



Water and Sewerage Services Cost and Performance Report for 2021-22

An assessment of NI Water's costs and
performance

September 2023



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, Markets and Networks. The staff team includes economists, engineers, accountants, utility specialists, legal advisors and administration professionals.



Our mission

To protect the short- and long-term interests of consumers of electricity, gas and water.



Our vision

To ensure value and sustainability in energy and water.



Our values

- Be a best practice regulator: transparent, consistent, proportionate, accountable and targeted.
- Be professional – listening, explaining and acting with integrity.
- Be a collaborative, co-operative and learning team.
- Be motivated and empowered to make a difference.



Abstract

The Utility Regulator undertakes periodic price controls to regulate the revenue NI Water receives. These set an overall revenue requirement, levels of capital and operational expenditure and targets for a range of key performance indicators.

This Cost and Performance report provides our assessment of how NI Water has performed against its financial and key performance indicator targets during the 2021-22 financial year. This is the first year of its fourth regulatory price control, PC21 which covers the period from April 2021 to March 2027.

Audience

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

Consumer impact

This report provides consumers with an assessment on NI Water's performance during 2021-22 in delivering the requirements of our price control.



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Executive Summary

NI Water's fourth regulatory price control period, PC21, began on 1 April 2021 and will run for six years until 31 March 2027. The Department for Infrastructure (DfI's) 2020 Social and Environmental Guidance set the policy and legislative aims for the period and our PC21 final determination¹ set the revenue and output requirements.

Our 2021-22 Cost and Performance Report assesses how NI Water performed against the requirements set out in our final determination in the first year of the PC21 price control period. It shows that the company has broadly delivered against its targets in challenging circumstances. The company's operational expenditure (opex) and capital expenditure (capex) were materially higher than the allowances set in our final determination, however there were some mitigating circumstances for both. The reasons for the expenditure variances and other key findings from our assessment of the company's performance in 2021-22 are summarised below:

Operating expenditure

NI Water's operating expenditure was £272.1m in 2021-22. This was £29.7m above our regulatory allowance of £242.4m (in 2021-22 prices). NI Water attributes £9.4m of this figure to differences in how the PC21 final determination allowed for pension costs and how NI Water allows for them within its accounts, leaving an overspend of £20.3m when measured on a 'like-for-like' basis². This is mainly due to the increase in power costs which almost doubled in nominal terms from £32.2m in 2020-21 to £61.6m in 2021-22.

Capital investment

The company invested £229m of capital expenditure (capex) in 2021-22. This was £46m higher than the figure published in our final determination. The difference is accounted for by DfI adjusting the public expenditure allocation to account for higher than expected inflation, re-profiling of funding and expenditure from later in the programme to utilise budget availability and the provision of additional funding through 'in year' monitoring rounds. In recognition of these changes, we will continue to assess cumulative delivery over the medium term taking account of adjustments in budget, inflation (taking account of any movements from assumptions made within the final determination) and the delivery of capital efficiency.

Output delivery

The company met or exceeded planned delivery for 37 of the 45 key output measures set in the PC21 final determination. This includes 10 out of 13 consumer

¹ <https://www.uregni.gov.uk/pc21-final-determination>

² This reconciliation issue will be considered further with NI Water.



service measures and all of the water and sewerage quality compliance measures. NI Water met two thirds of its nominated output targets and maintained stable serviceability in all service areas. There is a lag in delivery in some areas, primarily in the delivery of wastewater outputs.

1. Introduction

Price controls

- 1.1 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 (UR) 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.
- 1.2 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.
- 1.3 NI Water's fourth regulatory price control period, PC21, began on 1 April 2021 and will run for six years until 31 March 2027.
- 1.4 DfI's Social and Environmental Guidance for Water and Sewerage Services (2021-2027)³, published in August 2020, set the policy and legislative aims for the period. This guidance continues to reflect the themes of the "Sustainable Water, A Long Term Water Strategy for Northern Ireland 2014-2040" published in March 2016⁴.
- 1.5 NI Water's Business Plan for PC21 set out the work the company considered necessary to meet established needs and to address wastewater treatment and sewerage capacity constraints which are acting as a constraint on current and future development. It identified that significantly more funding would be needed in PC21 and subsequent price controls to sustain existing services, meet legal obligations and support economic and social development. The company's proposals for PC21 were presented on the basis of an affordable tariff.
- 1.6 Our PC21 final determination⁵ set out the revenue and output requirements for the price control period following the completion of our assessment and challenge of NI Water's business plan submission.

³ <https://www.infrastructure-ni.gov.uk/publications/social-and-environmental-guidance-water-and-sewerage-services-2021-2027>

⁴ <https://www.infrastructure-ni.gov.uk/publications/sustainable-water-long-term-water-strategy-northern-ireland-2015-2040>

⁵ <https://www.uregni.gov.uk/pc21-final-determination>

Cost and performance reports

- 1.7 We use Annual Information Returns and Cost and Performance Reports to assess and report on actual delivery against the requirements we set for the company in our price control determinations. As a minimum, our reports cover the key areas of costs and efficiency, operating expenditure, capital investment and delivery of key performance indicators (KPIs). However, on occasions the reports may also be used to explain material issues or developments that have occurred during the reporting period. We produce and publish Cost and Performance Reports annually.
- 1.8 This report provides an assessment of company performance at the end of the first year of the six year PC21 price control period (2021-22).
- 1.9 Our conclusion is that NI Water broadly delivered against the targets set out in the PC21 final determination. The company met 22 out of 26 water service area objectives and 15 out of 19 sewerage service area objectives. Further details can be found in the text under Table 3.1 and Table 3.2 in Section 3 of this report.

