

NSW Government response to the recommendations of the NSW Productivity and Equality Commission's Review of Funding Models for Local Water Utilities.

August 2025



Acknowledgement of Country

Department of Climate Change, Energy, the Environment and Water acknowledges the traditional custodians of the land and pays respect to Elders past, present and future.

We recognise Australian Aboriginal and Torres Strait Islander peoples' unique cultural and spiritual relationships to place and their rich contribution to society.

Artist and designer Nikita Ridgeway from Aboriginal design agency – Boss Lady Creative Designs, created the People and Community symbol.

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Image 1 Aerial view of a water treatment plant in Finley, NSW.

Executive Summary

This attachment sets out the NSW Government response to the recommendations of the NSW Productivity and Equality Commission's (the "PEC's") *Review of Funding Models for Local Water Utilities*.

The NSW Productivity and Equality Commission (the "PEC") provided the final report of its *Review of Funding Models for Local Water Utilities* to the NSW Government in July 2024. The PEC recommends significant changes to how local water utilities ("LWUs") are funded, as well as associated improvements to regulation and strategic planning.

The NSW Government's response to the PEC's recommendations has been informed by consultation and engagement with the LWU sector.

The NSW Government:

- Supports in principle adopting the PEC's funding principles for LWU funding, including effective targeting of funding to need, long-term predictability and stability of funding streams, and linking funding to measurable performance improvements. These principles will be used to develop a recommended LWU Investment Framework to strategically approach funding and support needs of the LWU sector.
- Notes and will consider further a shift from project-based capital funding to a CSO-type funding mechanism to support delivery of basic levels of service for LWUs, subject to financial decision making and further consideration of its design as well as consultation with the sector.
- Supports in principle improving the setting, and applying of efficient minimum regulatory standards (for water quality, water security, and environmental impacts) to enable the setting of effective and efficient basic levels of service and the identification of optimal solutions to deliver them.
- Support for the recommended review of government funded customer affordability support schemes, including pensioner rebates, with the aim of addressing social welfare needs and support utilities' ability to raise revenue from customers.
- Support for a continued reform approach for Western NSW, including co-designing a pilot program with willing Western NSW councils to explore how structural approaches preferred by LWUs can achieve expenditure efficiencies, optimise revenue raising, and test funding reforms.
- Reiterates its commitment to not forcibly amalgamate councils' local water utilities, as set out in the NSW Government response to the recommendations of the NSW Parliament's Joint Select Committee on Protecting LWUs from Privatisation.

The NSW Government will continue to develop funding and other reforms of the sector during a 2-year policy design phase, including engagement with the LWU sector and across the NSW Government.

A summary of the NSW Government's response to each recommendation is set out in Table 1 below.

Table 1 Summary of NSW Government responses to PEC recommendations

Recommendation from the PEC report	Response
Recommendation 1: Assess the design of any future funding approach against LWU funding principles identified by the PEC.	Support in principle
Recommendation 2: Use the LWU funding principles to review Safe and Secure Water Program funding that has been earmarked but not formally allocated.	Noted. A review of SSWP funding allocation is not possible as SSWP funding is fully allocated.
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.	Support
Recommendation 4: Develop a LWU Investment Framework to ensure funding to LWU sector is well targeted and minimises overall cost to NSW Government.	Support in principle
Recommendation 5: Prepare a draft LWU Funding Policy, with release for sector consultation prior to finalisation.	Support in principle
Recommendation 6: Work with LWUs and other NSW Government agencies to develop a Sector Priorities Plan.	Support in principle
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.	Support in principle
Recommendation 8: Introduce a CSO payment mechanism as a new funding approach for the sector.	Noted
Recommendation 9: Develop a CSO Policy as part of the LWU Funding Policy in consultation with the sector over the next 12 months.	Noted
Recommendation 10: Provide a report to the NSW Productivity & Equality Commissioner on the implementation of the CSO policy after 12 and 24 months.	Noted

Recommendation from the PEC report	Response
Recommendation 11: Ensure that implementation of minimum standards across the sector is efficient.	Support in principle
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 LG Act approval processes.	Support in principle
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.	Support in principle
Recommendation 14: Develop a voluntary customer retail service standard for LWUs.	Support in principle
Recommendation 15: Develop and adopt a Basic Level of Service description under its LWU Funding Policy in consultation with the LWU sector.	Support in principle
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.	Support
Recommendation 17: Develop a Strategic Business Case for CSO funding to Western NSW LWUs based on the output of the reform process.	Support
Recommendation 18: Evaluate pensioner rebates on all water services before the 2025-26 Budget.	Support in principle
Recommendation 19: Fund any targeted concessions/rebates deemed necessary in the LWU sector via a transparent CSO.	Support in principle
Recommendation 20: Develop a service level agreement with the Office of Local Government where a CSO is paid to all LWUs to support rebates/concessions to address hardship pressures.	Support in principle
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.	Support in principle

Background

In November 2023, the Minister for Water requested the PEC investigate alternative funding models for LWUs.

The NSW Government had identified the need for a comprehensive review of government funding for LWUs in phase 1 of the Town Water Risk Reduction Program (the “TWRRP”). The TWRRP's findings highlighted the need to explore alternative funding models to enhance the effectiveness and efficiency of government funding programs and strengthen the capacity of LWUs in delivering water supply and wastewater services to their communities.

