RIVERINA EASTERN REGIONAL ORGANISATION OF COUNCILS

Response

Productivity Commission's

Draft Report

Australia's Urban Water Sector

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Response to the Productivity Commission's

Draft Report into Australia's Urban Water Sector

This submission is prepared on behalf of the Riverina Eastern Regional Organisation of Councils ("REROC") in response to the Draft Report into Australia's Urban Water Sector ("the Draft Report") issued by the Productivity Commission.

REROC is a strategic alliance of 13 General Purpose councils and two water county councils located in the eastern Riverina region of NSW. The members of REROC are the councils of Bland, Coolamon, Cootamundra, Corowa, Greater Hume, Gundagai, Junee, Lockhart, Temora, Tumbarumba, Tumut, Urana, Wagga Wagga, Goldenfields Water County Council and Riverina Water County Council.

The REROC region covers an area in excess of 43,000 sq kms and a population base of approximately 140,000 people. The regional profile for the delivery of water and sewer services is detailed in Appendix A.

REROC has previously prepared responses to the NSW State Government inquiry into Local Water Utilities and Infrastructure Australia's recent Review of Regional Water Quality and Security the views presented in this paper are consistent with the views expressed in previous inquiries.

It is REROC's strong belief that the responsibility for the management and operation of water and waste water should be retained by local government. Local government is best placed to manage and deliver these services particularly in states such as NSW which have small populations dispersed over large geographic areas.

The major thrust of our response therefore is around the recommendations and comments made within Chapter 13 of the Report, Reform in Regional Areas.

1) ***Economies of scale and scope can be achieved through resource sharing and embedded service delivery***

REROC believes that the Report fails to recognise the economies of scale that are already being achieved in rural and regional areas as a result of embedding water and sewerage operations within existing council structures and functions. Of the 105 Local Water Utilities ("LWU") operating in NSW, five exercise their functions under the *Water Management Act 2000* (NSW) and five are county councils. The other 95 LWUs operate as embedded services within NSW general purpose councils.

It is of concern that the Commission appears to treat water and sewerage services in NSW as stand-alone utilities (in fact the Commission refers to them as such on pg 397 of the Report). In NSW stand-alone utilities are the exception and not the rule.

Water and sewerage services that are embedded within general purpose councils benefit from actively sharing:

- Senior staff (including a general manager);
- Technical staff particularly engineering and environmental staff;
- HR functions including HR administrative functions and staff resources;
- Payroll administration and staffing;
- IT platforms and IT support staff;
- Financial management platforms and financial and accounting staff;
- Revenue and billing services including debt collection;
- Procurement services;
- Customer service personnel;
- Administrative support staff;
- Governance and internal audit functions;
- Media and communications staff and functionality;
- Heavy machinery particularly in the provision of emergency servicing;
- Office space and the overheads associated with the maintenance of office space;
- Depots and storage space; and
- Fleet services.

All the above personnel, assets and infrastructure and functions would have to be established by any new water and sewerage entity, regardless of whether it is a GTE or a corporate entity. REROC notes that the costs of establishing entirely new operations from scratch and adequately staffing them has not been addressed by the Report.

It is of concern that the Report appears to focus only on technical staffing requirements relating to water and sewerage services and fails to consider all the other assets, staffing and operational needs that a viable and accountable enterprise must have in place. For example, based on REROC's recent experience an accounting system capable of meeting the needs of an aggregated entity is likely to cost in excess of $1million.

When water and sewerage operations are embedded in a council they benefit directly from a council's investment in its financial infrastructure and while the water and sewerage operations may have made some contribution towards the purchase and installation of the system it will have not met the entire cost. This will not be the case in the proposals under consideration by the Commission.

The Commission has used the Tasmanian reform model as one where horizontal aggregation of utilities has been effective, achieving the types of economies of scale that the Commission advocates. However our members note that when reform occurred in Tasmania, it necessitated the establishment of a Common Services Corporation, now trading as Onstream, to provide corporate services to the new Regional Water and Sewerage Corporations. Onstream provides the following services, which are paid for by the new Corporations:

- IT services
- Procurement services;
- Revenue and billing;

- Financial and accounting services
- Payroll and HR services; and
- Secretariat services (governance); and
- Assistance to the corporations with statewide stakeholder relations initiatives.

According to Onstream's most recent Annual Report the three new corporations paid Onstream $15.5 million in 2009/10 for the provision of these services. Onstream expended $6 million on employees and related expenses and over $8 million was spent on administration including funding two offices, one in Launceston and one in Hobart. The services which the Corporations are now paying for are services which would have originally been embedded within the councils that had previously owned the water and sewerage operations.

