Richmond Valley Council

[redacted]

council@richmondvalley.nsw.gov.au
www.richmondvalley.nsw.gov.au

ABN 54 145 907 009

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Mr Peter Achterstraat AM
NSW Productivity Commissioner

By email: LWUReview@treasury.nsw.gov.au

Dear Mr Achterstraat,

NSW Productivity Commission Review of Local Water Utility Funding Models

Thank you for visiting the Richmond Valley this week and enabling us to give you some insights into the challenges faced by many Councils to manage infrastructure that is approaching 100 years of age. We also welcome the opportunity to participate in the Productivity Commission's current review of local water utility funding models. Richmond Valley Council commends the NSW Government for commissioning the review and trusts that it will give due regard to the local government sector's feedback and the Commission's recommendations. This is a critical issue for regional NSW that requires urgent resolution and investment.

It is clear that the traditional policy, regulatory and funding models for local water utilities in regional NSW are no longer fit for purpose, nor achieving the priorities of the communities they serve. However, there is opportunity for positive change through improved strategic focus and collaboration, and a fresh approach to funding that acknowledges inter-generational equity.

While the NSW Government has focused, with increasing complexity, on the day-to-day regulation of water utilities, it has failed to address the emerging strategic crisis within the industry. Despite the historic efforts of the Best Practice Framework, the Town Water Risk Reduction Program (TWRRP) and other policy initiatives, the fundamental issues impeding progress within the industry have continued to grow. As a result, local water utilities across NSW are now facing infrastructure and resourcing challenges that threaten their long-term sustainability. New thinking and a willingness to embrace meaningful change is required at all levels of government to resolve these challenges and ensure the long-term health and development of thriving regional communities. This should include reshaping governance, resourcing, structural and regulatory frameworks within the sector, with a focus on delivering practical outcomes in improved water management and funding arrangements that are flexible and fit for purpose.

All local water utilities within regional NSW face their own unique challenges and it is important that they are supported with funding solutions that are appropriate to their regional context and scale of operations. While Council notes the review's limitations regarding ownership and boundary change, it has concerns with any proposed funding models that would see resources directed away from high-growth regional communities to provide perpetual subsidisation of LWUs that are unwilling to embrace reform to improve their long-term sustainability. Resolving this issue will require a working partnership between local and state government and a willingness to embrace new operating models.

Current challenges for water utilities

There are a number of key challenges for local councils within regional NSW in providing water and sewerage services to their communities. These include:

- Historic patterns of settlement, infrastructure investment and population growth;
- The current impacts of the post-COVID economy, resettlement patterns and ongoing skills shortages within the industry;
- The limitations of the Local Government Award and local government financing and investment regulations;
- Resourcing and lead-time impacts of water utility regulation, monitoring and reporting;
- Impacts of climate change and disaster adaptation.

Historic patterns and current changes

The history of regional NSW has been dominated by slow, steady population growth, with occasional spikes of investment in response to government-led programs. For example, post-war resettlement programs and the decentralisation initiatives of the 1970s saw an increase in water and sewer infrastructure investment in regional communities. Most of these assets were constructed by Public Works, with councils having limited input into the design, construction and commissioning phases. The slow population growth that followed much of this investment meant that augmentation often consisted of small scale “bolt on” initiatives with a mismatch of technologies i.e. coupling extended aeration systems with tickling filters and various tertiary treatment options in a sewage treatment plant. Much of this core infrastructure is now reaching the end of its asset life and requires major redevelopment to bring it up to date with current technologies and environmental performance requirements.

Casino’s aging sewage treatment plant (STP) is an example of this paradigm, with the original structure developed in 1932, with subsequent additional trickling filters in the 1960s-70s and bolt-on EAT systems in the ‘90s, in response to slow, steady growth within the town. The STP has reached the end of its asset life, following additional damage in the catastrophic floods of 2022. It requires total replacement as the mismatch of technologies can no longer meet modern workplace safety, environmental and sewage treatment standards. In an ideal world, councils such as Richmond Valley would have had time, over the years, to collect development contributions and build up reserves for the plant’s ultimate replacement. The post-COVID economy has then intervened, with materials and labour pricing escalating exponentially, compared to population and wage growth. Council had planned that the replacement of this plant would cost some $30m – which was achievable within its resources. However, within three years, the estimated cost of the STP has escalated to $65m – which is no longer affordable for our community, without recourse to substantial government funding. Councils throughout regional NSW are facing the same challenge.

