CSO funding to Western NSW LWUs based on the output of the reform process.**

- The SBC should outline options and support engagement between Councils and ratepayers prior to any recommendation and progress towards a Final Business Case.

## 9.1 Some LWUs in western NSW are unlikely to be commercially viable without external support

Some councils in western NSW are unlikely to be able to operate water supply and sewerage businesses on a commercial basis without ongoing external support. This is, in part, due to costs and in part, the lower level of capacity to pay relative to the remainder of the state.

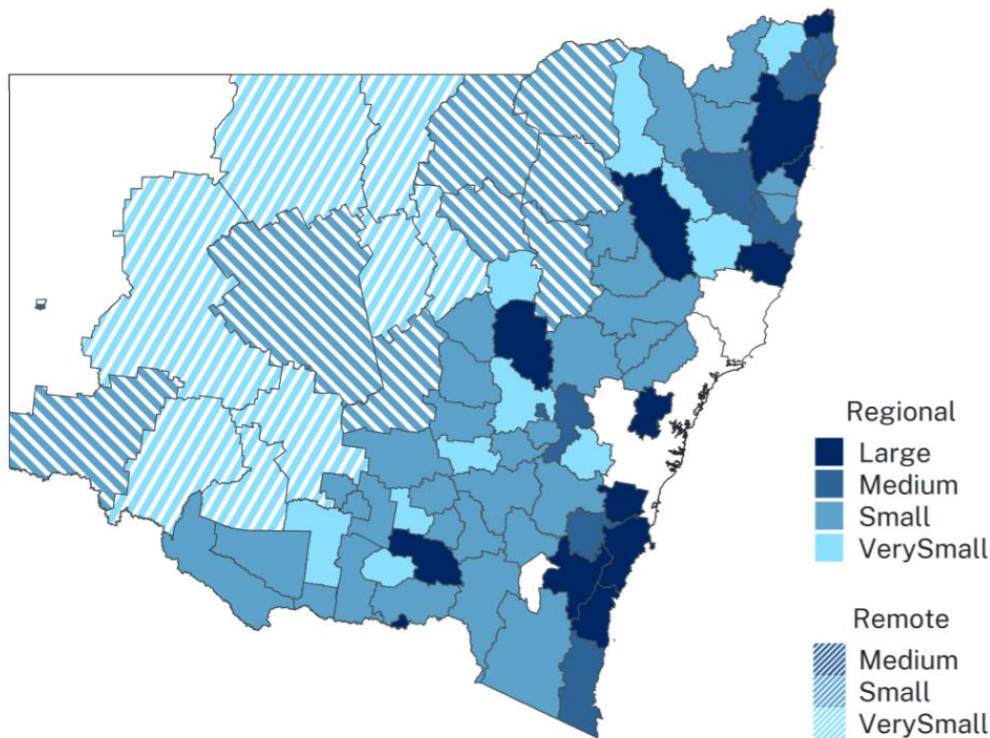
The NSW Productivity and Equality Commission (Commission) undertook targeted consultations with western NSW councils to test this premise and explore the existing challenges they are facing. These consultations highlighted the unique challenges they face, which can lead to high prices and difficulties recovering costs. Challenges include:

- the expense of transporting building materials,
- aging infrastructure,
- the cost associated with treating high water turbidity,
- difficulties retaining skilled staff,
- concerns around water security,
- the deterioration of previously established collaborative arrangements, and
- large annual depreciation costs due to issues with the grant process and capital solutions.

### 9.1.1 Analysis of western LWUs

The Commission analysed 16 LWUs in LGAs classified as ‘remote’ or ‘very remote’ — Balranald, Bogan, Bourke, Brewarrina, Carrathool, Central Darling, Cobar, Coonamble, Hay, Lachlan, Moree Plains, Narrabri, Walgett, Warren, Warrumbungle and Wentworth (Australian Bureau of Statistics 2023).

Figure 20: Map of Local Water Utilities



Note: Utilities in areas classed as regional by the ABS are in solid colours and those in remote areas are in dashed lines.  
 Source: DCCEE, ABS, Frontier Economics analysis, NSW Productivity and Equality Commission analysis 2024.

This analysis shows that for these remote utilities:

- Most (14 LWUs) are in the first or second quintiles for LGA socio-economic disadvantage meaning there is limited scope for further cost recovery (Australian Bureau of Statistics 2023).
- Around half (eight LWUs) do not recover operating costs from customer bills.
- They have lower connections on average (3,278 connections) compared to regional LWUs (18,163 connections) and account for only 4 per cent of all LWU connections.
- They have lower customer revenue on average<sup>46</sup> (\$4.18 million) compared to regional LWUs (\$19.08 million).
- Future costs associated with resolving water security, water quality and environmental risks suggests that these LWUs face a higher proportion of expected capital costs relative to their revenue. They account for only 5 per cent of all LWU revenue, yet face around 9 per cent of expected capital costs to LWUs.
- They have higher customer revenue per connection on average<sup>47</sup> (\$1,388) compared to regional LWUs (\$1,087).<sup>48</sup>
- Their customer bills (usage) are above the NSW median.
- Most (12) have a water quality ERIL risk score of 4 or greater.
- Most (13) have fewer than 5,000 total sewerage and water connections.

A submission from The Alliance of Western Councils<sup>49</sup> which represents 13 councils in western NSW echoed these findings:

<sup>46</sup> Based on a five-year average to 2022. Amounts are in \$2021-22.

<sup>47</sup> Based on a five-year average to 2022.

<sup>48</sup> Excludes sewerage only LWUs.

<sup>49</sup> Submissions from Orana Water Utilities Alliance, Cobar Shire Council and Lachlan Shire Council supported this notion.



Our current and worsening economic situation along with the tyranny of distance and an inability to get trained staff are the major limiting factors in ensuring the best water outcomes for our residents. On a user pay basis we are ill-equipped to maintain the utilities to a standard that meets the legislation particularly in the smaller and more remote locations across western NSW.<sup>50</sup>

(Alliance of Western Councils 2024, 1)

## 9.2 Structural reform should improve strategic planning, operations, and funding certainty

Structural reform should improve the strategic planning, operations, and funding certainty for LWUs in western NSW by enabling councils to share resources and skills to lift performance, prioritise investment, and facilitate a stable and appropriate level of funding to deliver services.

There is a wide range of structural options available for consideration that vary in their efficiency, effectiveness, and durability. The Commission's consultations with selected Councils revealed various level of initial support across a variety of possible organisational structures with no clear preference or limit on the options. Given this, all possible options should be explored by a reform process.

Table 14: Organisational structures available to LWUs

Options	Definitions of structural reform options
Local water utility	Individual council ownership over their water businesses, current alliance and joint organisation arrangements maintained.
Alliance	Local councils retain ownership over assets and functions, while the Alliance becomes responsible for certain council-determined functions such as planning. Alliances can be: <ul style="list-style-type: none"> <li>• <b>Formal</b> – may involve a CEO and executive officer (reporting to local council general managers) who undertake strategic, capital, and asset planning across the region.</li> <li>• <b>Informal</b> – may involve sharing of resources like training programs, knowledge sharing, and joint procurement for projects (e.g. pipe re-lining).</li> </ul>
County Council	Local councils may transfer certain assets to the County Council. County Council to function the water supply and sewerage services. The governing body of the county council must be elected by its constituent councils. The County Council must employ a general manager.
Joint organisation	Where ownership of assets may be transferred to joint organisation. The regionally based council would be responsible for the delivery of all water supply and sewerage services. For example, the Central NSW JO governance structure involves: <ul style="list-style-type: none"> <li>• A board consisting of the Mayors of each Member Council and non-voting representatives appointed (include county councils, public service officials).</li> <li>• A chairperson and deputy chairperson who are elected by the Mayors, with re-elections held on a regular basis.</li> </ul>
Council-owned water corporation	Assets and functions to be transferred to a corporation. A board would be established with local government as shareholders. This would likely require a new Act to be created and may be similar to the <i>Central Coast Water Corporation Act 2006</i> .



Options	Definitions of structural reform options
State-owned water corporation(s)	<p>Similar to above but local councils would have no role in providing water supply and sewerage services and the assets are transferred away from the LWUs. The State would assume these functions and would be the shareholder. Essential Water provides an example of this structure. A new state-owned corporation would likely require the establishment of a new Act.</p> <p>There may be hybrids where an entity such as Water NSW could own and operate bulk water assets such as pipelines and weirs.</p>
Corporatisation with joint ownership between councils and the State Government	<p>Assets and operations are transferred to the new entity. Shares are issued to member councils and the State Government, similar to TasWater under the <i>Water and Sewerage Corporation Act 2012</i>. The Tasmanian Water and Sewerage Corporation Pty Ltd's Constitution 2013 (amended 2021) stipulates shares be issued to all 29 local councils across Tasmania. The local councils in Tasmania are the majority shareholder. A Shareholders' Letter of Expectations is provided to TasWater, which specifies matters including the strategic priorities of the corporation and expectations for the performance of the business (Tasmanian Water and Sewerage Corporation Pty Ltd 2013). This option would likely require legislative change in NSW.</p>

### 9.3 Uncertainty around council groupings options should not hold back reforms

The definition of western NSW varies, making it difficult to determine how to structure these councils for efficient water supply and sewerage management. The Commission has not attempted to prescribe how best to group LWUs in western NSW. To enable discussion, the Commission has defined western NSW as comprising 16 LWUs in 'remote' or 'very remote' LGAs (see Section 9.1).

