

Our ref: R07/0028 Sub-709

10 August 2022

Ms Erin Cini
Director
Town Water Risk Reduction Program
Department of Planning and Environment

Email: erin.cini@dpie.nsw.gov.au

Dear Ms Cini

Financial and operating performance of local water utilities – Frontier Economics

Local Government NSW (LGNSW) is the peak body for local government in NSW, representing NSW general purpose councils and related entities. LGNSW facilitates the development of an effective community-based system of local government in the State. Identifying alternate models of funding for local water utilities (LWUs) will influence the management of all 92 LWUs throughout regional NSW. Therefore, I thank you for the opportunity to provide feedback on the draft report by Frontier Economics.

In this submission, LGNSW draws on commentary provided by both the Water Directorate and Mr Graham Kennett, General Manager, Kyogle Council. It also questions some apparent anomalies within the report.

LGNSW acknowledges the challenge in identifying the most equitable way to measure disadvantage and develop funding models that include needs-based Community Service Obligations with risk prioritisation and other factors. LGNSW would support a model that ensures LWUs that are in most need, including but not limited to those in socioeconomically disadvantaged communities and those lacking access to economies of scale, receive adequate State Government funding.

These communities generally have higher charges per connection and yet have lower levels of cost recovery. The data suggests they are underperforming financially and operationally; however, they are providing an essential service to their community in challenging circumstances, even if providing a lower level of service compared to better resourced LWUs. This is a clear example of why operational cost per connection is not an ideal indicator of economies of scale or the relative cost of doing business, as the service levels provided may not be comparable. LGNSW recognises that a minimum level of service is an important objective and will have a direct relationship to funding.

In reviewing the draft report, it is clear that no singular indicator can best illustrate economies of scale with LWUs. LGNSW agrees it is imperative that various indicators of economies of scale should be considered simultaneously, including length of mains per kilometre, network size and density, remoteness and socioeconomic disadvantage (ability to pay). This data is not entirely reliable as economies of scale are elusive in the case of LWUs.

LGNSW shares the Water Directorate's caution in its remarks on economies of scale, especially where the tyranny of distance impacts regional NSW. For example, a centrally managed utility is not necessarily more efficient in terms of workforce numbers, or infrastructure. A notable minor benefit of a centrally managed utility may be access to specialist skills to properly manage the risks any LWU will face, however there are potentially other procurement models for accessing specialist skills for small utilities that should be considered.

Some may infer that the report's emphasis on economies of scale is suggesting that corporatisation and aggregation of LWUs is required to improve the financial and operational performance of the sector. This is not supported by the analysis presented in the report and is strongly refuted by LGNSW. Council ownership also provides economies of scale through the sharing of resources, including skills and operational services. It also helps provide critical mass for councils and LWUs – an important factor in rural and regional areas. LGNSW does advocate LWU Alliance models to promote resource and skills sharing as well as strategic planning at a regional level through Joint Organisations or other arrangements.

LGNSW agrees with the Water Directorate that the scope of operations is a key factor, particularly where an LWU shares a dam on a regulated system owned/operated by WaterNSW in comparison to LWUs which own their dams and other headworks. Economies of scope can also be achieved where an LWU operates both water supply and sewerage services, as against one or the other.

Water security in two-thirds of LWUs is an externality where they depend on state-owned dams. The Water Directorate has articulated the "need to look at the individual operating context or reviewing water security scores against WaterNSW assets" to develop a more informed understanding of each LWU.

LGNSW supports commentary by the Water Directorate and Graham Kennett that the task in front of government and industry is to determine the most equitable way to measure disadvantage, so that any available funding can be distributed on the basis of horizontal fiscal equalisation. This situation is not unfamiliar for government.

There is a similar objective to the federal Financial Assistance Grants (FAGs), which are paid to councils across the country based on an agreed set of national principles, and the specific formula developed by each state's Local Government Grants Commission. The formula and the inputs used, are all very transparent and readily available for review.

LGNSW recommends the FAGs allocation model be referred to in developing a funding distribution model for LWUs. It is acknowledged that the FAGs model is designed for untied grants, not delivering specific infrastructure and services, so a suitable model for LWU grants would need to include other criteria such as risk.

It is unclear how Frontier Economics has come to the following conclusions:

1. 'Major' and 'Small' utilities have the largest number of unplanned supply interruptions,
2. Revenue per customer is higher in more socioeconomically disadvantaged areas, and
3. Small utilities have higher Net Profit After Tax (NPAT) per connection.

LGNSW requests a further explanation on how Frontier Economics has come to these conclusions, as the findings would appear counterintuitive. The latter dispels the notion of economies of scale. As noted by the Water Directorate, some of the conclusions "need ground truthing" – that is, to be validated as they may appear anomalous.

I thank you and Frontier Economics for leading this complex task. LGNSW would be pleased to further engage in the process. If you have any questions regarding the feedback, please contact Patrick Lee, Senior Government Relations and Policy Officer on (02) 9242 4073 or patrick.lee@lqnsw.org.au.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Damian Thomas', with a wavy line extending to the right.

Damian Thomas
Director Advocacy