2. Costs and Efficiency

Operational expenditure

- 2.1 NI Water's operating costs (opex)⁶ increased in nominal terms from £239.2m in 2020-21 to £272.1m in 2021-22. This rise of £32.9m, translates into a 7.6% real terms increase in the day-to-day running costs of the business over the year, once inflation is taken into account.
- 2.2 NI Water experienced real terms opex increases in some expenditure items, for example, 'materials and consumables' and 'hired and contracted expenses' driven by fuel, equipment, and contractor wages. By far the largest impact was from power costs which almost doubled from £32.2m in 2020-21 to £61.6m in 2021-22. This power cost increase was met through an additional resource budget allowance provided by Dfl.
- 2.3 NI Water's £272.1m of opex spend in 2021-22 was £29.7m higher than our regulatory allowance of £242.4m (in 2021-22 prices). This overspend is largely explained by the rise in power costs, which was primarily driven by the increase in electricity tariffs for 'large and very large' non-domestic connections. These rose from 9.0 p/kWh⁷ in 2020 to 16.1 p/kWh⁸ in 2021, representing a nominal tariff increase of almost 80%. NI Water also attributes some of the variance in reported expenditure to differences in how the PC21 final determination allowed for pension costs and how NI Water allows for them within its accounts⁹. NI Water estimate that this had an impact of £9.4m in 2021-22, meaning that the overspend would have been £20.3m if measured on a 'like-for-like' basis.
- 2.4 Other cost categories such as 'general and support' and 'hired and contracted' costs have not reduced since 2020-21, despite the lessening impact of Covid. Material costs have also risen in real terms, despite the relatively high level of inflation. NI Water maintains this is partly explained by legacy issues associated with Covid and the linkage between chemical and power costs. Consideration of the movement in operating costs between 2021-22 and 2022-23 will help establish the extent to which this is the case.
- 2.5 NI Water's operating expenditure was higher than our regulatory allowance in the first year of the PC21 period as a result of the items noted above. This

⁶ Operating costs also include Public Private Partnership (PPP) and Private Finance Initiative (PFI) costs.

⁷ See the Retail Market Monitoring Quarterly Transparency [Report](#) for Q1 2021 (p19, last graph). The pricing data detailed in this QTR is for the semester 2: July 2020 to December 2020.

⁸ See the Retail Market Monitoring Quarterly Transparency [Report](#) for Q1 2022 (p17, second graph). The pricing data detailed in this QTR is for the semester 2: July 2021 to December 2021.

⁹ This reconciliation issue will be considered further with NI Water.

is shown in the Figure 2.1 below.¹⁰ However, had the increase in electricity prices not been so material, NI Water may have outperformed the PC21 first year regulatory opex allowance.

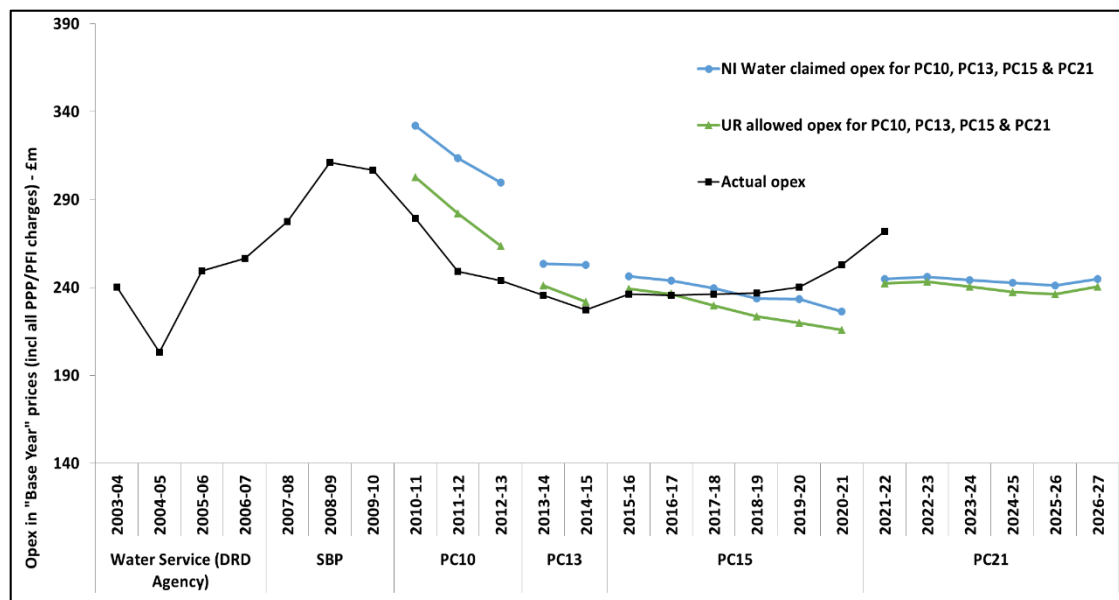


Figure 2.1: NI Water’s opex profile in real terms (2021-22 prices)

