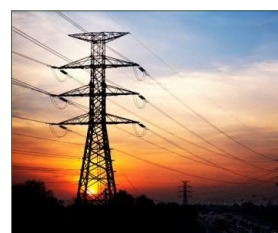


# Water and Sewerage Services

## Cost and Performance Report for PC13

An assessment of NI Water's costs and performance

November 2015



# About the Utility Regulator

The Utility Regulator is the independent non-ministerial government department responsible for regulating Northern Ireland's electricity, gas, water and sewerage industries, to promote the short and long-term interests of consumers.

We are not a policy-making department of government, but we make sure that the energy and water utility industries in Northern Ireland are regulated and developed within ministerial policy as set out in our statutory duties.

We are governed by a Board of Directors and are accountable to the Northern Ireland Assembly through financial and annual reporting obligations.

We are based at Queens House in the centre of Belfast. The Chief Executive leads a management team of directors representing each of the key functional areas in the organisation: Corporate Affairs; Electricity; Gas; Retail and Social; and Water. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.

## Our Mission

Value and sustainability in energy and water.

## Our Vision

We will make a difference for consumers by listening, innovating and leading.

## Our Values

Be a best practice regulator: transparent, consistent, proportional, accountable, and targeted.

Be a united team.

Be collaborative and co-operative.

Be professional.

Listen and explain.

Make a difference.

Act with integrity.

## Abstract

We regulate the revenue NI Water receives through periodic price controls. Our proposals set an overall revenue requirement and identify the levels of capital and operational expenditure. This report reflects our assessment of NI Water's performance during its second regulatory price control, PC13, covering the period from April 2013 to March 2015.

## Audience

Regulated utilities, regulatory community, industry, consumers and their representative bodies and statutory bodies.

## Consumer impact

This assessment provides consumers with information on the performance of NI Water from April 2013 to March 2015 in relation to our price control.

# Cost and Performance Report for PC13

## Contents

<b>Background.....</b>	<b>2</b>
<b>1.0 Costs and Efficiency .....</b>	<b>3</b>
1.1. Overall Financial Performance.....	3
1.2. Operational Expenditure .....	5
1.3. Closing the Efficiency Gap.....	6
<b>2.0 PC13 Monitoring Plan Performance .....</b>	<b>7</b>
<b>3.0 Capital Expenditure.....</b>	<b>11</b>
3.1. Investment by Service and Purpose .....	11
3.2. Capital Delivery .....	11
<b>4.0 Customer Service .....</b>	<b>13</b>
4.1. How Customer Service is Assessed .....	13
4.2. OPA Performance .....	13
<b>5.0 Key Issues for 2013-14.....</b>	<b>14</b>
5.1. Principal Issues of Note .....	14
5.2. Customer Measures / Customer Satisfaction .....	14
<b>6.0 Future Price Controls and Reporting .....</b>	<b>16</b>
6.1. Way Forward .....	16
6.2. PC13 (2013-15).....	16
6.3. PC15 (2015-21).....	16

# Background

Northern Ireland Water (NI Water) is responsible for providing water and sewerage services to consumers in Northern Ireland. Since NI Water is the sole provider of these services, the Utility Regulator regulates the amount of revenue the company receives. This ensures value for money for consumers. We therefore scrutinise the company's revenue requirements through periodic price controls.

NI Water is a government-owned provider of water and sewerage services. Financially, it is treated as a Non-Departmental Public Body (NDPB) since the majority of its income is from public funding. While domestic consumers do not directly pay for water charges, the cost of providing these services to commercial consumers is recovered through bills.

The second regulatory price control of PC13 began on April 2013 and ran until March 2015. The final year of PC13 was a challenging period due to the impact of industrial action in January 2015. However, in overall terms, NI Water successfully delivered against the PC13 final determination and Monitoring Plan for the period. The company succeeded in reducing prices and improving service to consumers. NI Water's third price control period (PC15) commenced on 1 April 2015 and runs for the six-year period until 2021. The 2015-16 Cost and Performance Report (CPR) will assess performance in the first year of PC15.

## Key Findings

It is clear from assessing the 2013-14 and 2014-15 data that in overall terms, NI Water has broadly delivered on the annual targets set by us for PC13. The company outperformed its operational (opex) efficiency target, while at the same time improving levels of service. Key findings for the PC13 period follow:

- NI Water's opex costs reduced in nominal terms from £190.7m in 2013-14 to £187.5m in 2014-15. This translates into a £3.2m nominal fall, and once inflation is taken into account, this represents a 3.5% real terms reduction in the day-to-day running costs of the business.
- The full capital investment budget was utilised in PC13. Our assessment of current and projected investment indicates that the company has delivered value for the capital committed over PC13.
- NI Water did not meet our 2014-15 Overall Performance Assessment (OPA) target, primarily due to the effects of the industrial action. Had this been excluded, the company would have met its target for interruptions to supply greater than 12 hours. Despite this, NI Water still ended 2014-15 with a higher OPA score than at the start of PC13. Scope remains for further service improvement however, not limited to OPA measures only.
- The company has met most of the Key Performance Indicators (KPIs) set by us in the PC13 Monitoring Plan, including 7 out of 14 consumer service measures and all of the water and sewerage quality KPIs. It has delivered the majority of output measures and maintained stable serviceability.