The PEC conducted its review in response to terms of reference provided by the Minister for Water, focusing on identifying sustainable, efficient, and equitable approaches to reforming NSW Government funding for LWUs. The PEC delivered its final report, *Review of Funding Models for Local Water Utilities* to the Minister for Water on 19 July 2024. The Minister released it publicly on 24 July 2024.

The PEC identifies the need to reform the NSW Government’s funding approach of the LWU sector to better target and meet the needs of the sector, noting that LWUs are council-owned businesses and their management and financial sustainability rests squarely with local councils.

The PEC proposes significant changes to how LWUs are funded and associated improvements to regulation and strategic planning, which include:

- Adopting funding principles to guide future NSW Government funding and ensure consistency, targeting, and alignment with government objectives, providing a stable and predictable foundation for funding to the LWU sector.
- Developing a LWU Investment Framework comprised of a LWU Funding Policy and Sector Priorities Plan.
 - The LWU Funding Policy would set funding pathways for the LWU sector, including a Community Service Obligation (CSO) funding mechanism, funded by the NSW Government, to support delivery of basic levels of service (BLoS) for LWUs that cannot recover their efficient expenditure needs to deliver BLoS from revenue that can reasonably be raised from its customers (based on their ability to pay), developers or other own source revenue. The CSO funding mechanism would:
 - Replace the current project-based capital funding approach.
 - Cover the total cost of services; that is, capital and operational expenditure needs.
 - Use a CSO service level agreement (SLA) with individual LWUs to provide long-term stability and predictability of funding, set performance requirements, and detail the process for continual re-assessment of the funding gap and apply relevant modifications to CSO payments if LWUs access funding from additional funding pathways.

- Provide LWUs discretion on using funding efficiently on capital and operational expenditures, subject to a CSO SLA.
 - The Sector Priorities Plan would set out the NSW Government’s funding priorities for the LWU sector over the short to medium term (1 to 4 years) based on well-coordinated strategic planning across LWUs, regional and state levels.
- Making improvements to regulatory standards and processes and to strategic planning requirements and coordination to facilitate the setting of efficient BLoS and identify optimal solutions to deliver them.
- Reviewing the delivery and structural models for water supply and wastewater service provision in Western NSW.
- Reviewing support schemes to address customer affordability, hardship and financial emergencies, including current pensioner rebates in regional and metropolitan areas, with a view to establish targeted schemes that are fully funded by government.

The NSW Government’s response to the PEC’s recommendations has been informed by consultation and engagement with the LWU sector on the PEC’s recommendation through a discussion paper and targeted workshops during October to December 2024. We received 16 submissions from a wide cross section of the LWU sector and held 10 targeted workshops with key sector stakeholders. Targeted engagement has been undertaken in relation to the PEC’s findings and recommendations on Western NSW LWUs (Chapter 9) which are being progressed by the department as part of a separate process that has included 20 western NSW LWUs, and their representative bodies¹.

In addition, an agency reference panel supported the development of the response. The panel included the Department of Climate Change, Energy, the Environment and Water’s Water Group, NSW Health, the NSW Environment Protection Authority, NSW Treasury, the Office of Local Government, and the NSW Cabinet Office.

The NSW Government thanks all stakeholders involved for their contribution to the development of the response.

¹ Balranald, Bogan, Bourke, Brewarrina, Carrathool, Central Darling, Cobar, Coonamble, Hay, Lachlan, Moree Plains, Narrabri, Walgett, Warren, Warrumbungle and Wentworth Shire councils, as well as the NSW Water Directorate, Local Government NSW, the Western Councils Water Alliance, and Central NSW Joint Organisation of Councils Water Alliance.

Response to PEC Report (Recommendation Chapters)

The NSW Government's response covers the PEC's recommendations set out in chapters 5 to 10 of the PEC's final report. Below, we respond to the PEC's suggestions in each of these chapters and the specific recommendations contained in them.

The first 4 chapters of the PEC's final report provide an overview of the LWU sector landscape, findings on its performance, funding, and sustainability, and the impact that future challenges will have on the sector. They do not include recommendations and so are not covered by the NSW Government response. However, we recognise the relevance of findings reported in these chapters to inform the recommendations in the following chapters (5-10).

1.1 The role of NSW Government and its funding - Proposed Funding Principles for the LWU sector

Chapter 5 of the PEC's final report sets out the challenges and issues with the NSW Government's current funding approaches for LWUs. It notes the significant role of NSW Government grants in funding LWUs expenses, highlighting that, despite progress, the focus on capital grants has created perverse incentives that undermine effective and long-term strategic planning and decision-making. The PEC report further notes that many LWUs have capacity, and should seek, to increase their revenue from customers and developers (that is, own source revenue) prior to seeking government funding.

The PEC recommends the following set of guiding principles to apply to any future funding programs for LWUs by the NSW Government:

Principle 1: Alignment of funding program with explicit government objectives

Principle 2: Consistent treatment of LWUs in line with well-defined eligibility rules for funding

Principle 3: Targeted and transparent funding

Principle 4: A predictable and stable source of financial support

Principle 5: Funding linked to measurable performance improvements

Principle 6: Minimise administration costs where feasible



Image 2 A water tower in regional NSW.