It is of serious concern to our members, given the Commission's strong support for full-cost recovery pricing that the resource sharing arrangements from which water and sewerage currently benefit will be lost if aggregated utilities are introduced with the shortfall being made up through higher water prices. If this is the case, then consumers will end up paying more for the product, to compensate for the loss of resource sharing, without actually obtaining any real benefits. We note that in the Tasmanian case, consumers with Cradle Mountain Water are contributing $74.00 per household per year towards the costs of Onstream's operations.

In order to properly assess the benefits of aggregating the sector, the Commission should have costed the losses that would result in withdrawing from the current embedded operations and losing the resource sharing activities that support those operations. The Commission has the Tasmanian model as a basis for determining whether or not consumers are now paying more per household for the provision of corporate services functions that were provided under the previous regime through embedded service delivery within individual councils.

REROC notes the Commission's comment that it is:

> *"...not convinced that the financial sustainability of councils is necessarily dependent on the net or gross income from water and wastewater services."* (pg. 404)

This comment fails to recognise that the financial sustainability of water and sewerage services in rural and regional areas may be dependent on the resource sharing that occurs with general purpose councils. If the cost of providing just the corporate services for the Tasmanian model is in excess of $15 million per annum then our members are very concerned about what the costs are likely to be for an aggregated service delivery in NSW. These costs will ultimately be passed to consumers.

REROC understands that under the Tasmanian reforms, water charges were set to substantially increase, however the Tasmanian Government capped the increases to 5% per annum and as a result is now providing a subsidy directly to the Corporations to make up the shortfall created by the cap. It was reported in *The Mercury* on 20 May, 2011 that the subsidy is costing the Tasmanian Government $31.5 million a year.

2) Economies of scale and scope that are being achieved through participation in existing local government collaborative arrangements

Local government in NSW has embraced the formation of strategic alliances and regional organisations of councils. These types of arrangements allow councils to create economies of scale and scope creating opportunities to operate more efficiently and effectively.

Water and sewerage services operated by councils also access these resource sharing and collaborative arrangements allowing them to achieve many of the benefits identified by the Commission as emanating from the proposed horizontal integration of water utilities. For example REROC has, for the last 13 years, facilitated tenders for the supply of bulk electricity to our member councils, including the county councils. Our most recent tender concluded this month involved some 80 sites, including pumping stations, office buildings, sewerage treatment works and streetlighting, The contract valued at almost $8 million resulted in prices that were lower than was available through State Government Contract pricing.

REROC also facilitates the bulk purchase of liquid alum for all our water supply councils; again bulk purchasing has resulted in significant savings for the individual member councils. We have been facilitating this contract for almost 10 years. All REROC's procurement services are provided to member councils as part of their annual REROC membership fee. REROC's total annual income derived through membership fees is $207,000 per annum, which demonstrates the efficiency with which this type of servicing can be delivered to members.

REROC has also been successful in accessing substantial funding for water savings and water quality projects. Currently the organisation is managing almost $2 million in funding from the NSW Environmental Trust to deliver 25 projects in water conservation, water harvesting, water quality, improved environmental flows and salinity. In addition the Organisation received $1.6million from Strengthening Basin Communities to fund a number of planning activities that respond to a world with less water.

Water and sewerage operations across the REROC region are benefitting from resource sharing activities undertaken under the REROC umbrella. The Commission's Report has not identified the savings and efficiencies that are obtained through these activities nor has it quantified the potential losses arising from the new regional water authority's inability to access these resource sharing opportunities.

Again we note that it is costing Tasmanian councils $15 million a year to maintain Onstream, which is achieving some of the same outcomes as resource sharing achieves through regional alliances and embedded service delivery.

3) Reform the governance structure of regional water utilities in NSW

The Report states that its preferred reform model is the creation of Regional Water Corporations governed by an independent Board. This echoes recommendations contained in the recent Infrastructure Australia report.

One of the reasons given for the larger corporate structure is that it is likely to give rise to increased efficiency. There is no evidence to support this conclusion and indeed the recent spate of council amalgamations in NSW would provide ample evidence that the creation of bigger entities does not automatically increase efficiency, particularly where the entity covers a large geographic area.

NSW is a large state with a dispersed population base. Service delivery is always going to be governed by the tyranny of distance. Water services in particular, as the Report points out, require constant monitoring for quality. Our members wonder how this is better achieved by a large organisation than a smaller one, particularly when the small organisation is located close to the water source and treatment works from which the service originates.