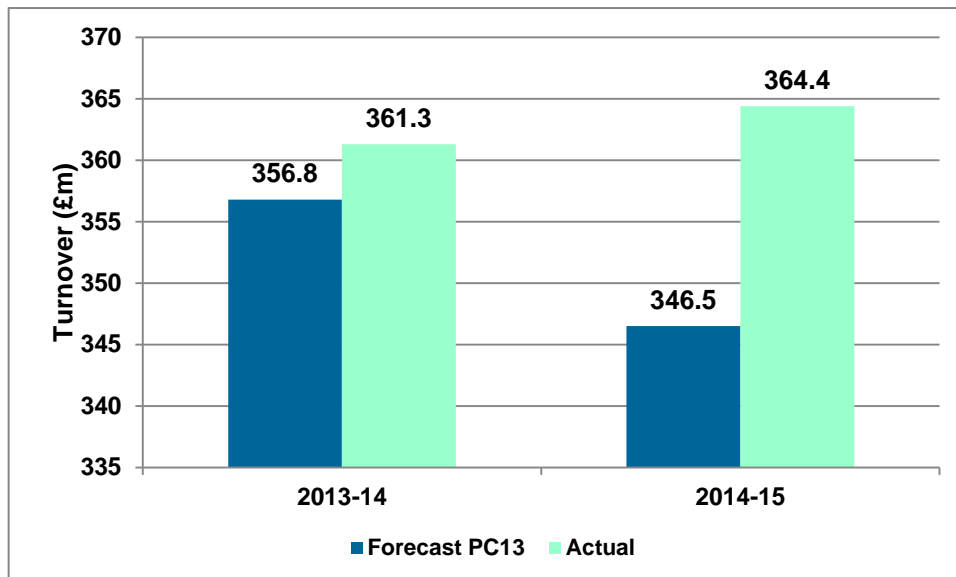
# 1.0 Costs and Efficiency

## 1.1. Overall Financial Performance

### Turnover

- 1.1.1 Over the PC13 period, turnover for the regulated business was above forecast levels with a total income of £726 million compared to the PC13 forecast of £703 million.
- 1.1.2 In 2013-14 the increased revenue was due to a number of reasons including higher RPI inflation, higher domestic customer numbers, increased volumes and under recoveries from PC10. In addition to these, back billing and releases in income provisions also contribute to the variance in 2014/15. The back billing arose due to meters not giving a reading, meters which were never entered on the billing system on installation and meters which had been read incorrectly.

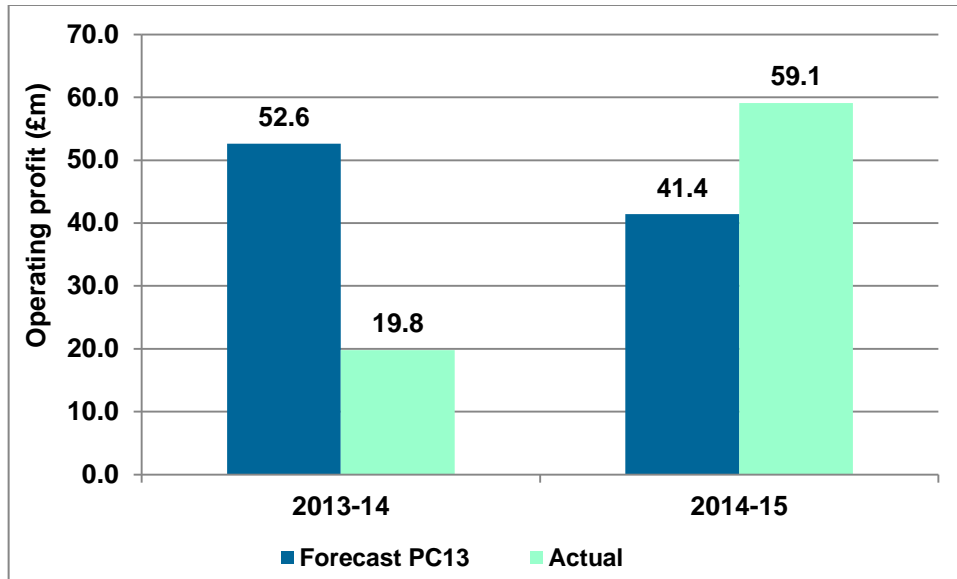
**Figure 1.1: NI Water turnover versus PC13 forecasts**



### Operating Profit

- 1.1.3 Over the PC13 period NI Water's operating profits were below the FD forecast, totalling £78.9 million compared to £94 million forecast.
- 1.1.4 In 2013-14 the reduced profit was largely due to accelerated depreciation on decommissioned assets. This did not repeat itself in 2014-15 when operating profit benefited by the increased turnover discussed above.
- 1.1.5 Operating expenditure variances also feature in the movement in operating profits and these are considered in more detail in section 1.2.