1.2 NSW Government response

The NSW Government notes that LWU sector feedback during consultation was broadly supportive of the PEC recommendations in this chapter. In particular, feedback indicated that the proposed funding principles address concerns regarding a narrow capital funding focus and can foster effective strategic planning through long-term stability and predictability. Key concerns raised related to applicability and scope of the principles, which have informed this response as detailed in the What We Heard report.

The NSW Government supports in principle the proposed funding principles, noting:

- **Principle 1:** The government's primary objective for the LWU sector is to achieve basic levels of town water supply and sewerage services for NSW regional communities. Other government objectives may also be considered to ensure expenditure can be eligible for funding support (e.g., net zero commitments and housing objectives). These other objectives would be set out in the LWU funding policy and/or the Sector Priorities Plan.
- **Principle 2:** Eligibility rules will be further detailed under the LWU funding policy.

- **Principle 3:** Targeted funding means that funding:
 - Will focus on LWUs that cannot recover efficient capital and non-capital costs for the delivery of basic levels of service from their own revenue sources; that is from customers and developer charges. This mean that some LWUs that have historically received government funding might not receive any more funding if they are assessed as being able to raise the required revenue from customer and developers.
 - Will only cover expenditure that is efficient, that is, only expenditure that is necessary to deliver services at the required quality.
 - Needs to rely on strategic planning by LWUs that is effective, and on broader strategic planning for water management and urban water services that is well-coordinated across local, regional, and state levels, to ensure the most effective and efficient service delivery options are pursued, including those that may extend over multiple LWU's operational areas.
 - Can include funding streams that target broader sector needs that cannot effectively and efficiently be addressed through direct funding to individual LWUs.
 - Can include funding streams that directly target customers that are unable to pay for service due to affordability, welfare, or hardship difficulties.
- **Principle 4:** Funding models to achieve basic levels of service would need to provide long-term predictability and stability of funding for LWUs. Stable, long-term and predictable funding improves LWU strategic decision-making, risk management, and accountability resulting in more efficient strategic decisions and investments. This includes long-term funding certainty under individual funding agreements between the NSW Government and LWUs.
- **Principle 5:** Funding agreements would incorporate mechanism to monitor and compel performance, as much as possible relying on regulatory frameworks for LWUs.
- **Principle 6:** Funding arrangement would need to be as efficient as possible in their administration, including for funding recipients.

The NSW Government notes that a review of the funding under the Safe and Secure Water Program against these funding principles is not possible as funding under this program is already fully committed and allocated.

The funding principles will guide the development and evaluation of future NSW Government funding programs for the LWU sector, including the LWU Investment Framework proposed by the PEC.

1.3 Response to PEC recommendations

SUPPORT IN PRINCIPLE for recommendation 1: Assess the design of any future funding approach against LWU funding principles identified by the Commission.

NOTED for recommendation 2: Use the LWU funding principles to review Safe and Secure Water Program funding that has been earmarked but not formally allocated.

— Note the proposed review is not possible as SSWP funding is fully allocated.

2.1 Using a strategic approach to better target funding – A *LWU investment framework and funding policy*

Chapter 6 of the PEC’s final report proposes a LWU Investment Framework to guide long-term funding for LWUs. The Framework includes a LWU Funding Policy and a Sector Priorities Plan.

The LWU Funding Policy is to set the government’s whole-of-sector objectives, roles and responsibilities, the rationale for government funding, and a clear link between government funding and measurable performance improvements. The LWU Funding Policy also is to set possible funding pathways. In particular, it is to include a “CSO for BLoS”: a Community Service Obligation (CSO) funding mechanism targeted to help achieve basic levels of service (BLoS) by covering the funding gap between a LWU’s efficient expenditure needs to deliver BLoS and its ability to raise own source revenue from customers and developers. The CSO for BLoS would replace project-based capital grants funding (see section 3.1).

The Sector Priorities Plan is to detail the NSW Government’s funding priorities over a short to medium timeframe (1 to 4 years). Priorities are to be determined based on the challenges identified from the sector’s strategic planning, including themes such as water security, water quality, environmental impacts, climate change, and population growth.

The PEC notes that effective and coordinated strategic planning by LWUs and the NSW Government would be fundamental to informing LWU sector priorities and risks, relevant funding pathways and ensuring effective targeting of funding support. The report identifies key gaps in current practices, including lack of mandatory LWU strategic planning and integration across local, regional, and state plans (e.g., regional water strategies and NSW Water Strategy).

The PEC highlights that effective strategic planning by LWUs would be essential to support the CSO for BLoS as it provides key inputs to understanding a LWU’s efficient expenditure needs to deliver basic levels of service, its ability to raise own source revenue, and where it needs to make performance improvements.

2.2 NSW Government response

The NSW Government notes that LWU sector feedback during consultation was broadly supportive of the PEC recommendations in this chapter. In particular, feedback indicated support for the development of a LWU Investment Framework (and its related components) with a focus on improving the effectiveness of funding through a CSO funding mechanism, the importance of effective strategic planning and its coordination, and the use of a stocktake to inform the policy design of these 2 elements. Key concerns raised related to the objective in recommendation 4 to minimise cost to the NSW Government, clarity on additional funding pathways (in particular for sector-wide initiatives), challenges and impacts of making (the effectiveness of) strategic planning mandatory (particularly for low resourced LWUs), and the need to account for LWU’s varied and

unique contexts. This feedback has informed the NSW Government response as detailed in the What We Heard report.