The use of the Victorian and Tasmanian examples for regional water corporations is flawed. These states are significantly smaller than NSW and the populations of both are more concentrated. It is inappropriate to take a model that works in such small locations and transfer it to any other state in Australia. As stated above in the Tasmanian instance the creation of the new corporations has resulted in the formation of OnStream which is costing the new corporations over $15 million a year.

We note that the Commission has commented that the county council structure has merit. Therefore it is concerning to see that where the Commission's Information Request on page 415 is in terms of whether a regional water corporation should be structured as a GTE or a corporation under the Co*rporations Act 2001* (Cth). There is no mention of the county council structure.

Further, the Commission states on page 425 that the corporate structure is preferred to the county council model however the Report provides only scant information as to why this is so. An assumption that the current county council boards are without skills and do not have a commercial imperative appears to underpin this decision. We would argue that county councils are governed by a board of independent members representing water users from within their respective local government areas, with a prime objective of delivering efficient and effective water management to those areas. They have senior management teams comprising water professionals; they are required to report to the relevant government Ministers as prescribed by the *Local Government Act 1993* and comply with licence conditions.

The County Council structure does give rise to increased efficiency while retaining 'ownership' within the serviced communities. While it is recognised that the delivery of dividends by the county councils is not a regular occurrence this is generally reflective of decisions by the Boards to minimise profit generation in order to keep the cost to consumers of an essential service as low as possible. Again we note that in Tasmania the new corporations are generating dividends to the member councils however in order to deliver those dividends the cost of the product has risen and the Tasmanian Government has had to provide an annual subsidy in excess of $30 million.

The structure provides a viable alternative to the GTE or corporation's structures proposed by the Commission. It is a structure that has worked very well in NSW and is therefore worthy of better consideration by the Commission.

4) *Best practice and cost reflective pricing are already in place in NSW*

The Commission makes the following all encompassing statement (pg 369):

> *...utility compliance with a range of public health and environmental regulations and performance against best practice principles and customer service standards are generally lower in regional areas*

The statement ignores the fact that in NSW water utilities in regional areas are required to operate under a Best Practice Management Framework. *The Best Practice Management of Water Supply and Sewerage Guidelines* released in 2004 and updated in 2007, provides a high quality and consistent planning framework for regional utilities.

The majority of regional water utilities in NSW already substantially comply with the requirements contained within these documents and where compliance has not yet been fully achieved are progressing towards full compliance.

We note that the Commission comments that 12 (of the 105) water utilities operating in NSW in 2008-09 failed to comply with the Australian Drinking Water Guidelines. Reporting of non-compliance is mandatory in NSW but we understand not in all other Australian states. We are very concerned that NSW's strong regulatory regime is being used to depict the State's water utilities in a poor light rather than to emphasise the importance of strong regulation regardless of structure. A feature which the Commission has recommended on page 370 of the Report.

In addition the Commission comments (pg 369) that "regional water utilities do not fully recover costs" and asserts (pg 379) that "it is vital that utilities achieve genuine cost recovery over the lifecycle of capital assets".

We also note the inherent conflict between reducing water use (an environmental and climate change imperative) and achieving full cost recovery. A community that is achieving high water efficiency outcomes can easily find that a direct consequence of its water efficiency is that householders and businesses are paying more for a unit of water so that the utility can continue to earn the same amount of revenue. Every drop of water counts because each drop that is saved represents lost revenue to the water utility.

This has certainly been the case in NSW where the Government has instituted a number of environmental programs over the last 5 years aimed at reducing carbon emissions through reduced energy consumption. However, as a result of recent price increases approved by IPART and the AEC, householders and small businesses that have substantially reduced their energy use are now finding that they are paying more per unit of energy so that the utility can raise the revenue it needs to fund infrastructure upgrades. In one case known to REROC a householder travelled overseas for a billing period and returned home to find an electricity bill which was larger than the one he had received for the corresponding billing period in the previous year, when the home was occupied for the entire period.

Reducing water use and achieving full cost recovery work against each other. The Commission cannot make recommendations in relation to pricing without considering the bigger environmental and regulatory settings in which water utilities operate. In regional and rural areas this picture must also include falling population, regardless of the size of a utility provider, falling population will drive up the per household cost of a unit of water.

In NSW the *Best Practice Pricing Guidelines* were released in 2002 which fully conform with NSW IPART requirements and provide a sound basis for water pricing. As a consequence of the Guidelines, all NSW regional water utilities are required to have in place a Best Practice Pricing Policy, however this is not considered in the Report.