The Commission has also reviewed previous studies and the existing alliances to provide examples of possible groupings:

- Independent Local Government Review Panel (2013) defined the far west as Balranald, Bourke, Brewarrina, Broken Hill, Central Darling, Cobar, Walgett, Wentworth, and NSW Unincorporated area (Independent Local Government Review Panel 2013).
- Armstrong and Gellatly (2008) defined the far north-west as Bourke, Brewarrina, Central Darling, and Country Energy (now Essential Energy).
- Orana Water Utilities Alliance comprises Bourke, Brewarrina, Cobar, Central Darling, Walgett, and more centrally located councils of Bogan, Warren, Coonamble, Warrumbungle, Gilgandra, Narromine, Mid-Western Regional, and Dubbo (Orana Water Utilities Alliance n.d.).
- Alliance of Western Councils comprises Brewarrina, Bourke, Walgett, Cobar, Warren, Coonamble, Warrumbungle, Dubbo Regional, Mid-Western, Central Darling, Bogan, Gilgandra, and Narromine

Groupings could also be formed based on common characteristics, like key challenges or dependence on the same water source. For example, the LWUs that depend on the Darling (Baaka) River could be grouped together as they face a common issue of the unregulated nature of their water supply.

To illustrate the type and size of potential groupings we have aggregated some of the business metrics of the remotely located LWUs that are in the Orana Water Utilities Alliance (Table 15). A water business with these five member councils would receive annual customer revenue of around \$14.2 million and staff of over 50 Full Time Equivalentents (FTEs).<sup>51</sup>

<sup>51</sup> FTE is max number of FTE reported by utilities between 2016-2020 financial years, this is to give a picture of the potential size of the organisation.

Within this potential area of operations there are 19 sewerage treatment plants and 11 water treatment plants providing potable water (14 including non-potable). The towns these LWUs are servicing are often located far apart, which could limit aggregation benefits at an operational level – for example, Ivanhoe and Wilcannia in Central Darling Shire Council are almost a two-hour drive. There could, however, be benefits at a management and strategic level, including enabling investment prioritisation and the ability to formulate consistent levels of service across the region. The sharing of skills and resources represent opportunities for benefit.

Table 15: Aggregated statistics for selected Orana Water Utilities Alliance (\$2021-22)

LWU	Customer revenue per connection	Average cost recovery 2016-22	Connections (no.)	Customer Revenue
Bourke Shire Council	1,383	88%	2,234	3,090,087
Brewarrina Shire Council	1,983	102%	910	1,804,628
Central Darling Shire Council	1,362	73%	1,060	1,442,783
Cobar Shire Council	1,121	89%	3,876	4,346,805
Walgett Shire Council	2,433	120%	1,437	3,497,270
<b>Total</b>			<b>9,517</b>	<b>14,181,573</b>

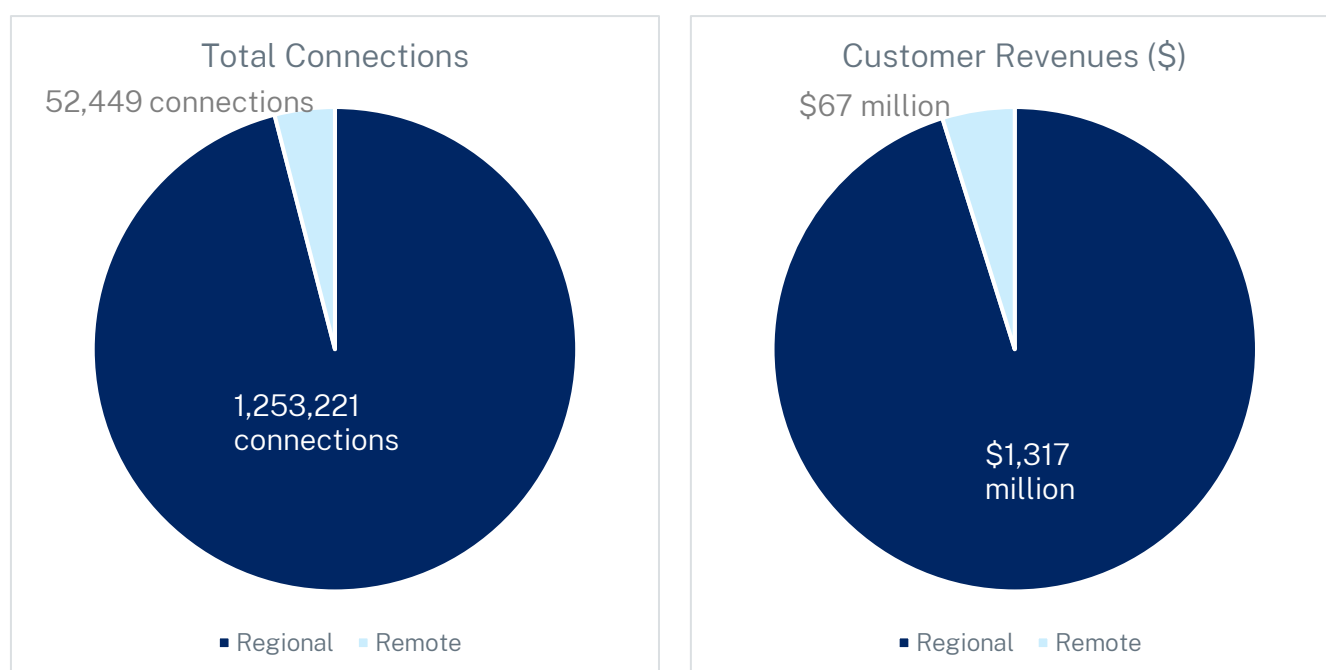
Source: DCCEE, Frontier Economics analysis, NSW Productivity and Equality Commission analysis.

Notes: Revenue is average revenue from charges between 2016 and 2022. Cost recovery (lower bound) = (Total revenue excluding capital works grants and interest income) divided by (sum of opex and depreciation). Selected LWU are more remotely located member councils.

### 9.3.1 Scale of other potential groupings of western NSW LWUs

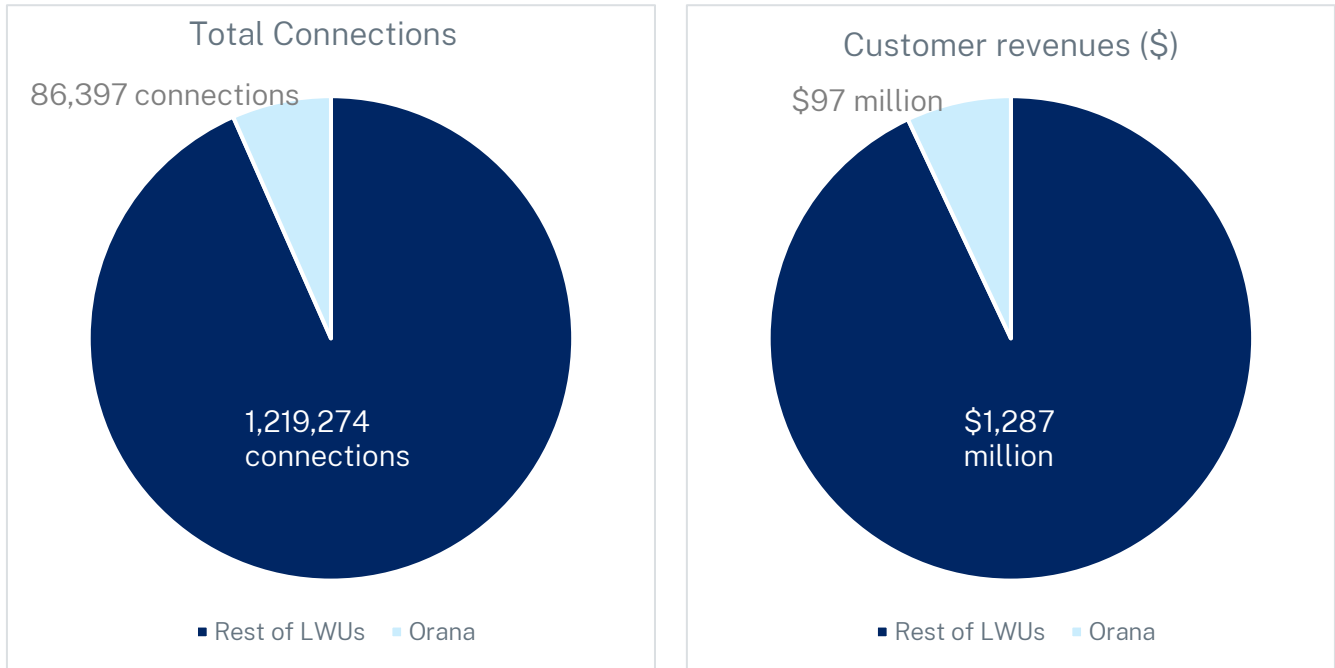
As discussed, all structural reform options should be on the table. Additionally, options for different groupings of councils should be discussed. The charts below highlight different groupings and the potential size of their businesses.

Figure 21: Remote LWUs vs Regional LWUs in NSW



Source: DCCEE, NSW Productivity and Equality Commission analysis.

Figure 22: Orana Water Utilities vs Rest of LWUs in NSW



Source: DCCEE, NSW Productivity and Equality Commission analysis.

The reform process should take an approach that examines options that are aggregations of councils akin to social catchments, that is regions where households and LWUs themselves are in some form of regular interaction and which Councils identify as ‘their’ region. The process however should adopt as wide as possible view and scope and involve a comprehensive list of relevant councils, at a minimum the 16 LGAs identified in this review.

## 9.4 Reform is required to put western NSW on a stable footing

As part of this review, the Commission consulted six councils to gauge support for structural reforms. We found that the selection of councils is willing to be involved in a process that reviews a wide range of delivery options for water and sewerage service provision. The principle of co-design is a key concern of western councils to have autonomy over services delivered to their communities.