Additionally, Casino is facing the impacts and opportunities of sudden, accelerated growth, following the establishment of the NSW Government’s Regional Jobs Precinct initiative. With Casino at the centre of an emerging regional employment hub and boasting a generous supply of flood-safe residential land, it is expected that the town's population will grow by an additional 4000 EP by 2040 (twice its previous growth rate). While Council welcomes this growth and continues to work with the NSW Government to activate the Regional Job Precinct, this issue reinforces the importance of supporting government-led regional employment and housing initiatives with investment in critical infrastructure.

Competing for diminishing resources

Rural and regional councils are generally not of a sufficient scale that they can quickly mobilise resources to adjust to sudden changes in growth, or economic shocks. This is exacerbated by the regulatory requirement for councils to separately manage their water and sewer fund, and the limitations on council borrowing and investment options. Our council is currently unable to borrow beyond a 20-year term, to construct infrastructure with an 80-100 year asset life. There is limited capacity for inter-generational debt within the local government system. In these situations, local councils traditionally compete for the funding provided through state and federal grants programs to make up the shortfall. There is no certainty that they will be successful in this bid, nor any certainty that these programs will be available in the future, as state and federal resources are challenged by the same pressures that are impacting local councils. This makes it difficult to deliver long-term infrastructure planning and investment. To build financial resilience, Councils need a more reliable safety net to deal with sudden, unexpected change and more flexible options to plan for inter-generational investment.

Sustained under-investment in water industry training programs within NSW over the past decade, and the impacts of the post-COVID labour market are also creating the perfect storm for local water utilities in obtaining sufficient resources to maintain and operate their water and sewerage services. There are currently 90 council-owned water utilities, competing for a diminishing pool of some 2,800 qualified and experienced water operators, engineers and technicians, when an estimated 3,200 employees are required to safely and efficiently operate regional systems. Councils do not have the resources to compete on a level playing field with the state-owned utilities and private enterprise water/sewer operations, which dominate the employment market. The limitations of the current industrial award add further complexities to recruitment and affordability. While it is acknowledged that both the Town Water Risk Reduction Program and the NSW Water Directorate have actively attempted to resolve the industry's training and recruitment challenges, the resourcing shortfall continues to grow.

Previous reviews of the future sustainability of regional water utilities have predicted that infrastructure failure and replacement costs would ultimately drive a sustainability crisis within the sector, however it now seems more likely that human resourcing issues will be the catalyst. The day is fast approaching when there will be insufficient qualified operators to run the regions' water and sewer treatment systems. This will substantially increase public health risks and severely impact service reliability. Sadly, simply providing councils with more funding will not resolve the labour shortage, however it could help with addressing increasing employment costs.

Regulatory burden

Local water utilities in regional NSW are currently subject to a disproportionate amount of regulation, monitoring and reporting, compared to their scale of operations. Consistently state regulators appear to have struggled to appreciate the difference between regulatory oversight and vicarious management of local water utilities, imposing complex processes, design rules and analysis on business operations with fewer than 10 employees. Although the TWRRP attempted to roll back some of the excesses of the Best Practice Framework, these gains are progressively being eroded by increasingly complex bolt-on guidelines and gateway requirements. Since the Best Practice Guidelines were introduced in 2008, along with associated LWU performance reporting requirements, local councils have devoted thousands of hours and resources to painstakingly measuring and monitoring more than 350 aspects of their operation to satisfy mandatory reporting.

Unfortunately for our communities, this endless introspection has done little to address the broader sustainability issues currently facing the industry. There is a persistent culture within the NSW water/sewer regulatory space that fails to fully appreciate the resourcing constraints, project delivery imperatives and statutory authority of local government water utilities. The focus should return to outcomes-based, appropriately scaled regulation.