Closing the efficiency gap

- 2.6 For some of our previous Cost and Performance Reports, we compared NI Water’s opex efficiency position with companies in England and Wales, on an annual basis. The estimates were derived using our Corrected Ordinary Least Squares (COLS) econometric and unit cost models, as employed in the determinations for previous price controls, PC10, PC13 and PC15. These models were based on an Ofwat suite of models used for their price controls, PR04 and PR09.
- 2.7 Our analysis showed a continued improvement over time, with NI Water closing the efficiency gap to the ‘frontier’, or best performing comparator company, from around 49% in 2007-08 to an estimated 13% in 2014-15.
- 2.8 We no longer benchmark efficiency annually and now only do this when undertaking price controls. This aligns with the approach adopted by other regulators such as Ofwat or Ofgem. For PC21 we developed a new methodology for assessing NI Water’s operational efficiency gap. This utilised comparator data from Ofwat, NI Water performance data and new water and wastewater variables to inform our efficiency assessment for the

¹⁰ The rise in NI Water’s opex allowance in 2021-22 (first year of PC21) is partly due to its forecast rates bill increasing substantially over the year, driven by the LPS rating revaluation exercise.

price control.

- 2.9 From this analysis we concluded that NI Water had continued to close the efficiency gap to companies in England and Wales. Based on an assessment of comparative data up to 2018-19, we estimated that the gap had reduced to 5.7% compared to upper quartile performance by English and Welsh companies.
- 2.10 The historic profile of the efficiency gap determined through our assessments is shown in Table 2-1 below.

Price Control Efficiency Gap Analysis	Gap
2007-08 Opex efficiency gap used @ PC10	48.7%
2010-11 Opex efficiency gap used @ PC13	38.1%
2012-13 Opex efficiency gap used @ PC15	21.6%
2018-19 Opex efficiency gap used @ PC21	5.7%

Table 2-1: Historic opex efficiency gap analysis

- 2.11 This shows the significant progress that NI Water has made over recent price controls.
- 2.12 Since the last comparative analysis was undertaken for PC21, NI Water's real costs have risen sharply and further work will be required to establish whether this has been replicated across other comparative water and sewerage companies (WaSCs).
- 2.13 As power costs have been such a significant factor we undertook a high-level analysis which indicates that the proportional increase for this element of NI Water's expenditure was higher on average than that experienced by other WaSCs in England and Wales. We intend to consider this further as part of our PC21 mid-term review to establish the potential reasons for any differences and the extent to which this comparison is appropriate.

3. PC21 Performance

Performance against PC21 final determination targets

- 3.1 Tables 3.1 and 3.2 present our assessment of delivery against the PC21 final determination targets for 2021-22.
- 3.2 To ensure comparison with delivery on a like for like basis during the price control period, the PC21 targets will be adjusted to:
- Include outputs which were expected to be delivered in PC15 but carried over into PC21;
 - Exclude outputs planned for PC21 which were delivered early (i.e. in PC15); and
 - Account for movements between programmes.
- 3.3 If an adjustment is made, it will be noted against the target figure in the table.
- 3.4 In addition, when categorising underperformance, we will consider the impact of cost delays, re-profiling of delivery undertaken by the company and the potential for 'catch-up' when coming to a marginal assessment.
- 3.5 Colour coding has been used to indicate whether NI Water is on track, has met or outperformed its target (green), is marginally behind target (amber) or is more significantly behind target (red). Where the company was required to deliver an annual target, the shading is solid. Some targets are however set for PC21 as a whole and we report performance against these targets on a cumulative basis. In these cases, the same colour coding has been used but the shading has been hatched.
- 3.6 Our conclusion based on reported performance in the first year of PC21 is that NI Water broadly delivered against the PC21 final determination targets in overall terms. Comments on exceptions are provided under Table 3.1 and Table 3.2 below.

Water service targets

Line description		2021-22 Target	2021-22 Actual	Comments
A	Consumer Service Water			
1	DG2 Properties at risk of low pressure removed from the risk register by company action	147	176	On track
2	DG2 Properties receiving pressure below the reference level at end of year	492	1715	Behind target
3	DG3 Supply interruptions > 12hrs (unplanned and unwarned)	0.09%	0.08%	On track
4	DG3 Supply interruptions (overall performance score)	0.81	1.59	Behind target
5	DG8 % metered customers received bill based on a meter reading	99%	99.66%	On track
6	Unwanted contracts	67000	66064	On track
7	First Point of Contact Resolved (FPOCR)	84%	84%	On track
8	Net Promoter Score (all contacts)	42	32	Behind target
9	Total Leakage (Ml/d)	157	156	On track
10	Security of supply index	100	100	On track
11	% NI Water's power usage derived from renewable sources	45.0%	52.8%	On track
B	Water Quality			
12	% overall compliance with drinking water regulations	99.83%	99.88%	On track
13	% compliance at consumers tap	99.74%	99.82%	On track
14	% iron compliance at consumers tap	98.62%	99.35%	On track
15	% Service Reservoirs with coliforms in >5% samples	0.00%	0.00%	On track
C	Water Outputs			
16	Water mains activity - Length of new, renewed or relined mains (km)	140	102	Behind target
17	Completion of nominated trunk main schemes	0	1	On track
18	Completion of nominated water treatment works schemes	1	1	On track
19	Completion of nominated improvements to increase the capacity of service reservoirs and clear water tanks	1	1	On track
D	Serviceability			
20	Water infrastructure serviceability	Stable	Stable	On track
21	Water non-infrastructure serviceability	Stable	Stable	On track
E	PC15 Additional Output Measures			
22	Number of lead communication pipes replaced	1844	1864	On track
23	Number of school visits	176	299	On track
24	Number of events	57	64	On track
F	PC21 Additional Output Measures			
25	Number of Catchment Management Plans	0	0	On track
26	Number of treatability studies completed	0	0	On track