Given the distinct challenges faced by LWUs in western NSW, a structured approach is needed to assess alternative management models. While not definitive considering the scale of challenges facing the LWU sector in western NSW, the Productivity and Equality Commission has a strong position that reform is necessary.

The high proportion of customers that are facing hardship and levels of service that are at a higher degree of risk warrant urgent action to find a lasting and financially sustainable solution to water and sewerage service delivery.

There is a challenge in accessing good quality source water in towns in the Western region (as defined by the Western Regional Water Strategy). While no towns ran out of water during the recent drought, due to concerted efforts by the community, LWUs and government (DPE 2022

Western Regional Water Strategy pg. 35), this does not ensure water security in the future. In the Western region, 8 towns supplied by weirs were assessed not having a secure town water supply.<sup>52</sup>

Collaboration on its own will not reduce the basic capital and operational costs of water and sewerage infrastructure, but it will enable better access to knowledge, skills and strategic capacity.

(Water Directorate 2024, 10)

Even with a new structure, a CSO is likely necessary for western NSW LWUs. It is however recommended there be a proper process for co-developing a future structure or structures in western NSW with the aim of improving efficiency and effectiveness. Reforms that focus on addressing skills and training issues or are an extension of the alliance concept alone will not provide a sufficiently robust organisational structure equipped to meet future challenges. Formal arrangements are required to ensure ongoing resource sharing and provide the certainty to design and implement long-term programs.

A regional solution will also provide a suitable organisational structure that can proposed a long-term capital and operating plan that can be used for the negotiation and striking of a CSO for the regional LWU.

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## 9.5 A co-designed process and support is required to assess structural reform options

The NSW Government should establish a reform process for water and sewerage provision across western NSW to identify and implement the most efficient and effective structure for providing water and sewerage services in Western NSW.

The reform process should involve:

- Developing, assessing, and consulting on possible definitions or groupings of western NSW to be part of structural reform process.
- Establishing appropriate working groups and reviewing governance to ensure councils and customers retain responsibility for any decision made in the process pertaining to their council's involvement in any future business structure.
- Identifying the efficient and effective structure for providing water and sewerage services in western NSW with a focus on an enduring solution.

The reform process should be conducted on an opt-in basis and the final decision should be based on formal positions made by the candidate LWUs.

The reform process should consider:

- A range of ownership and service delivery options including:
  - a formal alliance with a shared executive and strategic support,
  - a joint organisation or county council arrangement,
  - corporatisation with joint ownership between councils and the State Government,
  - corporation with State Government ownership such as Essential Energy or WaterNSW in providing on-going services and/or ownership of assets,

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<sup>52</sup> This analysis was based on a secure yield assessment that compared the secure yield for each town water supply against the 30-year unrestricted dry year demand for the town. The 30-year unrestricted dry year demand was estimated in accordance with the Department of Planning and Environment – Water's February 2019 integrated water cycle management checklist.

- The potential role for Water NSW in delivering specific services to LWUs or in owning or managing water delivery assets such as pipelines and weirs, and
- The potential role in service delivery for other groups identified through the process.

Options need not be limited to those outlined in this section. The process should also investigate whether functions of service delivery should be separated along the supply chain (e.g. bulk water, treatment and/or network and retail) as well as separating asset ownership and management from operation and customer relations.

### 9.5.1 Proposed process

- The western NSW reform process should take 18 months to finalise the strategic options and business case, develop a final business case, and adopt new structures for implementation by February 2026. It is expected that six months will be required to establish and develop a preliminary problem definition and options development and to gain a common understanding of issues. This includes developing a deep and shared understanding of the current and future challenges as well as understanding to what extent transfer of services or ownership is possible under current legislation for each model and what would require legislative changes.
- Any Reform Working Group will develop recommendations that are supported by councils and design a process for appropriate consideration and formal adoption of any structure by representatives of each candidate council.

The process could be led by:

- **local government** - with a Reform Management Group of nominated local government officials and a secretariate of NSW Government departmental staff.
- **Partnership** - comprised of a Reform Management Group containing both local and state government representatives and a working group of NSW Government departmental staff. For example, a support working group in Treasury, with an advisory group across departments and council representatives. The Commission suggests a mix of council representatives and technical staff to assist in this process.
- **State Government** - lead and complete the reform with advice from a Reform Advisory board. Under this model the options are developed, consulted on and presented to councils for opt-in sign off.

A partnership is proposed as co-design is important for the robustness and acceptability of the assessment and business case by all parties.

To minimise the impost on local government time and resources and ensure targeted and informed consultation, the NSW Government should be responsible for gathering the information, data and developing potential models to take to councils for consultation.

All structural reform options should be included in the evaluation and assessed against three criteria:

- **Efficiency** – does the structure ensure pricing reflects true operating and capital costs efficiently?
- **Effectiveness** – can the organisation deliver positive commercial, social, and environmental outcomes and compel member councils to adopt performance-improving strategies? In practical terms, this would include an assessment of whether the future challenges faced by LWUs can be better addressed under this structure.
- **Durability** – is the structure likely to last over the long term?

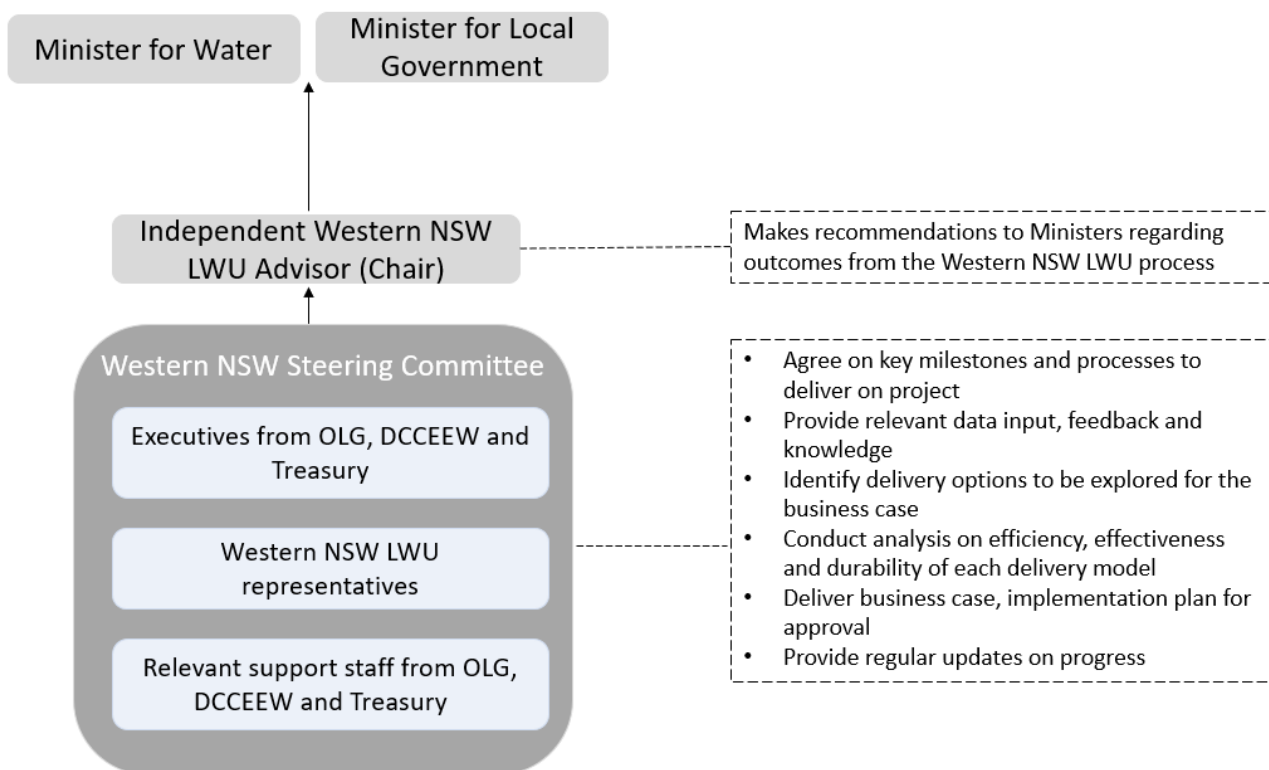
The options will be judged on their acceptability, however, it is recommended the options are assessed according to the above criteria. All options would be voluntary and there would be no privatisation of assets.

## 9.5.2 Leadership of the structural reform and timing

The Reform should be conducted by a Western NSW LWU Reform Working Group (see Figure 23).

- It is recommended that an independent Reform Chair be jointly appointed by the Ministers for Local Government and Water. The chair should be an independent, senior person from outside Government, with experience on similar projects.
- The Working Group should be led by a departmental team in DCCEEW, supported by OLG, with appropriate resources to fund appropriate investigations and business case development.

Figure 23: Proposed Western NSW LWU Reform Governance Structure



Source: NSW Productivity and Equality Commission.

The Reform should take 18 months and be completed by February 2026 for decision.