Historic 'one size fits all' requirements for local water utilities have left a legacy of resourcing impacts. Examples include the 75/25% split in water usage and access fees - which has resulted in consistent under-resourcing of major infrastructure renewal - and the 5-10-10 Design Rule, which has prompted millions of dollars in investment in water security infrastructure to achieve a service standard that has never been tested with the NSW community. The open-ended interpretation of the Local Government Act Section 60 approval process has also led to infrastructure design changes and delays that increase Councils' investment costs and liabilities. As a result, the average lead-time to replace major infrastructure such as a sewage treatment plant has increased to 10 years, when it should be possible to undertake this process in less than five.

The introduction of Health Based Targets will ultimately see increased complexity, lead-time and capital investment in water treatment barriers for local water utilities. Council welcomes the shift away from the rigid frameworks of the past through the most recent water reform initiatives. However, it is important that we preserve these gains by ensuring the spirit of the streamlined Regulatory and Assurance Framework continues.

Put simply, regulatory and reporting requirements eat up resources that councils desperately need to run their water and sewer operations. It is essential that regulation and reporting should be meaningful, risk-based and at an appropriate scale for LWU operations.

Impacts of climate change

The impacts of a changing climate, with extended periods of drought and increased frequency of flooding is also taking its toll on the financial sustainability of local water utilities. Following the worst drought in 130 years, in 2019, some 50 regional water supplies were identified as at high risk of failure. It is increasingly difficult for councils to plan for and resource sufficient infrastructure resilience against climate impacts. For example, providing the safety net of a second water source for Casino by connecting to the Rous Water network could require up to $80m in capital investment. Similarly, increasing frequency and severity of flood events is impacting significantly on councils' sewerage networks.

Following the 2022 floods, Richmond Valley Council is facing a $50m investment to repair and improve the resilience of its sewerage network. Councils are unable to insure against this level of damage and traditionally Disaster Relief Funding Arrangements (DRFA) have not been available to repair local government water and sewerage infrastructure. Following the 2022 floods, a one-off program (Water and Wastewater Repair and Recovery Program) was initiated to assist flood-impacted LWUs in the Northern Rivers was trialed, however, the lack of framework and processes around the trial created challenges with equitable distribution of available funds.

Richmond Valley Council would strongly support the permanent extension of DRFA funding arrangements to local water utilities impacted by natural disasters, with a standard application and allocation process for the funding. This would ensure that local government water/sewer reserves for infrastructure renewal and augmentation are not eroded by funding emergency infrastructure repairs.

Funding model considerations

Off-setting operational costs

The Review discussion paper seeks to identify the typical cost of providing water and sewerage services in a well-run LWU. This is an impossible question to answer, as every local water utility is different and faces constraints and advantages that are unique to its locality. For example, Richmond Valley Council is able to effect savings in large scale capital investment by sourcing its water supply for the Mid Richmond communities from Rous County Council. However, this is offset by the higher cost of bulk water from the County and its strategic capacity to compete more successfully in the regional employment market.

Each council has its own geographical and climatic challenges, its own settlement patterns, resourcing challenges and legacy infrastructure issues. There are also widely varying social considerations throughout regional NSW. For example, many regional utilities provide subsidised water pricing to major high-usage industries, such as abattoirs and mines because of the employment benefits they bring to the community. In this regard, attempts to estimate typical costs may see the range of variation so broad that the measure would have little meaning and limited benefit as an indicator for funding mechanisms.

Similarly, imposing minimum levels of service beyond the basic legislative requirements outlined in the Terms of Reference, may see some councils unduly disadvantaged because of their unique operating environment. Service levels can vary within an LWU's operating area because of available water sources, the size of the settlement and the capacity/willingness of its customers to pay. This makes it challenging to link LWU operating costs and service levels to a standardised funding model.

Councils currently receive funding under the Australian Government's Financial Assistance Grants program (FAGs) that is based on a series of complex financial, social and demographic considerations. This funding includes a roads component, that is also calculated based on the individual circumstances of each council. If the NSW Government wants to consider a model of annual operational funding for local water utilities, then the FAGs system may provide an avenue to develop an appropriate formula. However, due to the complexities of the operating environment, it would be essential to consult extensively with councils on appropriate methodology. This would ultimately ensure that small-scale LWUs who do not have capacity to recoup their operational costs from their limited customer base, could receive ongoing assistance – essentially a CSO payment.