The NSW Government supports in principle the development of a LWU Investment Framework with a LWU Funding Policy and Sectors Priorities Plan that are underpinned by the Funding Principles (see section 1.1).

The NSW Government notes and will consider further a shift from project-based capital funding to CSO-type funding as the main mechanism to address potential funding needs, and the introduction of a CSO for BLoS under the new LWU Funding Policy, to better target funding to the LWU sector, as per Funding Principle 3, and provide long-term predictability and stability of funding to LWUs, as per Funding Principle 4:

- Noting, as per Funding Principle 1, the main objective of introducing a CSO for BLoS would be to ensure the delivery of BLoS to regional NSW communities by funding the gap between a LWU's efficient expenditure needs to provide BLoS (including capital and operational expenditure) and the revenue that can be reasonably raised from customers and developers.
- Subject to financial decision making and further analysis during the policy design phase, including further consideration of:
 - The design of a CSO type funding mechanism in consultation with stakeholders, including by reviewing other CSO type funding mechanisms that could apply the funding principles and that may be administratively simpler and better aligned with LWU sector capabilities and NSW budget needs.
 - Outcomes of the review of customer affordability and hardship support schemes for vulnerable customers of water supply and sewerage services, including current pensioner rebates schemes (see section 6.2).
- Subject to the development of a package of parallel reforms to improve sector performance, efficiency, strategic planning, and own source revenue raising.

The NSW Government also notes and will consider further the development of proposed additional funding pathways, where identified problem and gaps warrant a different funding approach. This could include the following pathways:

1. *Sector-wide capability building pathway* to address systemic risks in the sector that could not effectively and efficiently be addressed by CSO for BLoS agreements with individual LWUs.
2. *Customer affordability and hardship support schemes funding pathway* – based on outcomes of the review of customer affordability and hardship support schemes - to reimburse the cost of such schemes provided by LWUs, including pensioner rebates and hardship schemes, noting that eligibility for such funding would not be dependent on LWU's ability to raise own source revenue.
3. *Restricted capital funding pathway*, for example, if NSW Government capital funding is deemed to be required (and is available) to enable the provision of capital funding through other government funding mechanisms. We note that there is no need for a specific capital funding stream for LWUs as capital expenditure needs to achieve BLoS would be eligible under a CSO for BLoS.

4. *Extraordinary circumstances pathway*, where emergent and unexpected strategic expenditure needs that could not reasonably have been strategically planned for (and therefore covered by a CSO for BLoS) are prioritised by the NSW Government under the Sector Priorities Plan (e.g., extreme natural disasters, PFAS).

The NSW Government supports in principle the development and use of a Sector Priorities Plan as an instrument to further detail the application of the funding pathways in accordance with the LWU Funding Policy, noting that the Sector Priorities Plan:

- Must not unreasonably negate Funding Principle 4, in particular the long-term stability and predictability of a CSO for BLoS.
- Is to focus on setting government objectives within a short to medium timeframe (1-4 years) and priorities are to be complementary to the primary objective of achieving BLoS across the LWU sector.
- Would be used to transparently set and prioritise funding for the complementary and limited funding pathways of the LWU Funding Policy.
- Would be used to transparently seek to manage any impacts resulting from NSW budget fluctuations and associated availability of funding from the NSW budget.

The NSW Government agrees that effective strategic planning, and coordination of broader strategic planning across local and state levels, plays a central role in identifying funding needs and ensuring stable, predictable, and targeted funding of the LWU sector. The NSW Government supports undertaking a stocktake of LWU strategic planning to identify barriers to the achievement of effective strategic planning by LWUs and for improved coordination of broader strategic planning across local and state levels. The stocktake will support the policy design of the LWU Investment Framework and LWU Funding Policy, as well as help identify priorities for the first Sector Priorities Plan. Note that, as set in the implementation plan, an initial limited stocktake will be undertaken focused on the Western NSW LWUs that opt-in to a co-design of pilot programs (see section 5.2). The initial stocktake will also be used to inform the subsequent sector-wide stocktake.

The NSW Government notes the importance of quality data and effective reporting processes to establish the funding envelope required for a CSO for BLoS, as well as the challenges some LWUs face to have adequate capacity and resources to collect and report data. Improvements to data collection and reporting will be included as part of the LWU Investment Framework, with the Sector Overview stocktake providing an initial assessment of needs and barriers.

The NSW Government supports in principle making effectiveness expectations for LWU strategic planning for water supply and sewerage services an explicit requirement for all LWUs in regional NSW, noting that a strategic planning framework for all council functions, including water supply and sewerage services, is already a mandatory function for councils under the *Local Government Act 1993's Integrated Planning & Reporting Framework* (the "IP&R Framework"). The effectiveness of strategic planning would be determined by LWUs meeting the expectations of section 3 of the *Regulatory and Assurance Framework for Local Water Utilities* (the "RAF"). The NSW Government acknowledges that there is currently a low level of compliance with existing regulatory expectation on the effectiveness of LWU strategic planning under section 3 of the RAF. The NSW Government

will consider how mandating the effectiveness of LWU strategic planning could best be achieved and supported, including through using the IP&R Framework and/or the *Local Government Act 1993*.