# 10 Pensioner rebates

## Findings – Pensioner rebates and hardship schemes

- The current setting of pensioner water rebates varies depending on whether a customer receives services from an LWU, or Sydney Water or Hunter Water. These different approaches mean that pensioners who are customers of Greater Sydney receive around \$602 per annum, Hunter Water receive around \$380 per annum and LWUs receive \$175 per annum.
- NSW Government funding of these pensioner water rebates exceeded \$170 million in the 2022-23 financial year.
- Current arrangements for pensioner water rebates across NSW are also inconsistent in that the NSW Government contributes 100 per cent of the costs (\$151.3m) of rebate for Sydney Water and Hunter Water customers whereas in the regions it contributes 55 per cent of the costs (\$21.3m) (Bureau of Meteorology 2024).
- These differences in arrangements for customers for type of water utility are inconsistent in terms of the impacts of concessions on water affordability and on who funds the concession, with other non-pensioner LWU customers paying for 45 per cent of the concessions in the regions.
- Pensioner water rebates are only available for households which pay a water service charge, which means renters are not eligible under current billing arrangements. If the objective is assisting pensioners with costs of living pressures the current approach is poorly targeted as only those pensioner households that own their own residence receive a payment.
- These pensioner water rebates are provided regardless of the differential abilities to pay of both beneficiaries and local councils. Efficient and effective concession scheme are highly targeted to meet the defined objective.
- In addition to rebates, there are payment assistance schemes (PAS) available for hardship purposes from some water utilities (Greater Sydney, Hunter Water). The NSW Government funds \$6 million per annum for those water customer under the PAS. Some LWUs have their own PASs (Shoalhaven Water).
- There is an important role for hardship schemes in providing emergency financial support to customers facing acute financial problems, as these schemes can accurately target those in need and directly address acute cost of living issues. The existing inconsistency between schemes and funding for LWUs however is problematic as some NSW customers cannot access this form of assistance.
- There is merit in developing hardship policies that outline the standards for water utilities when dealing with customers facing payment difficulties, and other measures to alleviate hardship for low-income and disadvantaged consumers in exceptional circumstances, such as utility grant schemes and alternative payment methods. These could be included in a customer service standard as a mandatory requirement.
- Where targeted concessions/rebates and hardship schemes are deemed necessary, they should be funded in full by governments through transparent Community Service Obligation payments.
- Any principles and approach to funding a CSO for hardship rebates going forward should also be included in the LWU sector Funding Policy and Framework which is to be developed over the next 12 months.

## Recommendations – Pensioner rebates and hardship schemes

**Recommendation: Evaluate pensioner rebate on all water services before the 2025-26 Budget.**

- The evaluation should:
  - Establish the policy objective of the existing water pensioner rebates in New South Wales.
  - Assess the appropriateness of the existing arrangements for providing concessions, including eligibility criteria.
  - Evaluate the efficiency and effectiveness of existing pensioner rebates in meeting the policy objectives, taking into account the role of hardship schemes in providing emergency financial support for customers facing acute financial stress.
  - Consider alternative policy options to deliver on the policy objective, including exploring broader cost of living options to address affordability challenges of utilities for low-income cohorts. This may involve a single rebate for utilities provided to both property owners and tenants or alternatively a hardship scheme to meet the needs of low-income cohorts who are struggling to afford utilities.

**Recommendation: Fund any targeted concessions/rebates deemed necessary via a transparent CSO with Office of Local Government.**

**Recommendation: Develop a service level agreement with OLG where a CSO is paid to LWUs to support rebates/concessions to address affordability pressures.**

The service level agreement should include key performance indicators to measure the effectiveness of the CSO in meeting its stated objectives. This could be done in aggregate for the LWU sector with appropriate reporting requirements.

**Recommendation: Include the principles and approach to funding a CSO for hardship rebates in the LWU Funding Policy to be developed over the next 12 months. (see Recommendation in Chapter 7).**

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## 10.1 Rebates and concessions are common in Australia but there is significant variation across jurisdictions

All levels of government offer concessions or rebates to particular groups of low-income earners on consumption of some goods and services, including water and sewerage, electricity, medicines, public transport and local council rates.

Eligibility for these concessions is typically based on holding one or more of several Australian Government concession cards targeted towards low-income groups. In New South Wales:

- Eligible pensioners qualify for a rebate on their water bill from their water supplier; and
- Hardship assistance is provided in some instances for customers who are experiencing financial hardship and struggling to manage their water bills.

The value of concessions or rebates offered, the method in which they are applied, and their eligibility requirements vary considerably between jurisdictions (see **Sections 10.3** and **10.4**).

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## 10.2 Some pensioners qualify for a rebate on their water bill

In NSW eligible pensioners qualify for a rebate on their water bill from their water supplier. Rebates are applied to each bill. In the case of eligible pensioners, the utility calculates the bill amount using

prevailing water and sewerage prices and deducts the applicable rebate amount as part of the regular billing cycle.

Currently, there are just under 800,000 age pension recipients in New South Wales, of which about 271,000 are in areas serviced by LWUs (Department of Social Services 2024). Pensioners who are eligible for the rebate are those who hold a Pensioner Concession Card issued by Services Australia or the Department of Veterans' Affairs, as well as specific Veteran Gold Cards. Each utility has established processes for verifying applications.

As property owners are responsible for paying water and sewerage bills, pensioners can claim the rebate if they own the property. Eligible pensioners are entitled to one rebate only.

In NSW a landlord can require the tenant to pay for actual water use if metering and water efficiency conditions are met. Where this does not occur, the landlord however is likely to pass on water and sewerage service charges when negotiating rental values. A pensioner tenant however cannot claim the pensioner rebate.

### **10.2.1 Pensioner water rebate amounts and funding are inconsistent across NSW**

The value of pensioner water rebates for LWUs are set via the *Local Government Act 1993* (NSW) which introduced a hard cap on the annual pensioner rebate paid set at \$87.50 for the water service and \$87.50 for the sewerage service per annum. The *Local Government Act 1993* does not provide for any increase in the rebate amount paid, with the value of these rebates falling by 55 per cent over the last 30 years.

There are significant differences in the pensioner water rebates received across NSW, with pensioners in the Greater Sydney area serviced by Sydney Water receiving up to:

- \$222 per annum more than their pensioner counterparts receiving their water services from Hunter Water
- \$427 per annum more than their pensioner counterparts receiving their water services from LWUs.

These differences are due to different methodologies used to calculate rebate amounts and a cap introduced on pensioner rebates received from LWUs in 1993.

Currently different methodologies are used to calculate rebate amounts for the State-owned Corporations:

- Sydney Water's \$602 rebate for 2023-24 was based on 100 per cent of the residential water service charge (\$67.6 rebate per year) and 86 per cent of the residential sewerage (\$534.8 rebate per year). Pensioners paying residential stormwater charges receive a further \$44 per year
- Hunter Water's \$380 rebate was based on 27.25 per cent of the typical residential bill
- Essential Energy's (Water) \$175 rebate was set with reference to the LWUs rebate.

### **10.2.2 There are markedly different levels of bill relief across NSW**

Typical water bills (based on 200 kL of usage) vary markedly throughout NSW. Sydney Water's customers paid a bill of \$1,135 in 2022-23 and Hunter Water's customers paid \$1,298.<sup>53</sup> LWU typical bills ranged from \$1,164 per year to more than \$2,700 per year, with a median bill of \$1,714 per year.<sup>54</sup>

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<sup>53</sup> Based on usage, \$2021-22.

<sup>54</sup> Based on using 200kL of water per year between 2015-16 and 2021-22. This measure is used to compare across regions. Amount is in \$2022-23.

The different typical bills and rebate amounts leads to varying levels of bill relief. As shown in Table 1, rebates reduced typical bills by:

- 53 per cent for Sydney pensioners
- 29 per cent for Hunter pensioners
- 10 per cent for LWU pensioners.

This means the typical pensioner bill for a LWU customer is around \$1,539 per year compared with the typical Sydney Water pensioner bill of \$533 per year – almost three times higher.

Table 16: Typical bills, rebate amounts and rebate value as a percentage of pensioner bill, 2022-23

	Sydney	Hunter	LWUs	Essential Energy (Water)	Notes
<b>Typical residential bill (per annum)</b>	\$1,135	\$1,298	\$1,714 <sup>55</sup>	\$1,311	All residential bills calculated using 200kL of usage
<b>Number of eligible pensioners</b>	396,370	76,100	271,290	2,865	Number of age pension recipients
<b>Rebate value</b>	\$602	\$381	\$175	\$175	LWU and EE rebates are fixed in real terms.
<b>Typical pensioner bill after rebate</b>	\$533	\$917	\$1,539	\$1,156	Residential bills calculated using 200kL of usage minus rebate
<b>Indicative rebate as percentage of pensioner bill</b>	53%	29%	10%	13%	Based on Residential bills calculated using 200kL.

Note: Data for LWUs sourced from DCCEEW.

Data for number of aged pensioners was sourced from Australian Government Department of Social Services.

The Commission has drawn upon the average residential water bill however notes that pensioners likely use less water. This means the indicative rebate as a percentage of the pensioner bill is likely higher than the amounts in the table.

The number of eligible pensioners is the population of age pension recipients. The number of connections that receive the pension rebate would be lower than this amount. The population of age pension recipients is representative of how many people can receive a rebate for their water. Pensioners who are eligible for the rebate are those who hold a Pensioner Concession Card issued by Services Australia or the Department of Veterans' Affairs, as well as specific Veteran Gold Cards. In NSW, they must be the homeowner to receive the rebate.

Source: Data for Sydney, Hunter and Essential Water are sourced from the Bureau of Meteorology's National Performance Report, 2023. NSW Productivity and Equality Commission analysis.

The difference in rebates received by Sydney Water and Hunter Water pensioners was commented upon by submissions made to this Review with many LWU submissions to the review highlighting the unfairness of the higher levels of rebate provided by Sydney Water and Hunter Water.<sup>56</sup>

Submissions from LWUs also argued that the NSW Government should provide funding for the full cost of the \$175 rebate provided to pensioner households. This was particularly highlighted by those councils who had a high proportion of senior residents.