Table 3.1: NI Water PC21 key outputs for water services

- 3.7 NI Water met or outperformed most of its consumer service and water output objectives for 2021-22.
- 3.8 The company fell below target in four water service areas:
- Although the number of properties receiving low pressure was much higher than the target level set for the first year of PC21, this was a result of work undertaken by NI Water to 'refresh' its low pressure Register. At the time of the final determination it had been identified

that this was necessary due to concerns that the number of low pressure properties was being significantly under represented. This investigative work was therefore included as a PC21 'Development Output', with the understanding that targets would need to be 'rebased' once it had been completed and the extent of low pressure problems was better understood. During 2021-22 the numbers of registered low pressure properties increased significantly as a result of the modelling and investigations undertaken by NI Water and the variance between the target and the reported figure is a consequence of this. The targets will be revised at the PC21 mid-term review so that the full impact of the development output work can be taken into account. In the interim, NI Water's other DG2 performance measure (i.e. the number of low pressure properties removed by company action) will be used to monitor the delivery of improvements in this service area. As can be seen in the first row of Table 3.1 above, NI Water reported it was ahead of profile for achieving its price control target of removing 846 low pressure properties by company action (i.e. by removing 176 against a target figure of 147 in 2021-22).

- NI Water did not meet its target for the supply interruptions overall performance score in 2021-22. This was due to a major burst on a strategic trunk main affecting around 13,500 properties. Had this event not taken place, NI Water would have met its annual target.
- NI Water did not meet its target for Net Promoter Score in the first year of PC21. NI Water reported that this was, in part, attributable to the outcome of the Metering and Billing surveys completed during 2021-22. NI Water has made the case that the targets set in the final determination are too challenging as they were disproportionately influenced by atypical performance in a year where Covid impacted its ability to issue non-domestic bills. The PC21 mid-term review will provide an opportunity for the PC21 CM/SAT working group to consider performance over a longer period to confirm whether this is the case and if any changes need to be made.
- Water mains rehabilitation activity was behind the annual delivery profile targets stated in the final determination. These figures were based on the target length set for NI Water for the price control period as a whole (i.e. 838km). NI Water reported that a number of factors contributed to performance falling below target. These include: availability of resources due to the draw from other utilities such as gas, telecoms and Irish Water; increases in material costs; and the fact that more work was undertaken in urban areas which is generally slower to complete. It indicated it anticipates catching up with final determination targets by 2023-24.

Sewerage service targets

	Line description	2021-22 Target	2021-22 Actual	Comments
A	Consumer Service Sewerage			
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.	0	3	On track
2	DG5 Properties on the 2 in 10, 1 in 10 and 1 in 20 risk register at the end of the year	120	107	On track
B	Quality Sewerage			
3	% of WwTWs discharges compliant with numeric consents	92.1%	93.8%	On track
4	% of total p.e. served by WwTWs compliant with numeric consents excluding upper tier failures	99.2%	99.2%	On track
5	Small WwTW compliance (works greater than or equal to 20p.e. but less than 250p.e.)	90.76%	92.0%	On track
6	Number of high and medium pollution incidents attributable to NI Water	12	12	On track
C	Sewerage Outputs			
7	Sewerage activity - Length of sewers replaced or renovated (km)	10.1	30	On track
8	Delivery of improvements to nominated UIDs as part of a defined programme of work	7	4	Behind target
9	Delivery of improvements to nominated WwTWs as part of a defined programme of work	1 ¹¹	1	On track
10	Small wastewater treatment works delivered as part of the rural wastewater investment programme	6	2	Behind target
D	Serviceability			
11	Sewerage infrastructure serviceability	Stable	Stable	On track
12	Sewerage non-infrastructure serviceability	Stable	Stable	On track
E	New Output Measures			
13	CSO and EO discharges at which event and duration monitoring equipment has been installed	66	52	Behind target
14	WwTWs upgraded to comply with PPC Regulations	0	0	On track
15	Impermeable surface water collection area removed from the combined sewerage network (m ²)	364,540	1200	Behind target
16	Number of sustainable WwTW solutions delivered (p.e. ≥ 250)	0	0	On track
17	Number of sustainable WwTW solutions delivered (p.e. < 250)	0	0	On track
18	Number of Economic Constraint Areas Removed	0	0	On track
19	Number of Serious Development Restrictions Removed	4	0	On track

Table 3.2: NI Water PC21 key outputs for sewerage services

3.9 NI Water met or outperformed 15 of its 19 sewerage service output objectives in 2021-22. Further details are provided below on the four service areas where performance fell below target:

- NI Water delivered fewer improvements to nominated unsatisfactory intermittent discharges (UIDs) than planned. Two of the 2021-22 outputs were delivered and the remainder have been re-profiled to later in the programme. Delays in two projects resulted in the

¹¹ Target amended for reasons described in 3.2 to ensure a like for like comparison with delivery

beneficial use dates for four outputs moving to 2022-23 and a council request for a planning application resulted in the delivery of another planned UID being delayed. Some of the 2021-22 shortfall was met by the delivery of two UIDs which were brought forward within the programme from later years.