However, Council strongly believes that each utility has a responsibility to ensure its operations are as cost effective and efficient as possible before accepting subsidies. To this end, small utilities that would benefit from voluntary structural reform, shared services or other arrangements should be required to explore these measures before receiving a CSO payment.

Off-setting capital costs

Achieving the increasing scale of capital investment required for water and sewerage infrastructure is one of the greatest challenges that local water utilities currently face. With construction costs escalating faster than the community's capacity to pay, councils need funding solutions that provide pathways for inter-generational investment. At present, Council is generally limited to loan periods of 20 years, with lending institutions adopting a cautious approach to debt servicing. While the extension of the TCorp borrowing facility to councils was a step forward, the corporation's conservative perspective on council investment policies has limited the overall benefit of its services.

It is encouraging that TCorp is now revising some of its views on councils' investment strategies, but the limitations on borrowing terms remain. Ultimately, councils are attempting to fund an asset that lasts for 80-100 years through a 20-year investment pathway. This means that the current generation carries the cost of infrastructure that benefits the next. Providing a longer-term lending facility, with low interest rates, would allow councils to spread the cost of inter-generational investment. More innovative options, such as infrastructure bonds and opportunities for superannuation funds to invest in community infrastructure, should also be explored. Many councils are not averse to borrowing for infrastructure investment, however the lack of suitable lending options currently impedes their ability to do so.

Options for direct capital funding from State and Federal governments should also continue to be provided. Ultimately, local water utilities are providing catalyst infrastructure that supports regional development and improved productivity. Much of the food production that sustains city families is supported through capital investment by regional water utilities – investment in servicing abattoirs, dairy and other food processing facilities. It is reasonable to expect that the broader community should help to fund the cost of this infrastructure when the regional, state and national economy ultimately benefits from the industries it supports.

In the current funding climate, councils generally seek to secure a hybrid of federal and state funding to support their water/sewer infrastructure investments. This is challenging when there is no synchronicity between state programs, such as Safe and Secure, and Federal programs, such as National Water Grid. Developing funding pathways between the two levels of government would allow for strategic co-investment in regional water/sewer projects that have wider economic benefits and ensure that these projects can be delivered within a reasonable timeframe.

Reliance on state funding programs alone does not provide sufficient levels of investment for the escalating costs of infrastructure. Replacement of the NSW Country Towns Water Program with the Safe and Secure Water Program has seen a shift from competitive grant applications to risk-based funding opportunities. However, there are anomalies within the risk ranking system for the Safe and Secure program that require further consideration. Lead-times for this program also need to be reduced, with participants progressing through multiple gateways, with multiple requirements attached to each phase. Richmond Valley Council is currently developing a number of water and sewer projects with support from the SSWP. While Council values and appreciates the funding opportunity, it is yet to commence construction on any infrastructure funded through this program after some four years of studies, consultation and pre-tender investigations. Reducing lead-time for infrastructure development is a key consideration in reducing the capital investment ultimately required. It is important that government funding programs should be as streamlined and efficient as possible in partnering with councils in shared investment opportunities.

Streamlining delivery models

Over the years, the NSW Government has experimented with a number of delivery models for LWU water and sewerage infrastructure. The old Public Works delivery model saw standardised infrastructure that was not always cost effective or fit for purpose delivered to communities, with councils carrying the cost of ongoing operation and maintenance. The Water Infrastructure NSW experiment followed a similar delivery model, with the authority ultimately being disbanded by the State a few years after its inception. Other models have included linking State funding with mandatory project management by Public Works. Council's experience of this particular model is that it has greatly increased project costs and delivery times.

Ultimately, the most appropriate delivery model for infrastructure is the council-managed model, with sufficient technical support from external consultants commensurate with the scale and complexity of the asset. For example, Council is current using a hybrid model of in-house management, supported by expert consultants and advisors to undertake the pre-construction work for its $65m Casino sewage treatment plant replacement. This will enable us to achieve an accelerated delivery timetable. Our challenge is that the construction phase of this project remains unfunded. Council is investing in the pre-construction works to ensure this essential community project is "shovel ready" to take advantage of any funding opportunities that arise.