'The Port Macquarie-Hastings LGA also has, like many coastal communities in NSW, a high proportion of senior residents with approximately 30 per cent of our population aged over 65. This is projected to increase to 35 per cent by 2046. Often this section of

<sup>55</sup> Median TRB using the average across utilities between 2016 and 2022 financial years. Amount escalated to \$2022-23. Not weighted by population.

<sup>56</sup> 15 including Shoalhaven Water p5, Riverina Water p9, Goldenfields Water p9 and Albury City p2.

the population is asset rich but cashflow poor. Also, this often correlates to high percentage of pensioner rebates.

Within our LGA 26 per cent of water connections and 27 per cent of sewerage connections claim a pensioner rebate. For 2022/23 this equated to \$1,252,000 (\$632,213 for water and \$619,787 for sewerage). After the 55 per cent Council received from the NSW Government the cost impact to Council was still \$563,401 (water - \$284,496, sewerage - \$278,905). This is the annual cost of approximately six water and/or sewer operations staff or renewing approximately 1.5km of asbestos cement reticulation pipe per year using contractors.

Council understands the importance of pensioner rebate scheme, however a 100 per cent cost recovery from NSW Government as part of a Community Service Obligation payment would allow these funds to be allocated towards providing and improving the water and sewerage service.'

(Port Macquarie-Hastings Council 2024, 3)

### 10.2.3 Pensioner rebate amounts across Australia also differ significantly

All states currently fund CSO payments for rebates paid to eligible pensioners on water and sewerage bills. Most state governments link eligibility to customers who own the property and hold a Pensioner Concession Card. In most instances, a common, state-wide pensioner rebate amount is paid to all eligible customers.

- Victoria provides a 50 per cent deduction on the water and sewerage charges up to a maximum of \$354.10 (Department of Families, Fairness and Housing 2024).
- Queensland provides a \$120 per year rebate on water service and usage charges for eligible pensioners (Queensland Government 2017).
- Western Australia provides various pensioner rebates of up to 50 per cent of service charges, capped at \$600 per year (Water Corporation n.d.). Some pensioners are also eligible for a 50 per cent rebate on water usage capped at different levels across the state.
- South Australian provides a rebate of 30 per cent of the total water bill, capped at \$359.70 per year, and a separate sewerage rebate of \$134.70 per year (Government of South Australia n.d.).
- Tasmanian provides a \$226.66 pensioner rebate for eligible water and sewerage customers (TasWater n.d.).

Residential tenants in Victoria, South Australia and Western Australia are responsible for paying water and sewerage bills. Tenants in all three states are eligible for pensioner rebates.

The ACT Government provides a 'utilities concession' of up to \$750 per year. The concession was introduced in 2017 and replaced the previous pensioner water rebate. The \$750 payment is designed as an all-in-one rebate on electricity, gas and water (ACT Revenue Office n.d.). Eligible pensioners receive the rebate via an adjustment made by electricity retailers when issuing electricity bills. In this way, eligible pensioners who rent a property, and pay the electricity bill, can access the utilities concession even though they do not pay the water and sewerage bill directly.

The Commission finds that the existing value of concessions or rebates offered for water and sewerage services and the different funding arrangements for the different schemes are inconsistent, both within NSW and between jurisdictions, in terms of the impact of concessions on affordability. These differences are currently resulting in much higher levels of financial support for pensioners living in the Sydney and Hunter regions compared with those living in areas serviced by LWUs. There is no clear justification for these differences.

In addition, unlike residential pensioner tenants in the ACT, Victoria, South Australia and Western Australia, NSW pensioner tenants do not receive the benefit of the pensioner rebate unless their landlord is a pensioner. The existing design of the NSW scheme is not targeted well if addressing cost of living pressures and affordability.



## 10.2.4 Inequities in funding

Currently NSW Government funding for pensioner water rebates exceeds \$170 million per year. The funding takes the form of a CSO which is paid to the water utilities, either via the Department of Climate Change, Energy Efficiency and Water or via the NSW OLG in the case of LWUs.

There are also differences in the funding of pensioner rebates for services received from different water utilities. The NSW Government covers the full cost of pensioner rebates for Sydney Water, Hunter Water, and Essential Energy. For 2022-23, funding for rebates included:

- Sydney Water - \$133 million
- Hunter Water - \$18 million
- Essential Energy - \$0.4 million.

In contrast, the NSW Government funds only 55 per cent of the rebate paid by LWUs, totalling around \$11.7 million in 2022-23. LWUs fund the balance, around \$9.6 million, from water and sewerage charges or other sources of council income.

The funding takes the form of a CSO which is paid to the water utilities, either via the Department of Climate Change, Energy Efficiency and Water or via the NSW OLG in the case of LWUs.

A council submits an independently audited return to the NSW Office of Local Government to be reimbursed for the state's 55 per cent share of the legislated \$175 rebate under the *Local Government Act 1993*. The balance of the rebate (i.e. 45 per cent) must be financed by the council out of its general revenue.

The net pensioner rebate per connection can vary significantly between council areas, ranging from \$3.60 to \$49.90 with a median of \$17.90.<sup>57</sup>

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## 10.3 Different payment assistance schemes are available for hardship purposes from some LWUs

In addition to the pensioner rebates, there is a Payment Assistance Scheme (PAS) for Sydney Water, Hunter Water and Shoalhaven Water customers. The PAS is also available to NSW electricity customers.

The PAS provides emergency support for any customer facing financial difficulty. Customer care teams within Sydney Water and Hunter Water or accredited community organisations make a case-by-case assessment of a customer's income, payment history and individual circumstances. The Scheme is available to tenants who pay the water use component of the bill.

NSW Government provides funding of about \$6 million per annum for water customers under the Payment Assistance Scheme. Sydney Water and Hunter Water can provide a one-off rebate of up to \$600 on water bills and a waiver of debt recovery fees.

Some NSW LWUs also offer equivalent type of PAS. For example, Riverina Water and the Central Coast Council ask customers who are experiencing serious financial hardship to contact them as they can assist those struggling to manage their water bills, such as offering an extended payment plan (Riverina Water n.d.).

Whether LWUs have hardship policy and associated PAS is a local decision and the Commission is uncertain as to how many LWUs currently have a hardship policy. Where they do, NSW Government does not provide funding for LWUs for hardship purposes.

The Commission considers that there is a role for hardship schemes in providing emergency financial support for customers facing acute financial problems. The existing inconsistency between

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<sup>57</sup> Based on average pensioner rebates for the total of water and sewerage between 2020-21 and 2022-23, in \$2022-23.



schemes and funding for LWUs however is problematic as some NSW customers cannot access the assistance.

Hardship policies outlining the standards for water utilities when dealing with customers facing payment difficulties, and other measures to alleviate hardship for low-income and disadvantaged consumers in exceptional circumstances, such as utility grant schemes and alternative payment methods, have merit. This is because they can be targeted towards those most in need which was supported by submissions to the Review.

Any principles and approach to funding a CSO for hardship rebates going forward should be included in the LWU sector Funding Policy and Framework which is to be developed over the next 12 months (**see chapter 6**).

As discussed in Chapter 8, the proposed Customer Service Standard should also be developed to include a consistent approach to hardship payments across the sector.

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## 10.4 Better targeting financial support to assist with cost of living pressures

The Australian Government plays a central role in cost-of-living outcomes. Settings in the tax and transfer system affect income levels in every Australian household. Examples include the various income tax rates and measures like the age pension, family tax benefits and Jobseeker payments. The NSW Government however does not have the same power or responsibilities for setting transfer payments targeting low-income households.

Even so, the NSW Government has put in place CSO arrangements to address affordability concerns in particular parts of the NSW economy, including the water and energy sectors. The Commission understands that Sydney Water has offered pensioner concessions since 1971, and pensioner rebates were added to Hunter Water's customer contract in 2009. The Commission has been unable to find the original policy rationale for the introduction of the rebates at the time, however, the Service NSW website lists the pensioner rebates as one of the 70 rebates and voucher 'savings measures' designed to help reduce the cost of living (Service NSW 2024).

Concessions and water rebates offer a better way of addressing affordability concerns over the alternative of setting prices below efficient levels (Productivity Commission 2011). State governments however can only address the affordability of one good or service at a time resulting in the following problems:

- governments can find it difficult to ascertain the impact of particular concessions in isolation from other measures
- rebates for water and sewerage services linked to usage can distort consumption decisions
- tenants who are charged for water usage by their landlord are often not eligible for concessions.

If the objective is assisting pensioners with costs of living pressures from water and sewerage bills the current approach is poorly targeted as only those pensioner households that own their own residence receive a payment. This contrasts with the existing NSW low-income electricity and gas schemes and the ACT's utilities concession which are targeted towards low-income pensioners irrespective of whether they are homeowners or renters (see **Box 11**).

Currently the NSW Government provides a rebate for eligible concession cardholders to address cost of living challenges for electricity, gas, and medical energy services.

The NSW Low Income (electricity) Household Rebate helps eligible concession cardholders pay their electricity bills, regardless of whether they rent or own a property. The rebate is \$313.50 per household, per financial year.

The NSW Gas Rebate helps eligible concession cardholders pay their natural gas or bottled Liquefied Petroleum Gas (LPG) bills. The NSW Gas Rebate is \$121 per embedded network (on-supply) or bottled LPG household, per financial year.

Residents are eligible if they live in NSW and all the following apply:

- you have a natural gas/electricity account for your home in NSW
- you're the account holder (the account and bill must be in your name)
- you hold one of the following:
  - Pensioner Concession Card issued by Services Australia or the Department of Veterans' Affairs (DVA)
  - Health Care Card issued by Services Australia, or
  - Department of Veterans' Affairs Gold Card marked with either 'War Widow', 'War Widower Pension', 'Totally and Permanently Incapacitated' (TPI) or 'Disability Pension' (EDA).