- NI Water did not achieve its target of delivering six small wastewater treatment works through the rural wastewater investment programme. NI Water reported that this was due to manufacturing delays impacting the delivery of three wastewater treatment units and one constructed works not achieving the necessary level of performance. Delivery of these four schemes will be re-profiled within the overall programme for PC21.
- NI Water installed event and duration monitoring equipment at 52 combined sewer overflows (CSOs), against a combined target of 66 for CSOs and emergency overflow (EO) discharges. The company has advised that the shortfall was a result of it deferring installations at wastewater treatment works to allow it to complete work being undertaken with NIEA to identify the most appropriate form of measurement. This programme of work has been identified as a PC21 'development output' due to the significant amount of further investigation required to confirm the priority, scope and scale of monitoring required. This includes the interaction with Drainage Area Plan models currently under development.
- The impermeable surface water collection area removed from the combined sewerage network was significantly below the target set. NI Water's PC21 business plan had indicated that the target for storm water removal was of low confidence and a 'development output' was included in the final determination as a result. In addition we also queried the scale of the 'step change' in delivery proposed by NI Water as part of the determination process but the company did not propose any target adjustments at the time. NI Water plans to provide further information, informed by modelling work completed in the early years of PC21, as part of its PC21 mid-term review capital investment submission. The provision of this additional information will allow us to determine if the targets need to be amended as part of the mid-term review process.

Quality compliance

- 3.10 Performance against some targets can be affected by things outside the company's control, such as the weather or sampling regimes. For PC21, we

identified performance ranges for water and wastewater quality which reflected this inherent variability. The specific annual targets for water and wastewater quality which were based on these ranges were all met in the 2021 calendar year (annual information report year 2021-22) as shown in Block B of Table 3.1 and Table 3.2 above.

- 3.11 The PC21 water quality output targets were set just below the average of the estimated performance ranges. Based on this analysis, the company might be expected to fall below these targets at certain times during the price control period. However when we engaged with NI Water in the determination process it advised that it expected to outperform these targets throughout.
- 3.12 In 2021, performance for all the water quality measures (overall water quality compliance, compliance at consumers' taps and iron compliance) lay at or close to the top of the performance range, as shown in the graphs below, and therefore well above the specific output targets.

