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27 March 2024

Peter Achterstraat AM
NSW Productivity Commissioner
Level 30 52 Martin Place
Sydney NSW 2000

via email (lwureview@treasury.nsw.gov.au)

Dear Peter,

IPART's submission to the NSW Productivity Commission Issues Paper on alternative funding models for Local Water Utilities

Thank you for the opportunity to provide a submission to the NSW Productivity Commission Issues Paper on alternative funding models for Local Water Utilities (LWUs).

IPART is the independent pricing and licensing regulator for many essential services in NSW. We set prices and, where applicable, administer licences for several metropolitan, regional and rural water utilities across NSW.¹ We are also the licence regulator for private water utilities under the *Water Industry Competition Act (NSW) (WIC Act)*. Our role regulating LWUs is currently limited to setting prices for the Central Coast Council's water related services.

We agree that many LWUs face challenging operating and financial conditions. These conditions are becoming more challenging as the effects of climate change and cost of living pressures increase. We support the NSW Productivity Commission's view that LWUs need a funding system that is fair, efficient, and meets the needs of regional and remote communities.

Potential benefits of improving the operating and financial sustainability of LWUs

Given the challenges faced by LWUs including their relatively small scale, low density, and large distances from population centres, improving the operating and financial sustainability of LWUs across regional and remote NSW could deliver significant benefits, including:

- Greater opportunity for LWUs to access specialist expertise and systems and deliver improved water quality, service levels and value for money to customers.
- Improving organisational capabilities in planning, risk assessment, procurement and incident response.
- Improving resilience to climate change including planning for longer-term variability in water supply and responding to shorter-term drought conditions.
- Enhancing LWUs' ability to access debt financing to optimise their capital structures and facilitate efficient investment in and maintenance of infrastructure.

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- Enabling adoption of more corporatised governance structures which would facilitate greater accountability, enhance effective decision-making, and incentivise improved performance.

Economies of scale and skill shortages

The Issues Paper identifies the lack of economies of scale and skill shortages as key challenges for LWUs and identifies the potential for greater collaboration among LWUs and between LWUs, State Owned Corporations (SOCs) and stakeholders in water reliant industries to achieve greater economies of scale.

We support the NSW Productivity Commission's focus on building capacity of LWUs to deliver value for their customers and communities. We consider the solutions need to be fit for purpose. That is, how each LWU is supported to build this capacity should be informed by their individual circumstances.

There is a strong case in exploring a range of options to increase collaboration among LWUs and between LWUs, SOCs and industry to enhance organisational capacity. These options should include, but not necessarily be limited to: expanding and formalising existing arrangements such as regional alliances, investigating the scope for the creation of water and wastewater county councils, investigating whether LWUs could outsource the management of their assets and delivery of their water and wastewater services to catchment or regional based service providers, and exploring opportunities for LWUs to partner with SOCs and water reliant industries.

We note that small water utilities constructed and operated across NSW under the *Water Industry Competition Act 2006* (WIC Act) may provide a model for LWUs where small purpose-built schemes offer value for customers. These schemes are generally designed to be flexible and scalable using readily available 'packaged' technology.

Minimum service levels

The Issues Paper seeks feedback on whether minimum service levels should be applied universally to all towns within the area serviced by a local water utility, irrespective of size, remoteness or cost.

IPART reviews and recommends to the Minister minimum service levels for Sydney Water, Hunter Water and WaterNSW at the end of each licence period. IPART monitors and enforces the standards set out in licences to ensure a high level of compliance. IPART plays a similar role in recommending and enforcing service standards for private water utilities under the WIC Act. The capacity for these utilities to develop and implement the systems required to maintain a high level of compliance with these standards is high.

IPART's regulatory and licensing processes are designed to identify minimum service levels that protect customers and ensure that water services are provided to a minimum standard at a price customers can afford. IPART supports the development of minimum standards or benchmarks for services provided by local water utilities where they are useful in driving improved performance in a way that is financially sustainable and affordable. This may include standards or benchmarks that are used to identify capacity shortfalls for individual local water utilities and assist in long term capital and operational planning.

We note that compliance with regulatory standards can drive cost increases and do not support the introduction of blanket regulatory minimum standards without consideration of the likely cost impact to customers. It is likely that long term transitional arrangements will be required and the capacity for local water utilities to plan for and implement the necessary operational and capital improvements will vary greatly.

Challenges to local water utilities reaching minimum service standards are common across all water utilities and will continue to impact affordability for local water utilities. These include:

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- The varying quality of raw water supplied to local water utilities across the State and its impact on the production of safe and affordable potable water by local water utilities.
 - The impact of climate change and the need to secure non-rainfall dependent sources of water.
 - A shortage of appropriately skilled and trained operators, particularly in remote or rural locations.
 - The relatively small pool of skilled water quality and water infrastructure auditors impacting the ability of regulators to monitor compliance effectively and affordably.

Strategies to improve standards of operation and secure safe drinking water across all local water utilities will need to consider how to best help each LWU, given its individual circumstances, overcome these challenges.

Independent oversight of service levels and pricing

The Issues Paper discusses the option of introducing independent oversight of LWUs to drive continuous improvement, determine eligibility for CSO payments, and ensure accountability for funds spent.

Regulation or service levels and prices should be targeted, outcomes-focused and aimed at promoting the long-run interests of customers. We considered the regulation of LWUs in our *2016 Review of reporting and compliance burdens on Local Government*. Stakeholder submissions received during our review identified several concerns with the existing regulatory framework applying to LWUs including that it is too prescriptive, inflexible, and outdated. Some stakeholders called for an overhaul of the existing framework and a move towards a principles or outcomes based regulatory approach. Our review recommended moving to regulating LWUs on a catchment or regional basis, rather than on an individual LWU basis, using a whole-of-government, risk-based and outcomes-focused regulatory approach.

We would support a review of the current regulatory arrangements for LWUs with a view to designing a regulatory framework that is more targeted, proportionate, and outcomes focused. Potential benefits of improving the regulatory framework for LWUs include:

- Reduced regulatory burden and greater focus on delivering outcomes for customers, communities, and the environment.
- Improved understanding and transparency of efficient costs which would enable prices to be set with a clearer reference to efficient costs while also supporting better targeted Community Service Obligation (CSO) payments.
- Greater ability to employ financial and reputational incentives to drive continual improvement in service quality and efficiency.

IPART's contact officer for this submission is Matthew Mansell, Director Pricing and Policy, contactable on [REDACTED]

Yours sincerely

27/03/2024

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ⁱ IPART sets prices and administers licences for Hunter Water, the Sydney Desalination Plant, Sydney Water and WaterNSW. IPART sets prices for Essential Water (Broken Hill), Central Coast Council and the Water Administration Ministerial Corporation (WAMC).