REROC does not support price setting by a third party for example IPART. Local Water Utilities have a strong understanding of the needs of the communities they serve and the values that they place on water and water use. This together with the level of asset planning they are required to undertake in NSW and the requirement to meet Best Practice Guidelines means that NSW Local Water Utilities are best placed to set their own prices.

Water is an essential service which must be affordable to all Australians regardless of where they live.

5) ***The skills shortages in the water industry are reflective of the labour market generally in rural and regional communities***

The current skills shortage being experienced across Australia is set to worsen as baby boomers leave the workforce in greater numbers than the Y generation enters it. REROC notes that recent projections released by demographer, Bernard Salt, (The Australian, 28/5/2011) indicate that over the four years to 2015, 3,000 Y generationers will enter the workforce while 33,000 baby boomers will turn 65 and commence exiting it. This represents a potential deficit of 30,000 workers, with boomers exiting at a faster rate than Ys are entering the productive stage in the life cycle.

Every level of Australian enterprise, both public and private, are experiencing skills shortages, not just the infrastructure industries as suggested by the Report (pg. 383). The Federal Budget released in May specifically addressed the problem of labour shortages in regional areas by increasing the number of regional skilled migration places by 16,000 for the 2011-12 year.

In considering the labour shortage problem the Commission comments (pg.387)

> *"...it is expected that structural reform (aggregation) will provide utilities with greater scope to share resources, thereby reducing total demand for skilled labour via workforce rationalisation."*

The aggregation of regional water utilities will not solve the problem of skills shortages and it is unrealistic to suggest that it can. Local governments in rural and regional locations already share resources; however this can only lead to a marginal reduction in workforce. The maintenance and operation of water and sewerage infrastructure requires *insitu* staffing, it is work that cannot be undertaken remotely. Therefore whatever the structure of the water utility and whatever its size, it will still need to find qualified staff to work at its Sewerage Treatment and Water Treatment plants whether they are located in Wilcannia, Wagga Wagga or Sydney.

This is one of the lessons learned by the aggregated electricity supply companies in NSW. In the mid 1990s the State Government initiated aggregation of electricity supply companies, which resulted in the formation of large State-owned corporations. What followed were significant workforce rationalisations. The rationalisations were undertaken because it was assumed that aggregation meant that less staff would be required to deliver energy services.

This assumption was wrong, at least for rural and regional communities, the energy provider servicing the regions found that rationalisation resulted in highly skilled staff spending unproductive time travelling to and from work sites, in order to provide basic service and maintenance. Over the last 10 years, service depots that were closed have reopened and additional staff have been recruited to support a decentralised service and maintenance regime which is the most efficient way to deliver outcomes across large geographic areas.

REROC does not support the Commission's comment (pg 387) that "aggregated utilities may be more effective in attracting and retaining staff..." Many of the staff working in water and sewerage operations within local government are attracted to councils because of the diversity of work available. Senior engineers for example know that when they join a council in a regional area that they will be engaged in road and bridge building, major infrastructure construction and upgrades as well as the delivery of water and sewerage services. Most do not want to be pigeon-holed into a single operational area as they perceive it to be a narrowing of their career options.

All NSW councils, including County Councils are required, as part of the NSW Division of Local Government's Integrated Planning and Reporting regime, to undertake workforce planning. This process includes career planning and training; this is an integral part of ensuring that staff are attracted and retained within the local government environment.

In addition, local government employees in NSW are permitted to carry their entitlements from council to council which provides them with the career development advantages of much larger organisations. Local government staff can chase career development opportunities across the State without losing their Long Service Leave or Annual Leave entitlements. This arrangement encourages staff to stay within the sector while developing their professional skills in a range of working environments.

REROC supports the increase of training opportunities for all staff working in rural and regional locations. It is often the tyranny of distance that makes access to training difficult in regional areas. Our members would support the introduction of funding to assist accredited training providers to develop more flexible delivery options, which would allow workers who operate in rural and remote locations to access first-rate training.

6) *Aggregation will not necessarily lead to improvements in Asset Management*

The Commission states (pg 399):

> *"To the extent that regional water utilities do realise economies of scale efficiencies following aggregation, the consequent improvement in the financial position of these businesses will provide utilities with greater capacity to invest in water system infrastructure"*

REROC does not agree with this statement. As stated above regional water utilities are already realising economy of scale efficiencies as a result of embedded service delivery and strategic collaborations. It is clear from the Tasmanian example that aggregation does not automatically lead to a improved financial positions; the substantial increases in the price of water that have been introduced together with the subsidies from the Tasmanian Government are evidence of this.

