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10 July 2026

Australian Government
Productivity Commission
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To whom it may concern

Comment on National Water Reform 2026: Water services reform directions

I write in response to the Productivity Commission's 2026 interim update on reform directions for the Australian water services industry.

I have extensive skills and 30 years of inter-jurisdictional Government experience as a practitioner in the water industry. For the purpose of this response, however, I will focus on regional water service provision and the application of Community Service Obligation (CSO) funding arrangements to regional infrastructure replacement, construction and operation.

General Comments

<u>Enabling timely investment in large, long-term assets (p.11)</u>

Whilst this section is included under water services in urban centres, it is also important for regional centres, yet the relevant section (Section 3) places no emphasis on this. The report gives no recognition to the funding history and background of investment in, and construction of, large, long-term assets in regional areas. Understanding the historical, centrally funded construction programs of 1960–1980 for many town water and sewerage systems is vital to developing workable solutions for the upgrade and/or replacement of that infrastructure. Regional areas now face a "perfect storm" of once-in-a-lifetime infrastructure replacement combined with decreasing revenues and worsening socio-economic affordability. These areas are now separately accountable for infrastructure financing that was previously provided and underwritten by State governments and their respective Treasuries – an unfair burden that has resulted in what your interim report describes as institutional differences of "fragmented governance and reduced economic oversight".

Omitting the historical funding background provides no context for rationalist urban-centre financial planning commentary when applied to regional water supplies. This historical ignorance was evident in the 2004 NWA's requirement for "full cost recovery" for water services (Section 65(ii)). Full cost recovery (and its associated depreciation requirements) has discouraged smaller water utilities from renewing or constructing essential water or sewerage infrastructure, out of concern over financial viability assessments and scrutiny by the respective state Audit Office. Your Interim Report contains only a vague reference to this situation ("aged assets", p.18) but provides no context for the cause.

This difficulty in the cost recovery doctrine has been partially acknowledged in the 2025 draft NWA Principles, which give some recognition to this fact (S1.19.2), after several commentators (including me) pointed this out. The Productivity Commission acknowledged this in its 2021 water reform report, noting the possibility of perverse outcomes from strict adherence to cost-recovery models for regional and remote service provision, and recommending that the NWI cost-recovery principles be examined (PC 2021, p.11).

I suggest the 2026 final report clearly set out this fundamental difference in funding history and financial models between urban and regional services. The Commission could demonstrate an understanding of how financial differences limit full cost recovery (sometimes even at lower bound pricing) and contribute to the current infrastructure challenge for regional water service provision, rather than focusing solely on operation and maintenance issues.

<u>The issue of asset depreciation</u>

Related to the financial resilience of asset investment is the issue of asset depreciation. This is an area where the Productivity Commission could drive meaningful reform, and responsibility for it sits firmly with the Commonwealth.

Cost recovery and economic viability (2004 NWA Section 69) require allowance for asset depreciation through the NWI pricing principles, which remain in effect in the 2024 NWA draft. As currently applied, this requirement has caused an inappropriate financial burden on regional utilities and has discouraged asset renewal.

Section 5 of the 2011 National Water Initiative Pricing Principles sets out an annuity, or regulated asset base/straight-line, approach to revenue and depreciation requirements. The annuity approach (which has a low initial rate of depreciation, but a higher one later in the life of a long-lived asset) has not been accepted by state Audit Offices, despite being endorsed by the NWI Principles. This is due to a conflict with *AASB 116 Property, Plant and Equipment* and *2014 AASB Interpretation 1030*, which are the primary directives followed by Government Audit Offices. These accounting standards require assets to be depreciated over their full life using a consistent depreciation method, and specifically preclude use of the annuity method – despite it being more appropriate for long-lived water assets.

I suggest the 2026 report examine the depreciation requirement and how it is affecting infrastructure investment decisions for regional service provision.

<u>Water services in regional and remote areas (p.17)</u>

The Commission should be commended for examining the issue of basic level of service (BLOS) (p.22). It is long overdue for the Commonwealth to show leadership in this area, beyond the principles of the NWA. Mandating BLOS is essential to implementing urgently needed reform of CSO funding for regional service provision, as BLOS is the foundation of the "community service" being purchased from the utility on behalf of the community.

The 2004 NWA allowed for this through a "case-by-case" approach in Sections 66(v)(c) and 77(i) of the 2004 Agreement; however, this was rarely implemented. S1.19.3 of the 2025 draft NWA provides some reinforcement of this concept. However, national action is required to progress beyond the traditional CSO payment concept of subsidising pensioner rebates or regional maintenance panels (currently reported by BOM) to supporting capital payments for infrastructure.

This innovative CSO application was the highlight of the NSW PEC 2024 report. Our firm recently completed a CSO financing study and Treasury application for the capital funding of a major regional infrastructure project. This incorporated BLOS, affordability, financial viability and funding option selection, and was prepared in close consultation with the Australian banking industry. We believe this process will enable many regional service providers to fund essential projects with State or Commonwealth Treasury support, addressing the "historical burden" they carry in providing long-lived infrastructure for the well-being of their communities.

I suggest the 2026 report strongly recommend accelerating the use of the CSO funding methodology by governments and broaden its use to capital works funding in regional areas.

Summary of Recommendations

1. The 2026 final report should explicitly document the differing funding history and financial models of urban and regional water services, and explain how this history contributes to the current cost recovery and regional infrastructure challenge.
2. The report should recommend a resolution to the conflict between the NWI Pricing Principles' annuity depreciation method and AASB 116/Interpretation 1030 – for example, by directing Audit Offices to accept annuity-based depreciation for long-lived regional water assets, or by seeking an amendment to the AASB standards.
3. The report should recommend a national framework for extending CSO funding beyond recurrent subsidies (such as pensioner rebates) to capital works funding for regional infrastructure, drawing on the NSW CSO capital-funding precedent.

I look forward to the Productivity Commission's final report. Please contact me by email if you wish to discuss these comments in more detail, or should the Commission wish to discuss the CSO financing approach outlined above.

Yours Sincerely

Bruce Whitehill
Principal