Ideally, funding for catalyst infrastructure, such as the Casino STP replacement, that supports regional investment should be provided through a negotiated pathway between local, state and national funding partners. This would ensure that the community's investment in the pre-construction phase delivers tangible outcomes, within an appropriate timeframe. Council would welcome the development of shared funding pathways that allow all levels of government to contribute to the cost of providing essential infrastructure under a standard funding agreement. After all, without safe, sustainable and efficient water supply and sewerage services, there is no point building hospitals, schools and other essential Government services.

Opportunities for regional collaboration

Ideally, water supply management should occur on a regional scale, as water catchments extend beyond the boundaries of most local water utilities. However, there are challenges with adopting regional models. This includes the current lack of a whole of catchment governance model to effectively reduce water quality risks. The lack of a governance model was highlighted in the Far North Coast Regional Water Strategy, but as yet there has been no progress towards addressing whole of catchment issues. This limits the benefits that can be achieved through regional water/sewer investment.

Traditionally, councils have used the County Council model as an option for regional water services. There are currently four water supply counties – Rous (of which RVC is a member) Goldenfields, Riverina and Central Tablelands. The only County Council offering both water and sewerage services (Mid-Coast Water) was subsequently amalgamated following mandatory structural reform of its constituent councils. This was a retrograde step, as the County had made significant improvement in infrastructure investment and operations for the region. Had an alternative governance model been available at the time, the cost and disruption of forced amalgamation could have been avoided and the community benefits retained.

The recent introduction of Joint Organisations for regional NSW provided a statutory authority with potential to support regional management of water/sewer services, however the legislative amendments to support the formation and operation of JO's fell short of providing reliable long-term management models, such as capacity to form council-owned corporations. Councils have been reluctant to embrace regional models, such as county councils because they are subject to the same uncertainties and regulatory oversight as their constituent members and the benefits of long-term planning can be lost through short-term policy change, often driven by changing politics. For example, Rous County Council invested substantially in responsible long-term water security planning for the Northern Rivers through its Future Water strategy. However, one of the foundational elements of this strategy – development of the Dunoon Dam – was subsequently overturned following the 2021 local government elections. This affected not only Rous' long-term planning and investment strategy, but also Richmond Valley's, as Council was relying on the Dunoon Dam proposal to support an affordable second source option for the Casino water supply.

If councils are to have confidence in committing to long-term regional-scale planning and investment in water/sewer management, then an alternative governance model to the County Council option may be required. This would allow groups of councils to share in infrastructure investment costs, but also to share in the benefits of that investment through dividends that are returned to the communities they serve. Council would support further exploration of governance models for regional water management that retain local government ownership of assets and provide community benefit.

Improving community outcomes – summary of recommendations

Richmond Valley Council believes there is considerable opportunity to improve funding models for local water utilities in regional NSW. However, it is important to ensure that funding is not directed away from high-growth regional areas to perpetually subsidise CSO payments for small LWUs that are unwilling to embrace voluntary structural reform or shared service models to improve their long-term sustainability. To support more flexible and fit-for-purpose funding models for regional water and sewerage investment, Council makes the following recommendations:

1. Ensure that investment in catalyst water and sewerage infrastructure is an intrinsic part of government-led regional development initiatives, such as Special Activation Precincts, Regional Job Precincts and NSW Reconstruction Authority adaptation initiatives.

2. Consider an extension of Disaster Relief Funding Arrangements to local water utilities in regional NSW impacted by natural disasters.

3. Increase national and state investment to address the current skills shortage in the water industry.

4. Reduce regulatory impacts on local government and ensure that regulation is risk-based and appropriate to the scope of operations of LWUs.

5. Consider options for improved operational funding models for regional LWUs, potentially through the FAGs system.

6. Provide options for greater access to inter-generational funding of water-sewer infrastructure, including longer-term, low-interest loans from TCorp, or use of infrastructure bonds.

7. Continue government funding programs to support capital investment in water/sewer infrastructure, with options to negotiate agreed funding partnerships between federal, state and local government for regionally significant projects.

8. Support council-led delivery models for infrastructure design and construction, with appropriate technical support.

9. Continue to explore alternative governance models, such as council-owned corporations to support regional collaboration on water management.

We look forward to the next steps in your review and would welcome involvement in further discussions to explore solutions that will enable local water utilities to be successful in providing services for our communities.

Yours sincerely

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Vaughan Macdonald
General Manager