**Figure 1.2: NI Water operating profit versus PC10 forecasts**



## Dividend

1.1.6 For the PC13 period NI Water paid £49 million of dividends (2013-14: £24 million; 2014-15: £25 million) to its shareholder, the DRD. This level of dividend is in line with projections in the PC13 FD.

## Loan Profile

1.1.7 By the end of PC13 the level of DRD loans reached £947.6 million. This results in a gearing figure of 49.1% which is lower than the forecast of 52.4% in the PC13 FD.

## Regulatory Capital Value

1.1.8 The Regulatory Capital Value (RCV) is the value of the appointed business on which NI Water earns a return at the determined weighted average cost of capital. The RCV is increased each year by the investment in new assets and reduced by the value of assets that have been used up or sold off in the year. NI Water's RCV has grown steadily from the start of its first price control (PC10) and stands at £2.046 billion at the end of PC13.

1.1.9 More detailed information on NI Water's financial information is set out in the company's statutory and regulatory accounts. These can be found in NI Water's annual report for each year which is published on its website<sup>1</sup>.

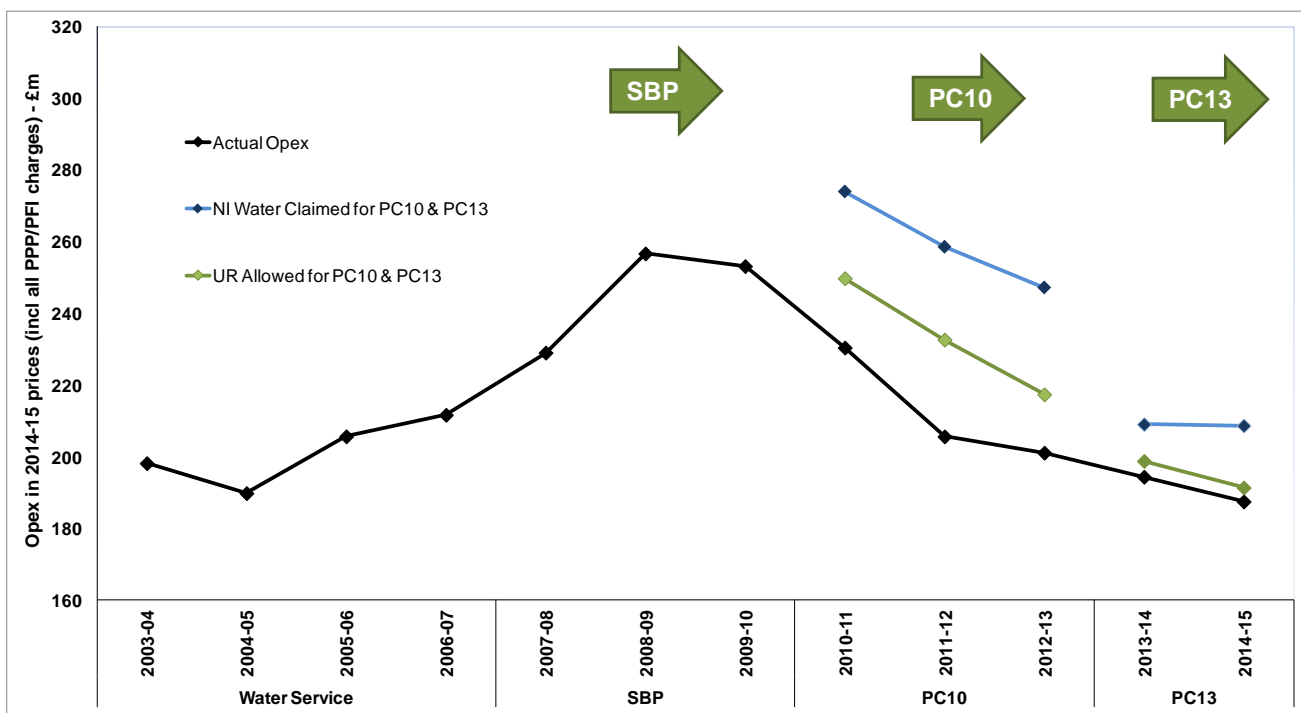
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<sup>1</sup> <http://www.niwater.com/annual-report/>

## 1.2. Operational Expenditure

- 1.2.1 NI Water's opex costs reduced in nominal terms from £190.7m in 2013-14 to £187.5m in 2014-15. This £3.2m nominal fall translates into a 3.5% real terms reduction in the day-to-day running costs of the business over the year, once inflation is taken into account.
- 1.2.2 Over the year, the most notable reductions in real opex have been seen in the categories of wages & salaries, materials & chemicals, power and PPP/PFI costs.<sup>2</sup>
- 1.2.3 NI Water's £187.5m of opex spend in 2014-15 compares favourably to our allowance of £191.4m (in current prices), representing an outperformance of some £3.9m in-year.<sup>3</sup>
- 1.2.4 NI Water's cost profile over the last six years has been one of reducing real opex. This is shown in the figure below.