The ACT Government provides a 'utilities concession' of up to \$750 per year. The \$750 payment is designed as an all-in-one rebate on electricity, gas and water. Eligible pensioners receive the rebate via an adjustment made by electricity retailers when issuing electricity bills. In this way, eligible pensioners who rent a property, and pay the electricity bill, can access the utilities concession even though they do not pay the water and sewerage bill directly.

Eligible applicants must be the primary holder of one of the following concession cards from Services Australia, the Department of Veterans' Affairs or the ACT Government:

- Pensioner Concession Card
- Low Income Health Care Card
- Health Care Card
- Veteran Gold Card Holders
- ACT Services Access Card.

Source: (Service NSW 2024) (ACT Revenue Office n.d.)

The NSW Council of Social Service (NCOSS) survey of respondents found that increases in utility prices over the 12-month period to mid-2023 presented a significant financial challenge. The proportion of respondents who reported they could not pay their utility bills on time increased from one-quarter in 2022 to approximately one-third in 2023. If the objective of the pensioner rebate is to assist pensioners with cost of living pressures for water services, the higher rebates paid to pensioners in Greater Sydney is inconsistent with NCOSS' findings that currently households in regional areas are reporting higher rates of difficulty with paying their utility bills (see **Table 17**).

Table 17: Percentage of NSW households struggling to pay their utility bills on time (by region)

SA4		SA4	
New England and North-West	67%	Outer West and Blue Mountains	31%
Riverina	64%	Coffs Harbour - Grafton	31%
Murray	52%	Southern Highlands and Shoalhaven	29%
Mid North Coast	47%	Sydney - Inner South-West	28%
Richmond - Tweed	46%	Sydney - Sutherland	26%
Newcastle and Lake Macquarie	45%	Sydney - Outer South-West	24%
Far West and Orana	45%	Baulkham Hills and Hawkesbury	24%
Hunter Valley	44%	Sydney - City and Inner South	21%
Central Coast	43%	Sydney - Eastern Suburbs	18%
Illawarra	41%	Sydney - Inner West	18%
Capital Region	41%	North Sydney and Hornsby	18%
Central West	40%	Sydney - Parramatta	18%
Sydney - Blacktown	37%	Sydney - Northern Beaches	17%
Sydney - South West	35%	Sydney - Ryde	15%

Note: The New South Wales Council of Social Service published a report in 2023, *'Barely hanging on: The Cost-of-Living Crisis in NSW'*. NCOSS surveyed 1,134 NSW residents and asked various questions about the impact of cost-of-living changes on household budgets.

Source: (NSW Council of Social Service n.d.)

Submissions from councils to the Review noted that those individuals most at risk are those who are disadvantage socio-economically with limited ability to pay. The Mid-North Coast Council's submission went further arguing that 'the NSW Government should fully fund the pensioner rebates for all LWU's across NSW consistent with the assistance provided to the SOC's and their customers.'

These findings indicate that the existing concessions that are not well targeted towards those most in need supporting the Australian Productivity Commission's conclusion that:

"Current State, Territory and Local Government concession arrangements for water and wastewater services are inefficient and inequitable.

For low-income households, the affordability of water and wastewater services and other essential goods and services is most efficiently achieved through non-concession elements of Australia's tax and transfer system."

(Productivity Commission 2011, 221-222)

Where a CSO is paid to support rebates such as the existing pensioner water rebate, a SLA should be completed.<sup>58</sup> In doing so, each agreement should include key performance indicators that measure the effectiveness of the CSO in meeting its objective. The Commission understands that the Department of Climate Change, Energy Efficiency and Water and the NSW OLG are yet to complete SLAs for the three water State-owned Corporations (SOCs) and the LWU Sector.

Given the absence of an SLA, the lack of a clearly stated policy objective, the existing inconsistencies in the application and funding of the pensioner rebates and the lack of targeting of assistance, an evaluation<sup>59</sup> of the existing scheme should be undertaken by February 2025 so that the NSW Government can respond to the evaluation's findings in the 2025-26 Budget. The evaluation should clearly consider a review of concessions on water services across New South Wales and local governments. The review should:

- identify the policy objective of the existing water pensioner rebates in New South Wales
- assess the appropriateness of the existing arrangements for providing concessions, including eligibility criteria,
- the efficiency and effectiveness of the existing pensioner rebates in meeting the policy objective
- alternative policy options to deliver on the policy objective, including an alternative means of for delivering any rebate, including the option of a single rebate for water and energy services provided to both property owners and tenants via electricity retailers.

In doing so, the evaluation should specifically consider:

- Levels of water and sewerage bill affordability among low-income households throughout NSW
- Equitable treatment between pension and other low-income households
- The rebalancing of the differential quantum of payments between metropolitan and regional pensioners/low-income households
- The role of hardship schemes in providing emergency financial support for customers facing acute financial problems.

If the evaluation finds that the affordability issues appear to be the result of general cost of living pressures rather than being water specific, there is a strong argument that the review should be broader than just water services and examine options to consolidate rebate/concessions schemes for targeted low-income cohort(s).

The review should also consider the significance of administrative savings from consolidating assistance for low-income households to a more streamlined payment.

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<sup>58</sup> NSW Treasury's 2023 Guidelines for Community Service Obligations, TPG23-19, apply to government departments that commission and fund CSOs as well as government businesses that implement CSOs on behalf of government departments.

<sup>59</sup> The Evaluation should be undertaken according to NSW Treasury' 2023 Policy and Guidelines: Evaluation, TPG22-22.

# 11 Implementation plan

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## 11.1 Implementation overview

The proposed reforms should be implemented as a matter of urgency prior to the provision of further funding to the LWU sector. The reforms need to be supported by engagement with the LWU sector and across NSW Government agencies where appropriate.

The reforms can be grouped into four areas:

4. Better regulation - including improving water quality and environment regulation and reforming the approach to the regulation of water security
5. Establishing LWU priorities – with a focus on NSW Government funding to allow better targeting
6. Development of a Local Water Utilities Funding Policy - including the establishment of a CSO funding mechanism
7. A review of the water and sewerage services in Western NSW.

Reform areas 2 and 3 combine to provide an NSW LWU Sector Investment Framework.

Implementation timeline

Table 18: to Table 22 provide a more detailed implementation timeline for the recommendations.

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## 11.2 Implementation governance

### LWU Sector Reform Steering Committee (Reform areas 2&3)

- Oversee development of LWU Sector Investment Framework including the design of the *LWU Funding Policy* and the *Sector Priorities Plan* process.
- To ensure that the reforms are coordinated and implemented and risks to implementation are addressed promptly as they arise. The Committee should provide regular progress reports (six monthly) to Government.
- Comprised of senior executive (Deputy Secretary and Executive Director) representation from relevant agencies including DCCEE, Office of Local Government and Treasury.

### Regulatory Review Steering Committee (Reform areas 1&4)

- Oversee regulatory improvements and coordination, including the development of regulatory impact statements and regulatory enforcement strategies.
- The RRSC should be based on the existing Regulators' Forum and include Office of Local Government.

### Stakeholder reference groups

Most recommendations will require significant engagement with councils and industry stakeholders to work through design detail, transition, and implementation issues. This engagement should be supported by three stakeholder reference groups and include representatives of local councils

- LWU Sector Investment Framework stakeholder reference group – may include NSW Water Directorate and other experts with relevant experience in funding and strategy development
  - LWU regulatory reference group – may include NSW Water Directorate and other Local Government NSW representation and technical experts
8. Any Western NSW reference group should be established as part of the reform arrangements.

## 11.3 Implementation timeline

Table 18: Implementation Plan – Governance

Recommendation and actions	Agency	Timing
Establish Investment Framework Implementation Streeting Committee and relevant stakeholder reference group	DCCEEW	Within 6 weeks circa mid Sep 2024
Develop a detailed implementation timeline for immediate actions required to implement Review’s recommendations over next 12 to 18 months and present to Steering Committee	DCCEEW	End Sep 2024
Establish LWU Regulatory Reference Group and relevant stakeholder reference group	DCCEEW	Within 12 weeks
Develop a detailed implementation timeline for immediate actions required to implement Review’s recommendations over next 12 to 18 months.	DCCEEW	End Oct 2024

Table 19: Implementation Plan – Regulatory Improvement

Recommendation and actions	Agency	Timing
Water Quality		
<ul style="list-style-type: none"> <li>Conduct a Regulatory Impact Statement (RIS) of the regulatory and enforcement strategy.</li> <li>Publish a regulatory and enforcement strategy for LWU drinking water quality.</li> </ul>	NSW Health	Mid 2025 (within 9 to 12 months)
Environmental		
<ul style="list-style-type: none"> <li>Conduct a Regulatory Impact Statement of the regulatory and enforcement strategy.</li> <li>Publish a regulatory and enforcement strategy for LWU environmental standards.</li> </ul>	NSW EPA	Mid 2025 (within 9 to 12 months)
Water Security		
<ul style="list-style-type: none"> <li>Publish methods and approaches for assessing the performance of an LWU in meeting water security expectations.</li> <li>Conduct a Regulatory Impact Statement of the establishment of a outcomes-led water security standard.</li> </ul>	DCCEEW	Late 2026 (within 18 months)