The NSW Government will consider and work with the LWU sector to put in place effective regulatory mechanisms, to be used instead of/prior to withdrawing funding under a CSO for BLoS, to ensure LWU strategic planning is effective, minimum regulatory standards for service levels (and associated basic levels of service) are achieved, and revenue raising from customers and developers is reasonable. This would allow the NSW Government to drive performance and improve service delivery in a more flexible manner and not only rely on the potentially counterproductive measure of withdrawing a CSO funding stream if performance is not achieved.

The NSW Government notes that LWUs would not be excluded from accessing a CSO for BLoS because of not having effective strategic planning in place. However, as a CSO for BLoS would cover expenditure that is required to put in place and maintain effective strategic planning, LWUs would be expected to have in place effective strategic planning as a performance requirement under their initial CSO service level agreement.

NSW Government agrees that providing services to currently not serviced communities needs to be considered in the LWU Investment Framework. This will be further developed during the policy design phase. The design will consider whether currently not serviced communities should be included into a CSO for BLoS or as a separate funding pathway, and consider equity, efficiency, and effectiveness of options.

NSW Government agrees to consider how discrete Aboriginal communities and Local Aboriginal Land Councils, currently supported by contracted service providers (either LWUs or contractors), should be included into the LWU Investment Framework, noting that lessons learned will be drawn from the successful Aboriginal Communities Water and Sewerage Program.

2.3 Response to PEC recommendations

SUPPORT for 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.

SUPPORT IN PRINCIPLE for recommendation 4: Develop a LWU Investment Framework to ensure funding to LWU sector is well targeted and minimises overall cost to NSW Government.

SUPPORT IN PRINCIPLE for recommendation 5: Prepare a draft LWU Funding Policy, with release for sector consultation prior to finalisation.

SUPPORT IN PRINCIPLE for recommendation 6: Work with LWUs and other NSW Government agencies to develop a Sector Priorities Plan.

SUPPORT IN PRINCIPLE for 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.



Image 3 Test point at water treatment plant in regional NSW.

3.1 Establishing CSO payments – *CSO funding pathway for LWUs*

Chapter 7 of the PEC report recommends CSO payments as the NSW Government's new main funding approach for LWUs (replacing project-based capital grant funding programs) and outlines the preliminary design of a CSO funding mechanism to help deliver basic levels of service (BLoS).

CSO payments would target support to LWUs that cannot recover the expenditure needs of efficiently delivering BLoS from the revenue that can reasonably be raised from their customers (considering ability to pay), developers, or other own source revenue. In principle, a CSO funding mechanism would cover the total expenditure needs of delivering services; that is, capital and non-capital (operational) expenditure needs.

The chapter sets out the process for assessing and administering CSO payments under the proposed CSO for BLoS (“the CSO policy” as per Recommendation 9). The proposed process would require:

- An on-going assessment of the LWU’s ability to fund delivery of basic service levels from customers and developers (“demonstrating a funding need”), based on their effective strategic planning.
- LWUs entering into a long-term CSO service level agreement with the NSW Government that would specify service levels, the ongoing CSO payments, and requirements to continue receiving CSO payments, including maximising revenue from other sources, engaging in regional collaboration, performance reporting, and meeting outcomes.

The PEC proposes a set of governance arrangements for evaluating LWUs’ requests for CSO payments, as well as the ongoing management of CSO service level agreements, such as through a CSO Working Group, CSO Specialist Adviser, and CSO Steering Committee.

3.2 NSW Government response

The NSW Government notes that LWU sector feedback during consultation showed strong support of the PEC recommendations in this chapter. Key concerns raised related to aspects of the CSO funding mechanism (e.g., scope of service level agreements and the impact of non-performance on funding) and limitations of current information systems to provide the data to operate the CSO funding mechanism. This feedback has informed the NSW Government response as detailed in the What We Heard report.

The NSW Government notes and will consider further the introduction of a CSO for BLoS, subject financial decision making, further analysis and parallel reforms as set out in section 2.2.

The NSW Government will consider the development of a CSO policy to detail the process for assessing and administering CSO payments under a CSO for BLoS (“the CSO policy” as per Recommendation 9), including the use of long-term service level agreements to provide stability and predictability of funding for individual LWUs and to manage performance, noting that:

- During the policy design phase, we will consider further the design of a CSO funding mechanism in consultation with the sector, including reviewing other CSO-type funding mechanisms that apply the funding principles and may be administratively simpler and better aligned with LWU sector capabilities and NSW budget requirements.
- CSO service level agreements would require an on-going reassessment of a LWUs funding gap, with CSO payments being adjusted, including if LWUs access funding from additional funding pathways (see section 2.2)

As per its implementation plan, the NSW Government will work with the LWU sector when considering a CSO policy and provide progress reports to the PEC.

3.3 Response to PEC recommendations

NOTED for recommendation 8: Introduce a CSO payment mechanism as a new funding approach for the sector.

NOTED for recommendation 9: Develop a CSO Policy as part of the LWU Funding Policy in consultation with the sector over the next 12 months.

NOTED for recommendation 10: Provide a report to the NSW Productivity & Equality Commissioner on the implementation of the CSO policy after 12 and 24 months.

4.1 Service levels and minimum service standards – *Setting basic levels of service for funding pathways*

Chapter 8 of the PEC report proposes to set BLoS that clearly communicate what the NSW Government considers an ‘adequate’ or ‘a minimum acceptable level of service’ it is prepared to fund. The PEC notes BLoS are a central element to the PEC’s proposed CSO funding mechanism as they would determine a LWU’s forecasted efficient expenditures. The PEC suggests that, depending on the service area, BLoS could be set or agreed on as part of individual CSO service level agreements that account for local circumstances and customer needs while ensuring effective and efficient regulatory outcomes.