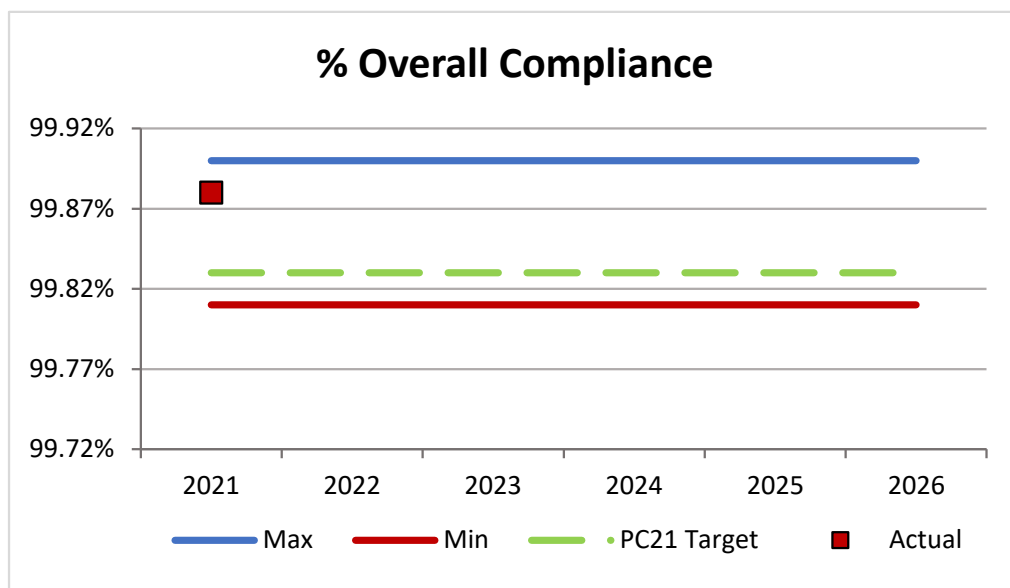


Figure 3.1: Overall water quality compliance

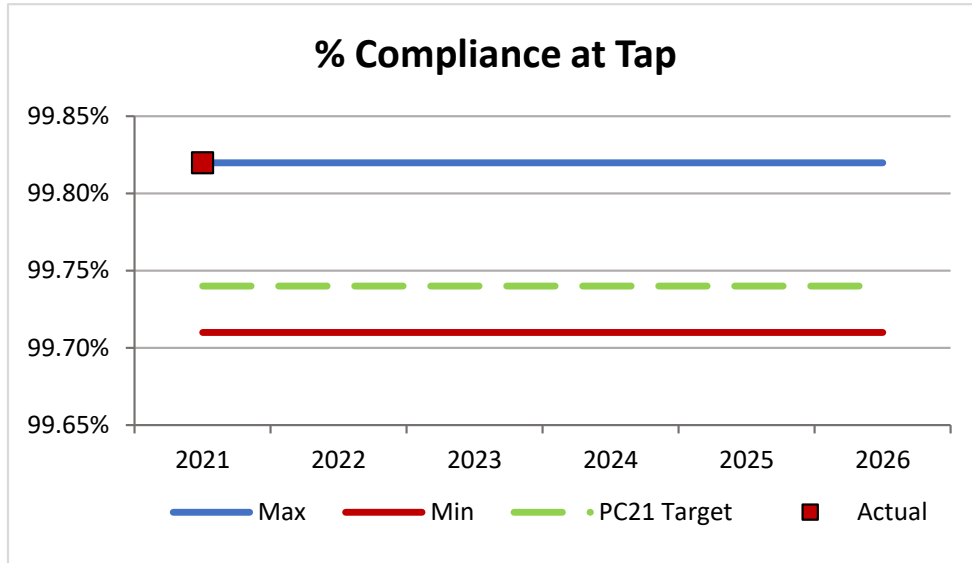


Figure 3.2: Water quality compliance at the tap

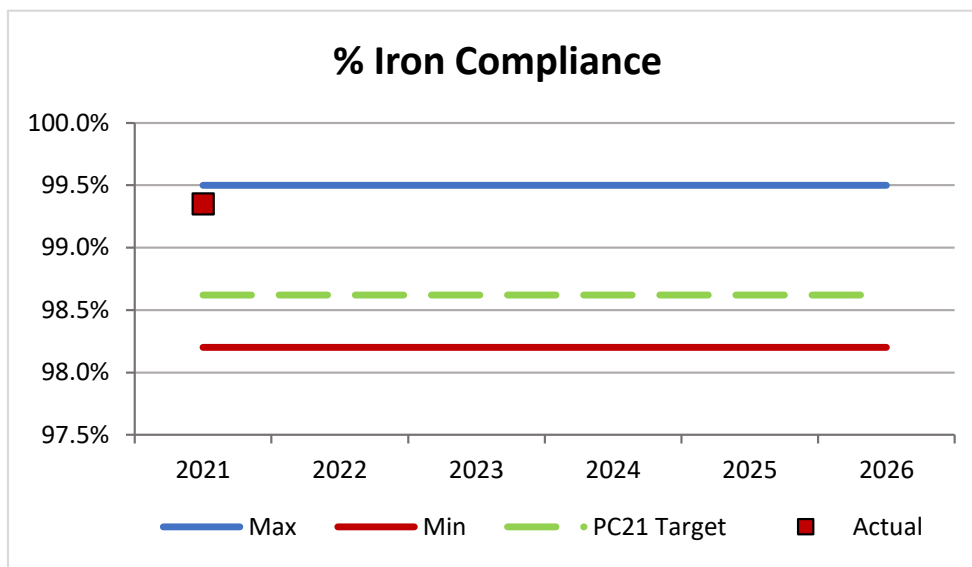


Figure 3.3: Water quality compliance at tap for iron

3.13 The PC21 targets for wastewater compliance, measured on the basis of the percentage of treatment works complying, were set at the bottom of our projected operating range, as shown in Figure 3.4 below. We therefore noted in the final determination that these targets represent the minimum level of performance we expect the company to achieve and we would expect NI Water performance to consistently lie above them during PC21. Figure 3.4 shows that this was the case in 2021.

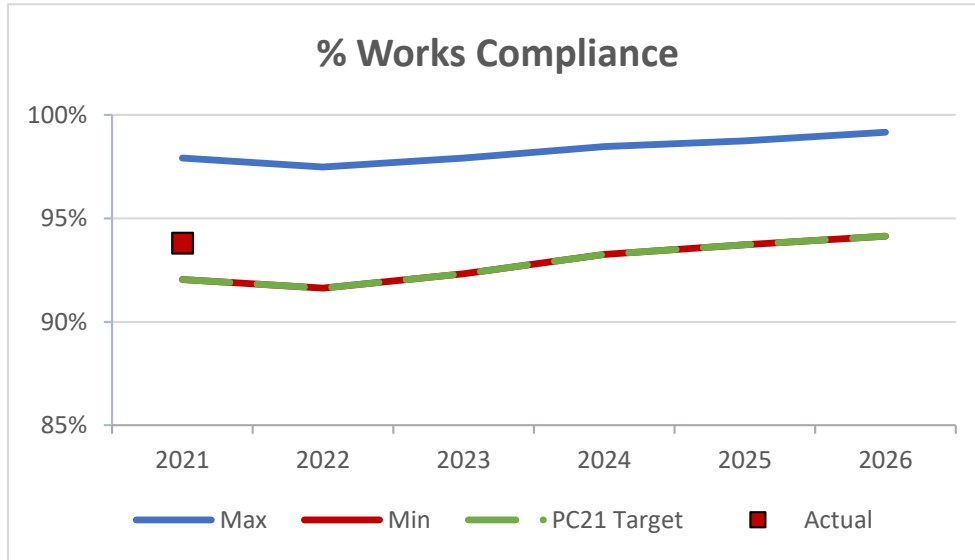


Figure 3.4: WwTW discharges compliant with numeric consents

3.14 NI Water’s proposed PC21 targets for wastewater compliance, measured on the basis of the population served, were accepted as they lay within our performance range as shown in Figure 3.5 below. We would expect NI Water performance to lie at or around this level and consistently above the minimum of our performance range during PC21. Figure 3.5 shows that this was the case in 2021.