**Figure 1.3: NI Water's opex profile in real terms (2014-15 prices)**



<sup>2</sup> PPP/PFI refers to Public Private Partnership / Private Finance Initiative schemes

<sup>3</sup> This £3.9m figure rises to £6.3m if Voluntary Early Retirement / Severance (VER/VS) costs (£0.7m) and costs associated with the industrial action (£1.7m) are excluded from actual spend. VER/VS was supported in principle by the Utility Regulator, but not funded through charges.



### 1.3. Closing the Efficiency Gap

- 1.3.1 Each year we compare NI Water's opex efficiency position with companies in England and Wales. Our analysis shows a continuing improvement profile in line with reduced real costs. Over the two years of PC13, NI Water has closed the efficiency gap to the 'frontier' from around 22% in 2012-13 to an estimate of 13% in 2014-15.<sup>4</sup>
- 1.3.2 The analysis shows year-on-year efficiency improvement since 2007-08. However, despite this progress, a gap still remains to the best companies in England and Wales. For every £1 of opex spent by the 'frontier' benchmark, NI Water spends approximately £1.15.

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<sup>4</sup> The efficiency gap estimate for 2013-14 has been revised by the UR to 17%.

## 2.0 PC13 Monitoring Plan Performance

2.1.1 Tables 2.1 and 2.2 report progress against the PC13 Monitoring Plan output targets<sup>5</sup>. Colour coding has been used to indicate whether NI Water met or outperformed its PC13 target (green), or failed its target (red).

2.1.2 Some target and performance figures are cumulative and reflect delivery over PC13 as a whole. Others reflect the outturn performance for the final year.

**Table 2.1 – NI Water PC13 Key Outputs for Water Services for PC13**

Line description		PC13 Target	PC13 Actual	Comments
<b>A</b>	<b>Consumer Service Water</b>			
1	DG2 Properties at risk of low pressure removed from the risk register by company action	288	318	Target met
2	DG3 Supply interruptions > 12hrs (unplanned and unwarned)	0.19%	3.10%	Target not met
3	DG3 Supply interruptions (overall performance score)	1.08	11.72	Target not met
4	DG6 % billing contacts dealt with within 5 working days	99.90%	99.97%	Target met
5	DG7 % written complaints dealt with within 10 working days	99.50%	99.96%	Target met
6	DG8 % metered customers received bill based on a meter reading	99.00%	99.11%	Target met
7	Call Handling Satisfaction score (1-5)	4.75	4.65	Target not met
8	DG9 % calls not abandoned	99.00%	97.99%	Target not met
9	DG9 % calls not receiving the engaged tone	99.90%	99.99%	Target met
10	Overall Performance Assessment (OPA) score (11 Measures)	215	206	Target not met
11	Total Leakage (MI/d)	165	166 <sup>6</sup>	Marginally below target
12	Security of supply index	100	100	Target met
13	% NI Water's power usage derived from renewable sources	20.0%	51.4%	Target met
<b>B</b>	<b>Water Quality</b>			
14	% mean zonal compliance with drinking water regulations	99.70%	99.84%	Target met
15	Operational Performance Index (Turbidity, Iron & Manganese)	99.10	99.52	Target met
16	% Service Reservoirs with coliforms in >5% samples	0.00%	0.00%	Target met
<b>C</b>	<b>Water Outputs</b>			
17	Water mains activity - Length of new, renewed or relined mains (km)	445	449	Target met
18	Completion of nominated trunk main schemes	3	1	Target not met
19	Completion of nominated water treatment works schemes	2	3	Target met
20	Completion of nominated improvements to increase the capacity of service reservoirs and clear water tanks	1	1	Target met
21	Completion of nominated Major Incident Mitigation schemes	5	5	Target met
<b>D</b>	<b>Serviceability</b>			
22	Water infrastructure serviceability	Stable	Stable	Target met
23	Water non-infrastructure serviceability	Stable	Stable	Target met

<sup>5</sup> [www.uregni.gov.uk/uploads/publications/PC13\\_Monitoring\\_Plan\\_20130327\\_-\\_FINAL.pdf](http://www.uregni.gov.uk/uploads/publications/PC13_Monitoring_Plan_20130327_-_FINAL.pdf)

2.1.3 NI Water has met or outperformed the majority of the consumer service and water output objectives set for PC13. The company has not met its targets in seven areas:

- Poor performance against targets for unplanned and unwarned interruptions to supply can largely be attributed to the industrial action in January 2015 which had a significant impact on consumers. Had this been excluded, the company would have met its target for interruptions to supply greater than 12 hours. However NI Water would still have fallen short of its target for the interruptions to supply composite score.
- Performance on call handling satisfaction fell just short of the target of 4.75, although the score of 4.65 out of 5 was the company's best performance against this measure since the survey began.
- Performance on call answering, measured as 'calls not abandoned', was 97.99% against a target of 99.00%. NI Water attributes this to a new High Volume Call Answering (HVCA) system introduced after the 2010-11 freeze-thaw to improve communication during extreme events. The number of calls not answered has increased because some consumers, diverted to the automated system at peak times, choose to hang-up. Even if all automated calls were treated as answered, performance would still have been below the PC13 target, at 98.69% because operational performance issues in May, June, July, August and September also contributed to higher numbers of abandoned calls.
- The company did not meet its overall performance assessment target of 215. This is discussed further in section 4.0.
- Two of the three trunk water main schemes programmed for PC13 were not completed in time. Industrial action in January 2015 delayed testing during the final stages of the Castor Bay to Belfast scheme and it was subsequently completed in May 2015. A trunk main from Ballydougan to Newry is now expected to be delivered in 2015-16.
- The company missed its leakage target by a narrow margin of 1Mld. The company would have outperformed its target had it not been for the impact of industrial action in January 2015. The exceedence is not material and leakage performance remains on track.