The PEC suggests that existing minimum regulatory standards, subject to being efficient, should form the basis for determining BLoS. In particular, the PEC suggests:

- Drinking water quality and environmental impact minimum regulatory standards have a clear rationale for protecting human health and the environment and should be adopted as part of a BLoS, subject to them being efficient.
- Water security currently has very limited regulatory minimum standards. There are non-mandatory, outcomes-focused process expectations set out under section 3 of the RAF, but there are no customer focused service level expectations. A BLoS for water security should be set, based on clear service level objectives and acceptable levels of risks.
- A minimum regulatory standard for service reliability (e.g. interruptions and response times to them, water pressure) is not needed, but, where reliability is a key cost driver for a LWU, a reasonable level of reliability could be established at a local level with reference to relevant industry benchmarks.
- A sector-wide retail customer standard does not exist but could be established to set expectations on providing/delivering retail water and sewerage services.

The PEC identifies uncertainty as to the effectiveness and efficiency of existing regulatory minimum standards for drinking water quality, water security and environmental discharges. It found the potential cost implications of minimum regulatory standards are unknown.

The PEC suggests exploring reform of existing minimum regulatory standards and processes for drinking water quality, environmental discharges, and water security to ensure regulation is effective and efficient. This would enable the setting of effective and efficient basic levels of service and the identification of effective and efficient solutions to deliver them, including through the approval process under section 60 of the *Local Government Act 1993*.

4.2 NSW Government response

The NSW Government notes that LWU sector feedback during consultation was generally supportive of the PEC recommendations in this chapter, noting feedback that any setting of minimum regulatory standards and related BLoS should produce net benefits, account for local conditions, emerging issues, feasibility of implementation (in technical and cost criteria), and be informed through customer engagement. Further, there was general support for improving regulatory coordination and ensuring efficient regulatory requirements and processes. Key concerns raised related to the quality of information systems required for this approach, the need to further define clarity, scope, and applicability of minimum regulatory standards and related BLoS in NSW (including for communities not connected to a reticulated network), and cost implications. This feedback has informed the NSW Government response as detailed in the What We Heard report.

The NSW Government supports in principle:

- The setting of efficient minimum regulatory standards for water quality, water security, and environmental impacts.
- The setting of BLoS as key determinants of a CSO for BLoS, with BLoS based on, and in alignment with, minimum regulatory standards.

During the policy development phase, the LWU regulators – that is NSW Health, the NSW Environment Protection Authority and the Department of Climate Change, Energy, the Environment and Water – will jointly work on how to set regulatory objectives, approaches and minimum regulatory standards. This will include considering how to optimally review minimum regulatory standards.

We note the above process will be guided by the NSW Government's commitment in the NSW Water Strategy to ensure that every person in NSW has a right to expect access to safe drinking water for use at home and water security in their communities to sustain job creating businesses and healthy natural environments. This is particularly important for regional NSW, where economies are often built on water essential industries such as agriculture, food processing and manufacturing, resources and tourism.

The NSW Government's support in principle is also subject to further consideration in consultation with sector stakeholders and regulators during the policy design phase on:

- The design of a CSO funding mechanism in consultation with the sector, including reviewing other CSO-type funding mechanisms that could apply the funding principles and may be administratively simpler and better aligned with LWU sector capabilities and NSW budget needs (see above).

- How to design a framework of minimum regulatory standards that can be set and applied efficiently at both sector-wide and local levels, while ensuring net benefits for NSW and balancing regulatory objectives (including through the section 60 process as appropriate) by applying the Better Regulation Principles set out in the *NSW Government Guide to Better Regulation*.
 - How to design a framework of minimum regulatory standards that can account for potentially changing conditions (e.g., climate change impacts), different LWU business models (e.g., alliance models and stand-alone LWUs), and relevant water management and regional planning instruments (e.g., Water Sharing Plans).
 - How to consider expenditure needs for achieving service reliability in a CSO for BLoS with reference to relevant industry benchmarks in the absence of existing regulatory standards.
 - How to consider expenditure needs associated with any established customer retail charter in a CSO for BLoS, in the absence of regulatory standards, noting that our response related to the establishment of support schemes to address customer affordability and hardship is set out in section 6.2.
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4.3 Response to PEC recommendations

SUPPORT IN PRINCIPLE for recommendation 11: Ensure that implementation of minimum standards across the sector is efficient.

SUPPORT IN PRINCIPLE for 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 LG Act approval processes.

SUPPORT IN PRINCIPLE for 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.

SUPPORT IN PRINCIPLE for recommendation 14: Develop a voluntary customer retail service standard for LWUs.

SUPPORT IN PRINCIPLE for recommendation 15: Develop and adopt a Basic Level of Service description under its LWU Funding Policy in consultation with the LWU sector.



Image 4 An aerial view of Bourke in Western NSW. Image credit Destination NSW.

5.1 Provision of services in Western NSW – *Investigating effective institutional and support mechanisms for Western NSW*

Chapter 9 of the PEC report identifies the pressing need for action to address the unique challenges faced by LWUs in Western NSW, which are mostly very small and in remote areas, and service some of the most socio-economically disadvantaged communities in NSW. The PEC presents the current state of service delivery and funding for 16 councils in Western NSW and identifies long-standing risks and challenges faced both individually and collectively.