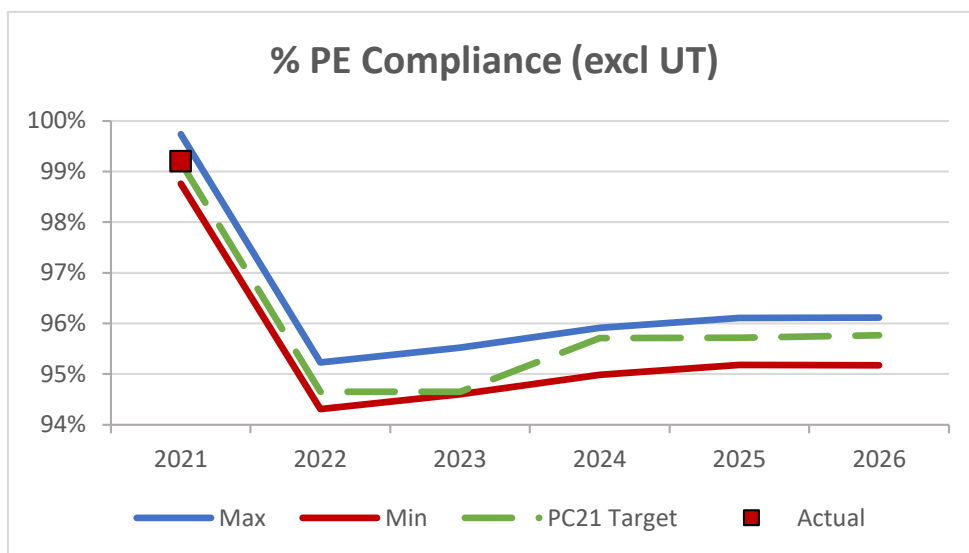


Figure 3.5: Population equivalent served by WwTWs compliant with numeric consents¹²

¹² The PC21 output measure for “Population equivalent served by WwTWs compliance with numeric consents” excludes upper tier failures. The step change in 2022 reflects a change in consent standards at two relatively large works leading to them becoming non-compliant.

Serviceability

- 3.15 We use trends for a range of primary and secondary serviceability indicators to assess how the company is maintaining its assets.
- 3.16 We have updated our PC21 final determination serviceability assessment for each primary and secondary indicator to include outturn data for the first year of PC21. The updated trends of the primary indicators in the four service areas are shown below. All four primary measures have been recorded as 'stable'. This results in an overall trend of '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	Percentage of WwTW discharges not compliant with numeric consents

Table 3.3: Primary serviceability indicators

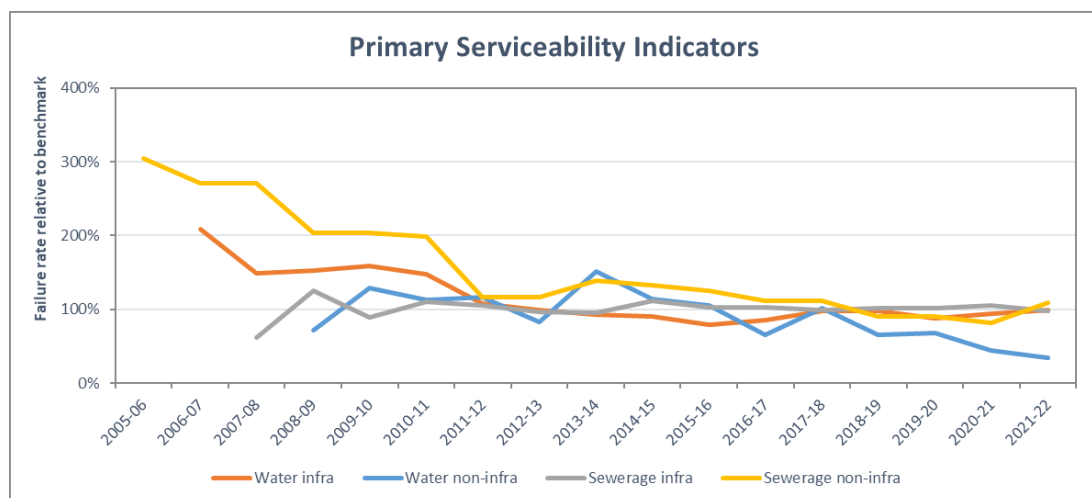


Figure 3.6: Primary serviceability indicator trends¹³

- 3.17 While our current assessment is that serviceability remains stable overall, some secondary serviceability indicators have shown improvement. In these cases we will monitor performance to establish whether this is sustained and merits any changes to our assessment moving forward.

¹³ A score of 100% represents operation at the reference level benchmark and a horizontal trend around this benchmark is indicative of stable serviceability. A reducing trend indicates an improvement and an increasing trend indicates a deterioration.

4. Capital Expenditure

PC21 investment

- 4.1 Our PC21 final determination allowed for a significant increase in the level of capital expenditure compared to previous price controls. This included a rapid rise in the early years of PC21. The overall nominal allowance of around £2bn represented an increase of c87% in real terms compared to the previous price control, PC15. This increase was determined as being necessary to start to address the lack of capacity in sewerage networks and wastewater treatment works which is acting as a constraint on development and economic growth.
- 4.2 It is recognised that the level of investment required in PC21 and subsequent price controls will place pressures on public expenditure budgets and that higher levels of inflation and cost pressures have the potential to exacerbate this issue. We will therefore continue to work with NI Water, DfI and other key stakeholders to ensure that the company continues to deliver the best possible package of outputs within the funding provided.