In NSW all income derived from water and sewerage operations are “ring fenced”. As a consequence the income earned from those operations can only be expended on furthering the delivery of those services. The pricing of the services are not affected by rate-pegging and therefore councils are able to set prices in line with their asset management and infrastructure requirements while taking into consideration the community’s capacity to pay.

All NSW councils are required by the Division of Local Government to prepare asset management plans as well as financial plans for future asset expenditures. NSW councils are also required to comply with Australian Accounting Standards in relation to their reporting on all assets. NSW councils are currently responsible for billions of dollars worth of assets, not just water and sewerage but roads, bridges, civic offices, libraries, swimming pools, museums, art galleries, footpaths, lighting, parks, gardens and sporting fields to name just a sample. The high level of expertise that is devoted to the management of these assets is shared across water and sewerage operations, it is difficult to see how aggregation will improve on the current regime.

Conclusion

REROC agrees with the Commission’s conclusion (pg. 391) that *“regional water utilities face a range of complex, economic, demographic and geographic challenges and that there is no one size fits all solution.”*

However, despite this statement the Commission appears to embrace a single solution; “horizontal aggregation”. Before the Commission commits to this stance REROC encourages it to fully consider the advantages that are already being derived through the resource sharing and economies of scale that are being achieved as a result of embedded service delivery and collaborative arrangements (particularly in procurement and staff sharing) between local government entities.

We believe it is a serious flaw within the Report that while it has embraced the resource sharing outcomes that may arise from aggregation it has ignored the resource sharing outcomes that the sector is already benefiting from through embedded service delivery and cross-council collaborations. We strongly recommend that the Commission cost what the loss of these benefits would be to the sector before it makes any final recommendations in relation to structural reforms.

REROC does not deny that the sector faces significant challenges, however the development of a one-size-fits all approach to the delivery of water services in Australia will inevitably result in inefficient and ineffective outcomes.

What works in Tasmania cannot realistically be expected to work in NSW. Tasmania is only 68,331 sq kilometres in size with a population of 504,000 while the REROC region is 60% the size of Tasmania or 43,000 sq kilometres in size with a population of 145,000. The distances, the population base and spread as well as the water management regimes are so completely different as to make models such as those found in Tasmania and Victoria impracticable and some could argue irrelevant.

Nevertheless REROC councils recognise that t is important to continuously review operations to ensure that services are being delivered to ratepayers at the most efficient and effective manner. To this end the REROC members will be further discussing reform options for the water and waste water sector at a Forum to be held in Wagga Wagga on 26 July 2011. The purpose of the Forum is to explore deliver models for water and waste water and where agreed seek to implement reforms that will improve service delivery and quality outcomes.

The REROC members would welcome the opportunity to discuss any of the issues we have raised with members of Infrastructure Australia.

Appendix A

Profile of Water and Waste Water Service Delivery in the REROC region

Riverina Water – a county council for the construction, operation and maintenance of works of water supply within areas of Wagga Wagga, Lockhart, Urana and parts of Greater Hume Shire;

Goldenfields Water – a county council for the construction, operation and maintenance of works of water supply, retails water to Temora, Coolamon, Junee and Bland Shires and parts of Cootamundra and Narrandera Shires; it also wholesales water to Cootamundra, Young and Harden Shires;

Cootamundra Shire – retails water to the Cootamundra urban area and provides sewerage services for the entire Shire. It also runs an effluent reuse scheme;

Gundagai Shire – retails water to the Gundagai Shire, provides sewerage services and operates an effluent reuse scheme;

Tumbarumba Shire – retails water to the Tumbarumba Shire and provides sewerage services;

Tumut Shire – retails water to the Tumut Shire, provides sewerage services and operates an effluent reuse scheme;

Corowa Shire - retails water to the Corowa Shire, provides sewerage services and operates an effluent reuse scheme;

Greater Hume Shire – retails water to parts of the Shire and provides sewerage services for the entire Shire;

Bland Shire – provides sewerage services to the Shire;

Temora Shire – provides sewerage services to the Shire and operates an effluent reuse scheme;

Junee Shire – provides sewerage services to the Shire and operates an effluent reuse scheme;

Coolamon Shire – provides sewerage services to the Shire and operates an effluent reuse scheme;

Lockhart Shire – provides sewerage services to the Shire;

Urana Shire – provides sewerage services to the Shire;

Wagga Wagga – provides sewerage services to the City and operates an effluent reuse scheme.