2.1.4 The company delivered an additional nominated water treatment works output. This was necessary to address emerging water quality issues and was included as an additional requirement through the established Change Control Protocol.

**Table 2.2 – NI Water PC13 Key Outputs for Sewerage Services for PC13**

Line description		PC13 Target	PC13 Actual	Comments
<b>A</b>	<b>Consumer Service Sewerage</b>			
1	DG5 Properties at risk of flooding - number removed from 2 in 10, 1 in 10 and 1 in 20 risk register by company action.	67	39	Target not met
<b>B</b>	<b>Quality Sewerage</b>			
2	% of WwTWs discharges compliant with numeric consents	91.0%	92.4%	Target met
3	% of total p.e. served by WwTWs compliant with numeric consents	97.8%	98.4%	Target met
4	Number of high and medium pollution incidents attributable to NI Water	44	25	Target met
<b>C</b>	<b>Sewerage Outputs</b>			
5	Sewerage activity - Length of sewers replaced or renovated (km)	23	46	Target met
6	Delivery of improvements to nominated UIDs as part of a defined programme of work	84	68	Below target.
7	Delivery of improvements to nominated WwTWs as part of a defined programme of work	38	37	Marginally below target
8	Small wastewater treatment works delivered as part of the rural wastewater investment programme	25	25	Target met
<b>D</b>	<b>Serviceability</b>			
9	Sewerage infrastructure serviceability	Stable	Stable	Target met
10	Sewerage non-infrastructure serviceability	Stable	Stable	Target met

2.1.5 NI Water has met or outperformed most of the sewerage service outputs set for PC13. The company has not met its targets in three areas:

- Not as many properties were removed from the flooding register by company action as planned. The company attributes this to the fact that the detailed feasibility studies it undertakes to understand the problem and develop a solution have shown fewer properties were at risk of flooding than originally thought. This resulted in delays as other problem areas were investigated.
- Only 68 unsatisfactory intermittent discharge (UID) improvements were delivered against a target of 84. Delays occurred as the company worked through the development of integrated solutions to complex drainage problems and subsequent permissions to allow construction to proceed. The completion of delayed PC13 projects have moved into PC15. In the majority of cases the deferred UIDs were replaced by new projects proposed by NI Water through a change control submission. Where the value of the substitutions was lower than the projects they replaced, we took account of this in the PC15 final determination.
- The company delivered all but one of the planned number of wastewater treatment works upgrades for PC13.

2.1.6 Performance against some targets can be affected by things outside the company's control, such as the weather or sampling regimes. In PC13 we identified performance ranges for water and wastewater quality to reflect this

inherent variability. The PC13 output targets shown in Tables 2.1 and 2.2 were set at the lower limit of these ranges. Performance for all these measures was better than the minimum targets at the end of PC13, with:

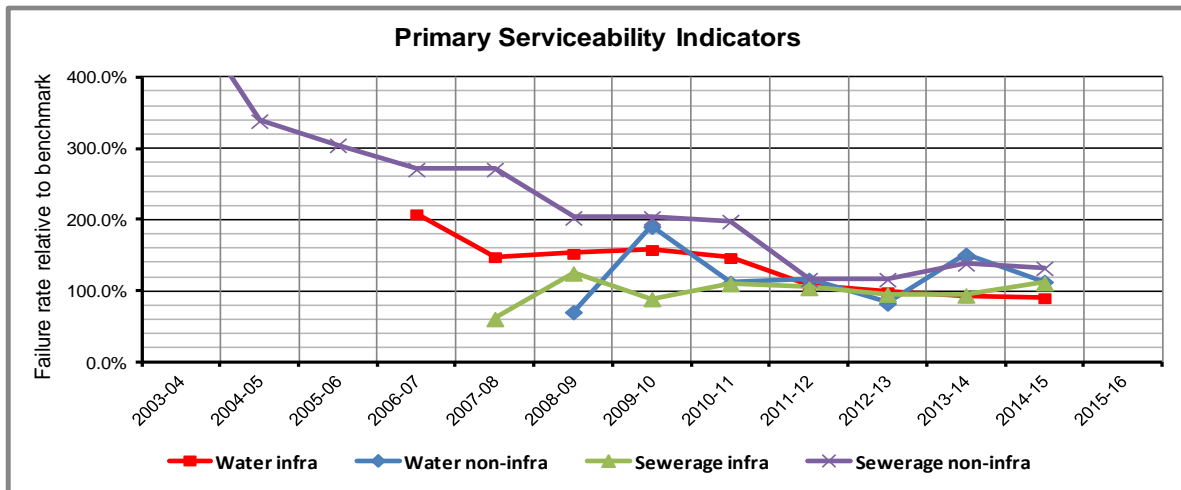
- water quality compliance and wastewater compliance based on population, at or above the upper ends of their range; and
- wastewater compliance based on the percentage of works at midrange.