The PEC proposes exploring the scope to implement structural reforms across Western NSW LWUs to improve the ability to deliver strategic planning, conduct operations, share resources and provide certainty of funding for Western NSW councils. The PEC suggests applying the proposed LWU Funding Policy to alternative structural approaches with willing Western NSW councils. Due to the seriousness of issues facing LWUs in this part of the state, the PEC recommends a reform approach to codesign and adopt alternative structural approaches within 18 months.

5.2 NSW Government response

Given the need for urgent action in Western NSW, the NSW Government has asked the department to work with councils in Western NSW to explore the service delivery options outlined in the PEC report. The NSW Government reiterates its commitment to not forcibly amalgamate councils' local water utilities, as set out in the NSW Government response to the recommendations of the NSW Parliament's Joint Select Committee on Protecting LWUs from Privatisation. Consistent with NSW Government's broader policy position on local water utility ownership, councils could opt-in to a co-design process to identify appropriate localised solutions.

The Department commenced consultation with the 16 councils² in Western NSW identified in the PEC report in October 2024. At the request of the Western Councils Water Alliance (WCWA), 4 additional WCWA councils (Dubbo Regional, Gilgandra, Mid-Western and Narromine) were included to account for the strong preference of WCWA member councils to work together.

Western NSW LWUs and key stakeholder groups were consulted on a strategic analysis of structural reform options outlined in the PEC report. The options included LWUs providing services as standalone entities, as groups of LWUs working together (i.e., an alliance model), county councils and various corporate models (council owned, State/council joint-owned and State-owned).

Western NSW LWUs do not support county council or corporate models, primarily due to concerns of loss of local representation and financial impacts of removing LWU businesses from other council operations. WCWA member councils favoured to pursue reform through the alliance of councils model. Most other Western NSW LWUs favoured service delivery as standalone entities. One council expressed interest in exploring the option of the NSW Government delivering water and sewer services on its behalf.

The strategic options analysis found that only the corporate models present a positive benefit cost ratio and best address the underlying challenges facing western NSW LWUs. However, even the most economically efficient corporate models require significant additional investment to meet basic levels of service. The analysis also found that LWUs' preferred options (i.e. standalone LWUs and alliances) may address some of the underlying challenges but require more investment as compared to other structural interventions that increase economic efficiency.

As corporate models are not supported by LWUs, the NSW Government has determined that more work is required to better understand if LWU preferred approaches can achieve service improvements, scale efficiencies, improved governance and professional capability up-lift. As such, the Government and Western NSW LWUs that opt-in to the process will co-design a pilot program, the details of which will be taken to Government for approval (including funding), with a view to commencing in mid-2026 in-line with the recommendations of the PEC.

² Balranald, Bogan, Bourke, Brewarrina, Carrathool, Central Darling, Cobar, Coonamble, Hay, Lachlan, Moree Plains, Narrabri, Walgett, Warren, Warrumbungle and Wentworth Shire councils.

Further details about the first phase of the co-design process, including feedback received from the 20 western NSW LWUs are contained in the What We Heard report.

5.3 Response to PEC recommendations

SUPPORT for 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.

SUPPORT for Recommendation 17: Develop a Strategic Business Case for CSO funding to Western NSW LWUs based on the output of the reform process.

6.1 Pensioner rebates – *Setting expectations for pensioner and hardship rebates through a CSO funding stream*

Chapter 10 of the PEC report identifies marked differences in rebates between regional pensioners and those living in Sydney and Hunter regions, as well as issues in equitable access to rebates. The PEC also finds inequities of NSW Government funding for these rebates between regional LWU, Sydney Water, and Hunter Water customers.

The PEC recommends considering broader support schemes to address customer affordability, hardship and financial emergencies, including current pensioner rebates in regional and metropolitan areas. The PEC recommends that government fully fund targeted concessions/rebates and hardship schemes through transparent CSOs.

6.2 NSW Government response

The NSW Government notes that LWU sector feedback during consultation showed strong support of the PEC recommendations in this chapter. This feedback has informed the NSW Government response as detailed in the What We Heard report.

The NSW Government supports the review of customer affordability and hardship support schemes for vulnerable customers of water supply and sewerage services, including current pensioner rebates schemes. The review will cover regional and metropolitan NSW with the aim of establishing fair and equitable support schemes, funded directly by the NSW Government, that address social welfare and hardship needs and support LWUs' ability to raise revenue from customers.

The review will implement the Funding Principles from the LWU Investment Framework and consider PEC recommendations 19 and 20. Note that the 'targeting' aspect of Funding Principle 3 would not apply insofar as a LWU's ability to raise own source revenue is concerned.

Further, the review will consider the most effective and efficient arrangements to provide funding for the cost of such support schemes via a transparent funding stream, including as an additional funding pathway for LWUs described in section 2.2., separate from a CSO for BLoS.

The state-wide review will be part of the policy design phase and produce an outcomes report for NSW Government consideration in mid-2026 to inform the detailed design of the new customer affordability support schemes framework, with aim of implementation from mid-2027.

6.3 Response to PEC recommendations

SUPPORT IN PRINCIPLE for Recommendation 19: Fund any targeted concessions/rebates deemed necessary in the LWU sector via a transparent CSO.