Recommendation and actions	Agency	Timing
Customer Service Standard		
<ul style="list-style-type: none"> <li>Development of a voluntary customer retail service standard to outline procedures and practices to protect customers.</li> </ul>	DCCEEW	Late 2025 (within 18 months)
Regulatory approval processes under Section 60		
<ul style="list-style-type: none"> <li>Include structured scoping of a range of solutions to managing water quality and environmental risks before moving to an asset approvals process.</li> </ul>	DCCEEW / EPA & NSW Health	Mid 2025 (within 12 months)

Table 20: Implementation Plan – LWU Strategic Priorities for NSW Government

Recommendation and actions	Agency	Timing
Sector Priorities Plan		
<ul style="list-style-type: none"> <li>Develop a preliminary prioritisation framework across problems for the sector including objectives and costs and benefits, and update as RIS and other analyses are completed.*</li> </ul>	DCCEEW-led with support from NSW Treasury	Early 2025
<ul style="list-style-type: none"> <li>Prepare a stock take of existing strategic plans for LWU sector, including state, regional and local plans, and a preliminary Sector Overview to support new funding approaches.</li> <li>Utilise the stock take to identify significant gaps in strategic planning to be addressed by either NSW Government or LWUs.</li> </ul>	DCCEEW-led with support from OLG and NSW Treasury and input from LWUs	Early 2025, for release for public consultation in mid 2025
<ul style="list-style-type: none"> <li>Develop a draft interim Sector Priorities Plan, based on existing water strategic planning, as soon as practicable.*</li> </ul>	DCCEEW-led with input from other NSW Government agencies and LWUs	Early to mid 2025
<ul style="list-style-type: none"> <li>Release the draft Sector Priorities Plan for public consultation.*</li> </ul>	DCCEEW-led engagement with other agencies and LWUs	Mid 2025
<ul style="list-style-type: none"> <li>Finalise and release <i>Sector Priorities Plan</i> and any updates to the Sector Overview.</li> </ul>	DCCEEW	Late 2025
Integrated Planning and Reporting framework		
<ul style="list-style-type: none"> <li>Integrate key elements of the RAF into the Integrated Planning and Reporting Framework to streamline long term business and financial planning by councils and serve as a basis for sector-wide planning and prioritisation.</li> </ul>	Office of Local Government with advice from DCCEEW	Late 2024 (or within 2 months)

\* Present to Implementation Steering Committee for approval prior to Budget proposal.

Table 21: Implementation Plan – Develop LWU sector Funding Policy and CSO funding mechanism

Recommendation and actions	Agency	Timing
LWU Sector Funding Policy		
<ul style="list-style-type: none"> <li>Prepare a draft LWU Funding Policy for sector consultation.</li> </ul>	DCCEEW-led with agency support from Treasury, NSW Health and EPA	Late 2024 to early 2025
<ul style="list-style-type: none"> <li>Release the draft LWU Funding Policy, with the interim Sector Overview and potentially the draft Sector Priorities Plan, for sector consultation.</li> </ul>	DCCEEW with input from LWUs and NSW Government agencies	Early to mid 2025
<ul style="list-style-type: none"> <li>Finalise LWU Funding Policy.</li> </ul>	DCCEEW-led with support from OLG and NSW Treasury	Mid to late 2025
CSO Funding Mechanism		
<ul style="list-style-type: none"> <li>Prepare a draft CSO Policy and Agreement Pathways Guidelines as part of the LWU Funding Policy for sector consultation.</li> </ul>	DCCEEW-led with support from NSW Treasury	Late 2024 to early 2025
<ul style="list-style-type: none"> <li>Release the draft LWU Funding Policy, with the Sector Overview, for sector consultation.</li> </ul>	DCCEEW-led with input from LWUs and other NSW Government agencies	Early to mid 2025
<ul style="list-style-type: none"> <li>Finalise CSO Policy and Agreement Pathways Guidelines.</li> </ul>	DCCEEW with support from NSW Treasury and OLG	Late 2025
<ul style="list-style-type: none"> <li>Provide a report to the NSW Productivity &amp; Equality Commissioner on the implementation of the CSO policy after 12 and 24 months.</li> </ul>	DCCEEW	Mid 2025, 2026
<ul style="list-style-type: none"> <li>Establish CSO Advisory Steering Committee and interagency working group.</li> </ul>	DCCEEW and other NSW Government agencies	Late 2025
<ul style="list-style-type: none"> <li>Appoint a CSO Specialist Advisor.</li> </ul>	DCCEEW	Late 2025
Pensioner rebate on water services		
<ul style="list-style-type: none"> <li>Evaluate the pensioner rebate on all water services before the 2025-26 Budget while broader cost of living utility measures.</li> </ul>	DCCEEW (NSW Treasury CEE assistance)	Late 2024 (within 3 months)
<ul style="list-style-type: none"> <li>Develop approach to address cost of living pressures for water in response to evaluation findings and incorporate into the LWU Funding Policy.</li> </ul>	DCCEEW (and LWUs)	Early 2025
<ul style="list-style-type: none"> <li>If approach approved requiring funding from NSW, finalise Service Level Agreements for delivery and funding of concessions to be developed with each water utility, and includes key performance indicators to measure effectiveness of CSO in meeting its objective.</li> </ul>	DCCEEW-led with support from NSW Treasury (Commercial Group)	Late 2025 (September 2025).

\* Present to Implementation Steering Committee for approval prior to Budget proposal.

Table 22: Implementation Plan – Western NSW

Recommendation and actions	Agency	Timing
Implementing a western NSW approach		
<ul style="list-style-type: none"> <li>Establish a reform process to identify and implement the most efficient and effective structure for providing water and sewerage services in western NSW.</li> <li>(Note: This scoping exercise should identify potential LGAs, range of options for negotiation, key issues/risks and support for LWUs to participate).</li> </ul>	DCCEEW supported by NSW Treasury (Commercial) and OLG	Immediate (within 6 months)
<ul style="list-style-type: none"> <li>Seek Cabinet/ERC approval for agreement making process with western NSW and preliminary estimate of funding envelope.</li> </ul>	DCCEEW, NSW Treasury, OLG	Early 2025
<ul style="list-style-type: none"> <li>Undertake formal process to establish a regional service agreement and CSO funding with western NSW LWUs.</li> </ul>	Independent chair, DCCEEW, NSW Treasury,	Mid to late 2025
<ul style="list-style-type: none"> <li>Approach to be developed and agreed with funding by early 2026.</li> </ul>	DCCEEW	Early 2026
Develop a Strategic Business Case		
<ul style="list-style-type: none"> <li>CSO funding to western NSW LWUs based on the output of the reform process.</li> </ul>	DCCEEW, NSW Treasury, OLG	For Cabinet consideration by September 2025 (within 12 months)
<ul style="list-style-type: none"> <li>Final business case and funding to be approved as part of the 2026 budget.</li> </ul>	DCCEEW, NSW Treasury, OLG	Early 2026
<ul style="list-style-type: none"> <li>Implementation and CSO negotiations to inform 2026 budget.</li> </ul>	DCCEEW, NSW Treasury, OLG	June-July 2026

## Ongoing implementation

Once established, updates to the Sector Priorities Plan and CSO and service level agreements should be ongoing, preferably designed as an annual cycle.

### Prioritisation and Strategy Cycle

- Updates to the Sector Overview as strategic planning occurs at local, regional, and State level (DCCEEW, supported by NSW Treasury and INSW, with input from councils)
- Updates to the Sector Priorities Plan on at least an annual basis (DCCEEW, supported by NSW Treasury, with input from councils.)

### CSO funding and agreement cycle

- Seek expressions of interest from Councils for future tranches of CSO and service level agreements with LWUs (after western NSW). (DCCEEW, supported by OLG.)
- Prepare budget/ERC submissions for future tranches of CSO and service level agreements based on expected priority LWUs, with funding envelope and policy parameters. (DCCEEW, supported by OLG)
- Review and provide advice to Councils with applications for CSO and service level agreements (DCCEEW, supported by other regulatory agencies)

4. Review of applications and advice to Minister for Water and Treasurer. Negotiations with LWUs if required. (CSO Advisory Steering Committee and CSO Specialist Advisor)
5. Minister for Water and Treasurer to agree on final funding quantum for CSO and service level agreements (DCCEEW /NSW Treasury)
6. Finalise and implement CSO and service level agreements. (DCCEEW)

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## Appendix A: Terms of reference

### NSW Productivity Commission Review of funding models for Local Water Utilities

The NSW Productivity Commission should investigate the range of alternative funding arrangements that would help reduce service risks for local water utilities and provide advice to the NSW Government on next steps for a future direction.

The investigation should consider:

- The current funding arrangements for the 89 council-owned local water utilities in NSW and strategies that could better optimise the current funding approaches, including:
  - NSW Government funding programs
  - Existing requirements for user charges and levies.
- The minimum level of service for water supply and sewerage services (see assumptions and limitations).
- The diversity of local water utility performance, financial performance and business models and unresolved service risks
- The extent to which alternative funding arrangements could lift the performance of the most poorly performing, smaller utilities to minimum performance without creating disincentives to the efficient operation of good performers.
- Pathways to transition to a new approach over time, including different levels of NSW Government funding or opportunities to reduce risks by better leveraging the State Government's existing investments in publicly owned state-owned corporations.
- Pensioner rebates, noting this part of the review spans regional and metro settings.

### Assumptions and limitations

The NSW Government's policy position is that there shall be no forced amalgamations and that councils will continue as the owners of their water and sewerage assets. Continuation of this policy position is a critical assumption of this investigation.