2.1.7 We use a range of serviceability indicators to assess how the company is maintaining its assets.

2.1.8 We have updated our serviceability assessment to include outturn data for 2014-15. The updated trends of the primary service indicators for the four service areas are shown below and all show a stable trend. We have concluded that overall serviceability remains stable.

Service	Primary service indicator
Water Infra	Mains bursts per 1,000km
Water Non-infra	Percentage of regulatory samples taken for Turbidity at WTWs which exceed 0.8 NTU
Sewerage Infra	Sewer collapses per 1,000km
Sewerage Non-infra	Number of WwTWs with one or more compliance sample result (BOD, SS or Ammonia) exceeding the numeric consent value

Figure 2.1 – Primary serviceability indicator trends<sup>7</sup>



<sup>7</sup> A score of 100% represents operation at the reference level benchmark.

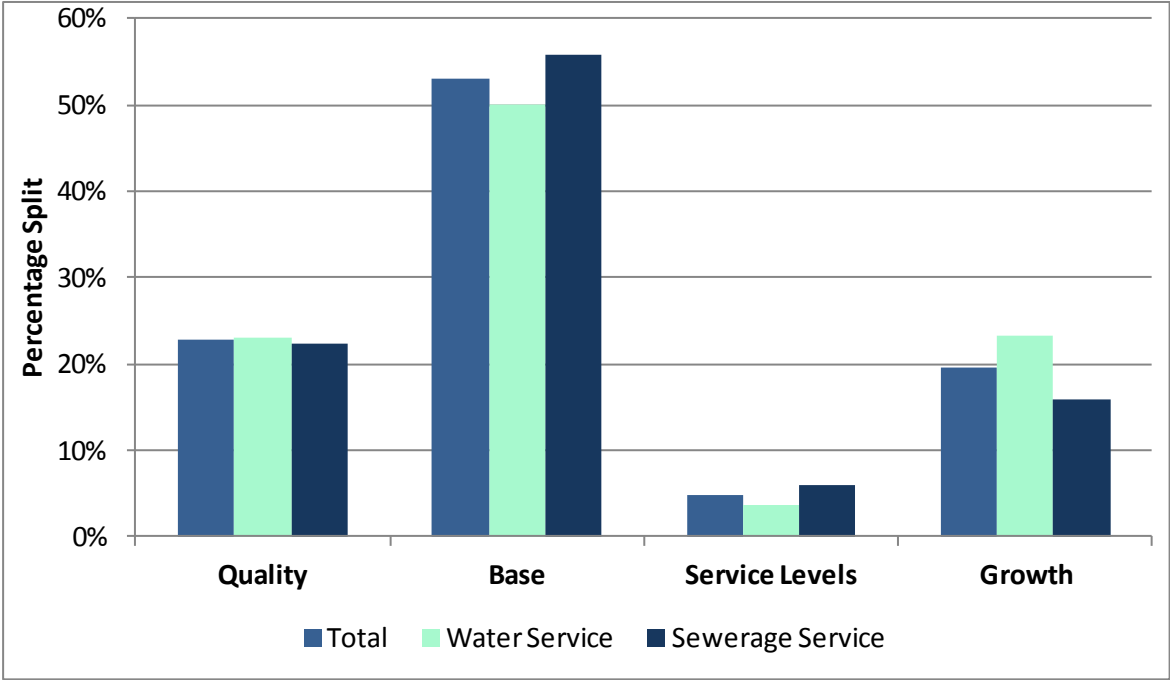
# 3.0 Capital Expenditure

## 3.1. Investment by Service and Purpose

3.1.1 In PC13, NI Water invested £326m to maintain its existing assets, to meet more demanding quality obligations, to provide extra capacity for growth, and to improve the service it currently provides. Investment over PC13 was in line with the final determination estimate of £324m.

3.1.2 The allocation of investment by purpose is shown in Figure 3.1 below. Investment in 2013-14 to maintain the existing assets (base) was higher than planned while the company took time to develop and procure elements of its enhancement investment programme. The company took steps to rebalance its programme in 2014-15, but base maintenance investment remained slightly higher than planned over the PC13 period.