SUPPORT IN PRINCIPLE for recommendation 20: Develop a service level agreement with the Office of Local Government where a CSO is paid to all LWUs to support rebates/concessions to address hardship pressures

SUPPORT IN PRINCIPLE for 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.

7.1 Implementation plan proposed by the PEC report

Chapter 11 of the PEC report details an implementation plan for the proposed reforms, including a proposed governance structure and implementation timeline. The governance structure includes a LWU Sector Reform Steering Committee to coordinate the reform and oversee the development of the LWU Investment Framework; a Regulatory Review Steering Committee to oversee regulatory improvements; and stakeholder reference groups to inform the development of the LWU Investment Framework, the reform of regulations, and the Western NSW reform process.

7.2 NSW Government response

The NSW Government notes that LWU sector feedback during consultation showed support for a paced, transparent approach to reform (through extensive sector consultation) and for the governance and engagement structure proposed by the PEC. Key concerns raised related to consultation fatigue and clarity on timing and oversight of the reform process. This feedback has informed the NSW Government response as detailed in the What We Heard report.

The NSW Government has considered the implementation approach and plan proposed by the PEC, as well as sector feedback, in the development of its implementation plan. The NSW Government's implementation plan, as summarised below, sets out 3 sequential phases over the 2-year policy design period to allow for a paced and meaningful sector engagement, supported by transparent and accountable governance structures. These phases enable the LWU sector and NSW Government to plan and take action on current LWU sector needs while strategically building and shaping the reform from comprehensive analysis and lessons learned.

Implementation workstreams

The policy design and implementation will involve the completion of 3 phases over a period of 2 years as detailed in Table 2 below.

Table 2 Workstreams during 2-year policy design phase

Workstream	Sub-streams	Lead
PHASE 1 (2025/26)	Begin comprehensive policy and economic analysis, and sector consultation, on developing the LWU Investment framework, including considering a CSO type funding mechanism for LWUs, basic levels of service, and additional funding pathways for LWUs. LWU regulators to jointly work on how to set regulatory objectives, approaches and minimum regulatory standards for town water services.	DCCEEW – Water
PHASE 1 (2025/26)	Begin comprehensive policy and economic analysis, and sector consultation, on reform options that improve sector performance, efficiency, strategic planning and own source revenue raising, including potential changes to legislation and regulation. Review/consider regulatory approaches to optimise revenue raising, performance against minimum regulatory requirements and associated basic levels of service, effectiveness of strategic planning, and improvements to governance of strategic decision-making.	DCCEEW – Water
PHASE 1 (2025/26)	Review of customer affordability and hardship schemes (including pensioner rebates) and their funding across regional and metropolitan NSW.	DCCEEW – Water

Workstream	Sub-streams	Lead
PHASE 1 (2025/26)	Co-design pilot programs with willing Western NSW councils and initial stocktake of levels of service, effectiveness of strategic planning, and information systems focused on Western NSW.	DCCEEW – Water
PHASE 2 (2026/27)	Implementation of Western NSW pilot programs.	DCCEEW – Water
PHASE 2 (2026/27)	Undertake broader LWU sector stocktake of levels of service, effectiveness of strategic planning, and information systems. Develop first Sector Priorities Plan.	DCCEEW – Water
PHASE 2 (2026/27)	Continue analysis and sector consultation on funding reform, including the LWU Investment Framework and a CSO type funding model to achieve basic levels of service.	DCCEEW – Water
PHASE 2 (2026/27)	Continue comprehensive policy and economic analysis, and sector consultation, on reform options that improve sector performance, efficiency, strategic planning and own source revenue raising, including potential changes to legislation and regulation.	
PHASE 2 (2026/27)	Design/implement an education and communication strategy for customers and communities.	DCCEEW – Water
PHASE 3 (2026/27 and 27/28)	Based on previous phases and informed by stakeholders, finalise for implementation funding, regulatory, governance, and structural reform of the LWU sector over a long-term reform horizon. Outcomes from policy and economic analyses and lessons learned from pilot programs inform the proposed comprehensive and tailored LWU sector reform program.	DCCEEW – Water

Governance and engagement

As proposed by the PEC, a LWU Sector Reform Steering Committee will be established as a high-level steering group comprised of senior executive representation from relevant agencies. The Committee will provide accountable direction and oversight during the policy design phase and oversee the development of LWU Investment Framework, including the design of the LWU Funding Policy and the Sector Priorities Plan process as well as other reforms.

The following engagement processes will be used for the policy design phase:

- **Agencies Review Panel**

The Agencies Review Panel will contain LWU regulators and relevant agencies with roles and responsibilities related to overseeing the regulation and funding of water supply and sewerage services in regional NSW. The Panel will be engaged throughout the project and serve as a key

forum for discussing, reviewing, and developing relevant policies, including reviewing feedback from consultation with the sector.

- **Stakeholder working groups and focus groups**

Stakeholder working groups and focus groups containing LWUs, sector stakeholders and relevant agencies will be established to work through specific policy design issues, such as the LWU Investment Framework, regulatory reform and the Western NSW reform process.

- **General engagement and consultation**

General engagement mechanisms will be employed to keep LWU sector stakeholders informed using fit-for-purpose communications channels and accessible messaging and undertake broader engagement through paper, submissions and surveys.