In order to investigate the options for alternative funding arrangements, and in particular the Community Service Obligation option, the NSW Productivity Commission should consider a minimum service standard for water supply and sewerage services. A complete portfolio of basic service levels is not set in NSW, however for the purposes of this investigation can be assumed that the following policy and regulatory settings would continue:

- Water quality: Australian Drinking Water Guidelines as the minimum service level for safe drinking water.
- Water security: Risk based water security service levels.
- Environmental: Compliance with Environment Protection Licences as the minimum service level for the environmental performance of wastewater treatment.
- Fluoridation: All relevant facilities will comply with the Code of Practice for Fluoridation of Public Water Supplies.

Through the consultation the NSW Productivity Commission should consider views as to whether the minimum level of service should change for these assumptions now or over time. Further, whether any key basic service levels are missing from this list. For example, reliability (service interruptions) or water pressure.

In undertaking its review, the Productivity Commission should:

- consult with councils, local water utilities, joint organisations of councils, industry groups, NSW Government agencies, and the community, as appropriate

- leverage from the analysis report from phase 1 of the Town Water Risk Reduction Program, entitled *Financial and operating performance of local water utilities (2022)*, and produced by Frontier Economics, which outlines the historical operational and financial performance of local water utilities
- assemble and analyse any other relevant data
- draw on best practice in other jurisdictions, previous reviews, and published research.

## Appendix B: Stakeholders involved in the public consultation process

The NSW Productivity and Equality Commission (the Commission) received 42 submissions in response to the issues paper from local government councils, county councils/joint organisations/alliances, state government agencies and state-owned corporations, peak bodies, private businesses, and individuals. These have been published on the Commission’s website except where confidential.

The main issues raised in submissions were the:

- challenges with grant programs, including limited resources for planning, time constraints, co-funding requirements, and cost of depreciating an expensive asset
- need for revised funding approaches that address climate risks as well as streamlined processes to support infrastructure resilience and equitable access
- significant diversity in the operating environment for LWUs in regional NSW
- large disparity in the service levels delivered to communities across regional NSW
- increasing cost of regulations imposed on the sector and the need to compare socio-economic costs against the benefits of increasing regulatory standards each year
- benefits (e.g. knowledge, digital services, planning, procurement, and asset management) and barriers (e.g. funding and political will) of regional collaborative models
- inequity in pensioner rebates between Sydney Water, Hunter Water, and LWUs.

### Submissions to the issues paper

Stakeholder group	Stakeholders
Local government councils	<ul style="list-style-type: none"> <li>• Lachlan Shire Council</li> <li>• Bellingen Shire Council</li> <li>• Richmond Valley Council</li> <li>• Leeton Shire Council</li> <li>• Albury City council</li> <li>• Murray River Council</li> <li>• Mid Coast Council</li> <li>• Glen Innes Severn Council</li> <li>• Port Macquarie Hastings Council</li> <li>• Goulburn Mulwaree Council</li> <li>• Clarence Valley Council</li> <li>• Tweed Shire Council</li> <li>• Berrigan Shire Council</li> <li>• Shoalhaven Water</li> <li>• Singleton Council</li> <li>• Tamworth Regional Council</li> <li>• Cobar Shire Council</li> <li>• Bega Valley Shire Council</li> </ul>

Stakeholder group	Stakeholders
	<ul style="list-style-type: none"> <li>Dubbo Regional Council</li> </ul>
County Councils/Joint organisations/Alliances	<ul style="list-style-type: none"> <li>Alliance of Western Councils</li> <li>Goldenfields Water</li> <li>Central NSW Joint Organisation</li> <li>Riverina Water</li> <li>Canberra Region Joint Organisation</li> <li>Orana Water Utility Alliance</li> <li>Central Tablelands Water</li> </ul>
State Government agencies and State-owned corporations	<ul style="list-style-type: none"> <li>Hunter Water</li> <li>Local Aboriginal Land Council</li> <li>Office of Local Government</li> <li>Independent Pricing and Regulatory Tribunal</li> <li>Essential Energy</li> </ul>
Peak bodies	<ul style="list-style-type: none"> <li>Water Services Association of Australia</li> <li>NSW Water Directorate</li> <li>Australian Water Association</li> <li>Infrastructure Sustainability Council</li> </ul>
Private businesses	<ul style="list-style-type: none"> <li>Business 1</li> <li>Stephen Palmer Consulting</li> <li>Conexa Infrastructure Partners</li> </ul>
Individuals	<ul style="list-style-type: none"> <li>Individual 1</li> <li>Individual 2</li> </ul>

## Stakeholder roundtable participants

The Commission conducted a range of roundtables and meetings with stakeholders.

Stakeholder group	Stakeholders
Local government councils and representatives	<ul style="list-style-type: none"> <li>Lismore</li> <li>Ballina</li> <li>Tweed</li> <li>Byron</li> <li>Richmond Valley</li> <li>Clarence Valley</li> <li>Kyogle</li> <li>Bogan</li> <li>Bourke</li> <li>Brewarrina</li> <li>Cobar</li> <li>Dubbo</li> <li>Gilgandra</li> <li>Mid-Western</li> <li>Narromine</li> </ul>



Stakeholder group	Stakeholders	
		<ul style="list-style-type: none"> <li>• Warren</li> </ul>
	<ul style="list-style-type: none"> <li>• Bega Valley</li> <li>• Goulburn</li> <li>• Hilltops</li> <li>• Queanbeyan–Palerang</li> <li>• Snowy Monaro</li> <li>• Snowy Valley</li> <li>• Upper Lachlan</li> <li>• Wagga Wagga</li> <li>• Wingecarribee</li> <li>• Yass</li> </ul>	<ul style="list-style-type: none"> <li>• Blayney</li> <li>• Cabonne</li> <li>• Forbes</li> <li>• Lachlan</li> <li>• Oberon</li> <li>• Orange</li> <li>• Weddin</li> </ul>
County councils Joint organisations alliances	<ul style="list-style-type: none"> <li>• County Councils: Rous, Central Tablelands, Goldenfields, Riverina</li> <li>• Northern Rivers Joint Organisation</li> <li>• Alliance of Western Councils</li> <li>• Central NSW Joint Organisation</li> </ul>	
Peak bodies	<ul style="list-style-type: none"> <li>• Water Services Association of Australia</li> <li>• NSW Water Directorate</li> <li>• Country Mayors Association</li> <li>• Local Government NSW</li> </ul>	
State Government agencies and State Owned Corporations	<ul style="list-style-type: none"> <li>• Department of Climate Change, Energy, Environment and Water, Office of Local Government, NSW Health, Environmental Protection Authority, NSW Treasury</li> <li>• Hunter Water, Water NSW</li> <li>• SA Water, TasWater, Water Corporation (WA)</li> </ul>	

## Targeted consultations

Stakeholder group	Stakeholders
Local government councils and representatives	<ul style="list-style-type: none"> <li>• Central Darling Shire Council</li> <li>• Brewarrina Shire Council</li> <li>• Bourke Shire Council</li> <li>• Balranald Shire Council</li> <li>• Cobar Shire Council</li> <li>• Lachlan Shire Council</li> </ul>

## Appendix C: Previous reviews

### Reviews and guidelines

Date	Reviews and guidelines	Description
2008	Release of <i>Inquiry into secure and sustainable urban water supply and sewerage services for non-metropolitan NSW</i> by the Department of Water and Energy (2008)	Investigated structural groupings of councils to help achieve financial sustainability.
2015	Release of <i>Country Towns Water Supply and Sewerage Program</i> performance audit by the Audit Office of New South Wales (2015)	Found the Country Towns Water Supply and Sewerage Program had helped improved the performance of LWUs by providing tools, guidance, and support that promoted better management practices.
2020	Release of <i>Support for regional town water infrastructure</i> performance audit by the Audit Office of New South Wales (2020)	Found that the department lacked a LWU sector regulatory policy, formal coordination mechanisms and a clear picture of IWCM planning. While the latest iteration of Safe and Secure helps to address town water risks with defined metrics, the original program failed to prioritise investments effectively.
1993-present	Strategic planning outcomes webpage by (NSW Department of Climate Change, Energy, the Environment and Water n.d.)	A range of guidance material including pricing, strategic planning, and management and of water supply and sewerage businesses.
2022	Regulatory Assurance Framework	Sets out guidelines for managing the provision of water supply and sewerage services by councils.

### Programs

Date	Program	Description
1994 to 2018	Country Towns Water Supply and Sewerage Program (CTWSSP)	To assist LWUs that provide public water supply and sewerage services to urban areas of regional NSW. Key outcomes include: <ul style="list-style-type: none"> <li>• 520 water supply and sewerage projects completed</li> <li>• \$1.27 billion in funding committed (NSW Government n.d.)</li> </ul>
2008 to present	Aboriginal Communities Water and Sewerage Program	Aimed at ensuring the level of water and sewerage services provided to Aboriginal communities is of equivalent standard to nearby non-Indigenous towns.

Date	Program	Description
		<ul style="list-style-type: none"> <li>• \$200m in funding</li> </ul>
2017 to present	Safe and Secure Water program	<p>To provide safe, secure, and sustainable water and sewerage services to towns in regional NSW. There are three funding streams:</p> <ul style="list-style-type: none"> <li>• Stream 1 – funding for high-priority projects that improve water quality and security.</li> <li>• Stream 2 – funding for strategic planning by LWUs.</li> <li>• Stream 3 – funding for repair or decommissioning of high-risk dams.</li> </ul> <p>(Department of Planning and Environment 2022)</p>
2022	Town Water Risk Reduction Program	<p>To improve the Department’s coordination for regional town water infrastructure and respond to service risks identified in the Safe and Secure Water Program.</p> <ul style="list-style-type: none"> <li>• \$24.59m in funding over 2 years (2024-25) to continue to program.</li> </ul>

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