**Figure 3.1: Allocation of investment in PC13 by service and purpose**



## 3.2. Capital Delivery

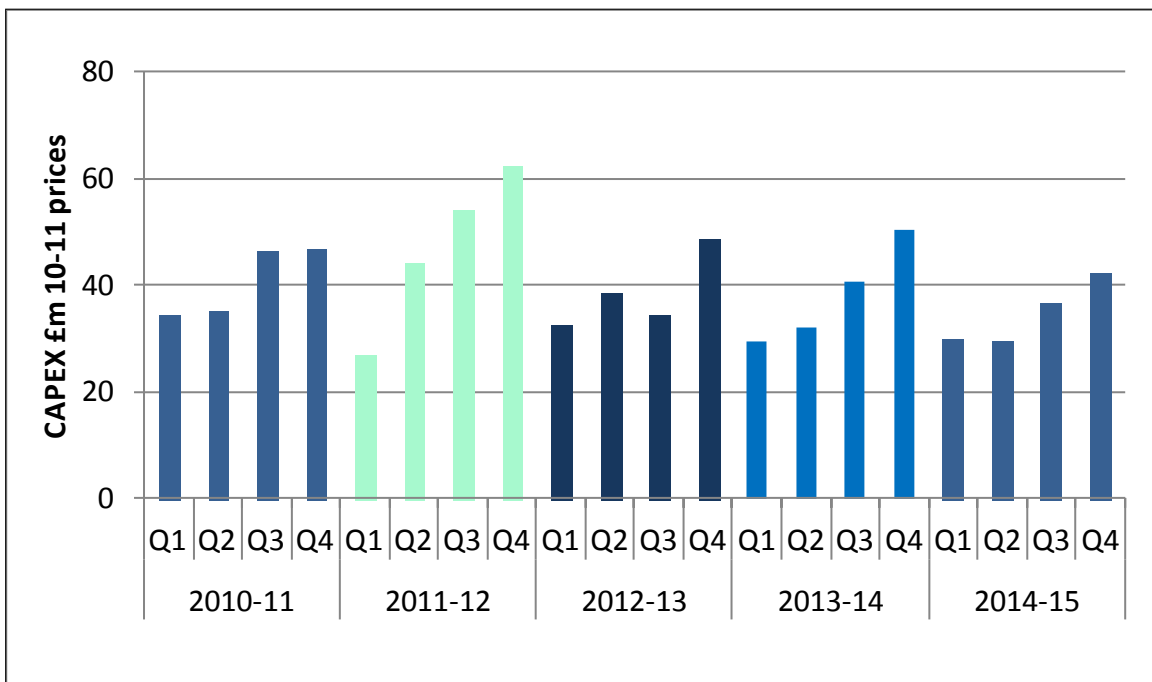
3.2.1 The company has invested the planned capital budget over the PC13 period demonstrating its ability to plan and manage capital spend within annual public expenditure limits. It has maintained a focus on the delivery of the outputs agreed for the PC13 final determination, including nominated outputs agreed with the quality regulators.

3.2.2 Where the company has experienced delays, it has worked with water industry stakeholders through an agreed Change Control Protocol to manage change.

This ensured that necessary priority outputs continued to be delivered within the constraints of annual spending limits.

- 3.2.3 For the Cost and Performance Report we have updated our assessment of capital delivery over the PC13 period initially carried out for the PC15 final determination. This confirmed our preliminary conclusion that NI Water has delivered value for the capital invested over the period. Our assessment took account of changes in inflation, which eroded the purchasing power of the nominal level of funding available and the increase in base maintenance investment. As a result of these changes the delivery of some PC13 outputs were delayed to PC15. We took account of these changes in the PC15 determination to ensure that consumers do not pay twice for the same output.
- 3.2.4 In previous Cost and Performance Reports, we have highlighted a consistent annual cycle of expenditure.
- 3.2.5 Peak levels of investment occur in the winter months and expenditure is at its lowest level in the first quarter of each year. Figure 3.2 shows that this trend has continued throughout PC10 and PC13. This cycle of investment, driven by annual spending constraints, remains disruptive for the supply chain and detrimental to efficient delivery.

**Figure 3.2: Capital investment from 2010-11 to 2014-15 by quarter**



# 4.0 Customer Service

## 4.1. How Customer Service is Assessed

4.1.1 In order to fully assess how NI Water is performing, we have adopted the Overall Performance Assessment (OPA) framework. This monitors the overall level of service that NI Water provides to its customers.

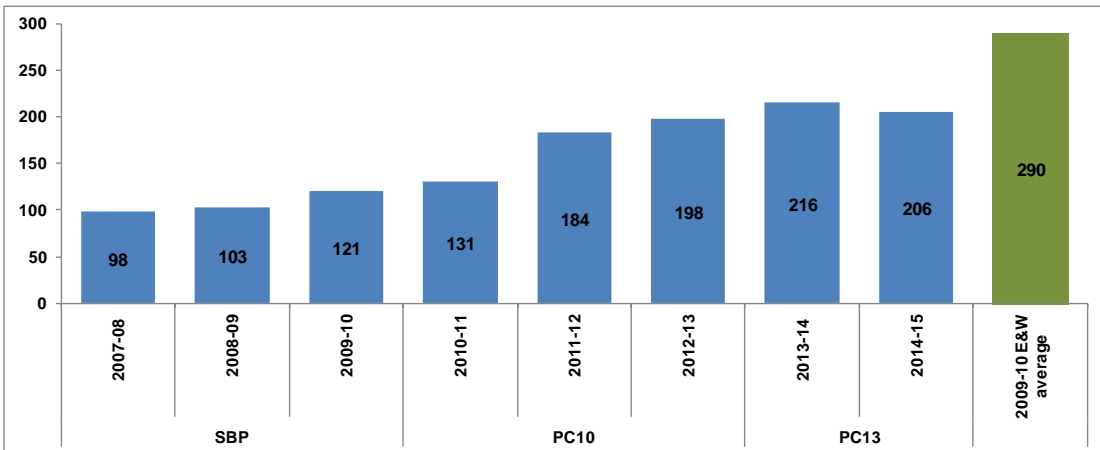
4.1.2 Our OPA combines 11 individual service measures and scores them against a reasonable range. Scores are then weighted in order of importance and combined to give an overall picture of service level performance.

## 4.2. OPA Performance

4.2.1 The chart below details NI Water’s actual OPA scores. Key messages include:

- Although NI Water outperformed our OPA target (of 202) for 2013-14 by 14 points, the company failed our OPA target (of 215) for 2014-15 by 9 points<sup>8</sup>. Over the 2014-15 year, notable service improvements were made in the areas of drinking water quality, risk of low pressure, sewage treatment works compliance and low category sewage pollution incidents.
- A sharp rise in the number of unplanned interruptions had the greatest negative impact to overall service levels over the year, primarily due to the effect of the industrial action.
- Excluding the impact of last year’s industrial action, it is clear that NI Water have been steadily improving its overall service levels since 2007-08. Although there is still a service gap with English and Welsh (E&W) companies, the scale of the gap has closed markedly since 2007-08.

**Figure 4.1: NI Water’s OPA scores**



<sup>8</sup> NI Water state that they would have outperformed our OPA target of 215 for 2014-15, but for the effect of the industrial action (which occurred towards the end of the reporting year).



## 5.0 Key Issues for 2014-15

### 5.1. Principal Issues of Note

5.1.1 It is worth noting a number of specific issues of importance relating to this reporting period. These include:

- Industrial action by NI Water staff in 2014-15; and
- Customer measures / customer satisfaction.

### 5.2. Industrial action by NI Water staff in 2014-15

5.2.1 Industrial action was taken by some NI Water employees over a period of about one month from the end of December 2014 to the end of January 2015. The industrial action included the withdrawal of out of hours working and meant that some faults, which would be repaired quickly in normal circumstances, resulted in the shutdown of some Water Treatment Works. This led to significant disruption to water supply in parts of Northern Ireland in early January 2015. As a result, the Minister for Regional Development asked us to undertake a review of NI Water's response to the consumer aspects of the dispute.

5.2.2 The Utility Regulator undertook its review under the following headings: impact and cause; contingency planning; communication; leadership and management; and financial impact. The review considered NI Water's performance in the run up to and during the event, focusing on the actions taken by NI Water in respect of the impact on customers and in planning for and reacting to the event.

5.2.3 Our review found that NI Water had made significant progress arising from our investigation of the 2010-11 freeze-thaw incident. It also identified areas where further improvements should be made and included a number of associated actions which the company is required to deliver. The majority of these are to be completed by the end of March 2016.

5.2.4 The company has been required to prepare an action plan and a programme for delivery of both our required actions and the actions included within the company's own internal review. The Utility Regulator will monitor NI Water's progress in delivering the actions within the plan. This will include NI Water's progress on improving its approach to asset management.

### 5.3. Customer Measures / Customer Satisfaction

5.3.1 The consumer measures (CM) / customer satisfaction (CSAT) or CM/SAT working group continues to develop new consumer measures and a new means of measuring satisfaction with NI Water for introduction during the PC15 period.

5.3.2 CM/SAT's work will be included within the PC15 Monitoring Plan. It is focused on bringing in a new consumer satisfaction survey which will provide NI Water with

the actionable data it needs to improve satisfaction. Our hope is the data may also then enable comparison against companies across different sectors and countries.

5.3.3 New consumer measures are being developed by CM/SAT to focus the customer services efforts of NI Water staff on:

- 'First Point of Contact Resolution', to improve satisfaction with contacting NI Water and to reduce the costs from consumers having to make 'repeat contacts'; and
- Promoting 'wanted contacts' i.e. consumers informing NI Water of location of leaks whilst reducing 'unwanted contacts' i.e. consumers making repeated contacts with NI Water concerning the same service issues.

## 6.0 Future Price Controls and Reporting

### 6.1. Way Forward

- 6.1.1 Reporting annually on NI Water's costs and performance against our regulatory price controls will continue to be our customary practice. The periods relating to specific price controls are set out below.

### 6.2. PC13 (2013-15)

- 6.2.1 This Cost and Performance Report covers both years of PC13.

### 6.3. PC15 (2015-21)

- 6.3.1 We are currently in the first financial year pertaining to the PC15 price control. Our final determination for this six year price control PC15 is available at:

[http://www.uregni.gov.uk/water/price\\_control/pc15/final\\_determination](http://www.uregni.gov.uk/water/price_control/pc15/final_determination)

- 6.3.2 The PC15 price control sets out a number of areas where further progress is expected from NI Water with one of the main areas being its approach to asset management. We will continue to monitor such progress throughout PC15 which should feed through into ongoing performance improvements.
- 6.3.3 In next year's Cost and Performance Report we will be reporting on performance relating to the 2015-16 financial year.