Expenditure to date

- 4.3 NI Water invested around £229m¹⁴ in 2021-22 to:
- Maintain its existing assets;
 - Meet more demanding quality obligations;
 - Provide extra capacity for growth; and
 - Improve the levels of service it currently provides.
- 4.4 Inflation in 2021-22 was higher than we assumed in our final determination, which represents a change from PC15. This increase in RPI was allowed for by DfI in NI Water's public expenditure Capital DEL allocation, resulting in a figure which was £5.2m higher than published in our final determination.
- 4.5 Investment in 2021-22 was £40m higher than the re-indexed allowance of £189m. This was primarily a consequence of NI Water making use of an

¹⁴ This figure includes both Interreg and International Financial Reporting Standards (IFRS) costs. The Interreg cost relates to projects where costs are shared with the Republic of Ireland. Interreg costs do not form part of our price control determination as they are funded separately. The Interreg cost in 2021-22 was c. £1m. The IFRS cost relates to the accounting methods used to complete the annual returns. NI Water added this to its capital investment monitoring table as a distinct line after the standard was introduced. The IFRS cost in 2021-22 was c. -£2m. Had these costs not been included in the analysis, the annual total would have been £1m higher, at £230m.

additional budget of around £31m that was available within Dfl by accelerating the delivery of PC21 schemes, though it should be noted that there can be a lag before this is reflected in the delivery profile of nominated outputs. This 'early' allocation was provided on the understanding that it would be balanced by equivalent budget reductions in subsequent years. The remainder of the additional expenditure largely resulted from additional in-year allocations for Living with Water and a renewable energy pilot.

- 4.6 In PC15 we noted that some of the sewerage projects that were intended to deliver priority nominated outputs had been subject to delay. This has continued in 2021-22. However, as this is only the first year of the price control, it is too early to draw any firm conclusions on this and so we will continue to monitor the extent to which this pattern is sustained.

Expenditure by purpose

- 4.7 The allocation of investment by purpose in 2021-22 is shown in Figure 4.1 below. Investment to maintain existing assets (base maintenance expenditure) was 53%. This was a similar level to 2020-21 and PC15 as a whole. The remaining 47% was enhancement expenditure which was used to improve quality compliance, improve the services delivered to consumers and provide for growth.

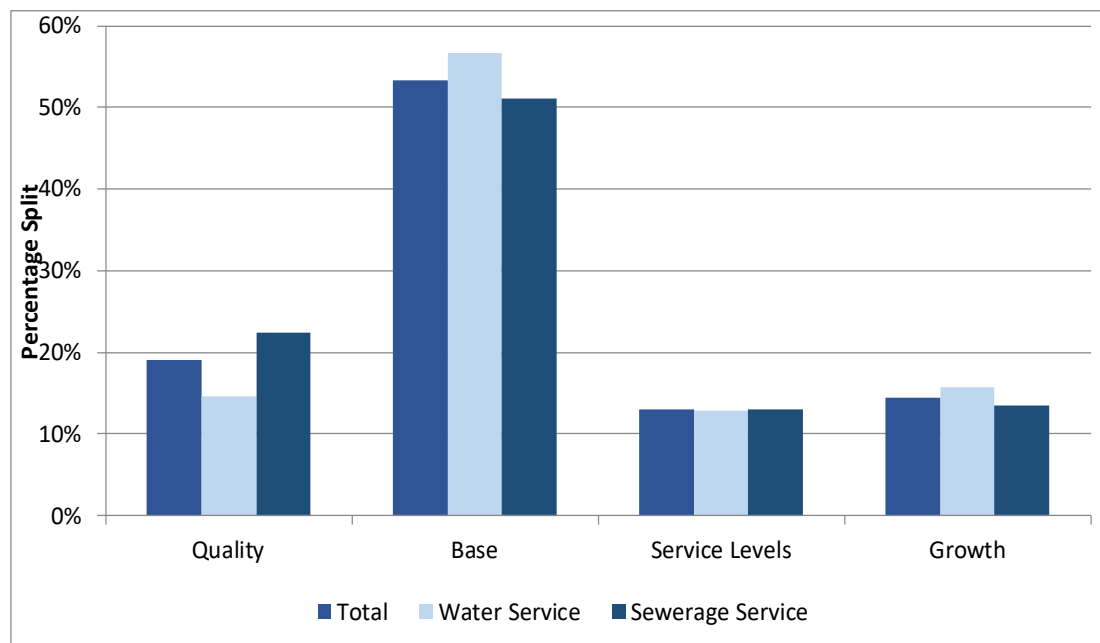


Figure 4.1: Allocation of investment in 2021-22 by service and purpose

- 4.8 As indicated above, the investment to maintain the company's existing assets and the service they deliver is the largest element of the company's

capital programme by proportion. In 2021-22, the company invested £122m in base maintenance, which was approximately £3m higher than the average annual nominal allowance of £119m provided for in the PC21 final determination.

4.9 NI Water’s ability to maintain the service delivered by existing assets to existing consumers during the PC21 period depends on it managing the balance between ‘base’ and ‘enhancement’ expenditure effectively over the period as a whole. This needs to take account of movements in inflation and be informed by associated performance, including serviceability trends. The increase in expenditure in 2021-22 was in line with what we would have expected the company to spend to maintain serviceability when the higher than assumed level of inflation is taken into account.

Expenditure profile

4.10 In previous Cost and Performance Reports, we have highlighted a consistent annual cycle of expenditure. Peak levels of investment occur in the winter months and expenditure is at its lowest level in the first half of each year. Figure 4.2 shows that this trend has continued into PC21. This cycle of investment, driven by annual spending constraints, remains disruptive for the supply chain and detrimental to efficient delivery. It could be mitigated by longer term budget allocations and end of year flexibility.

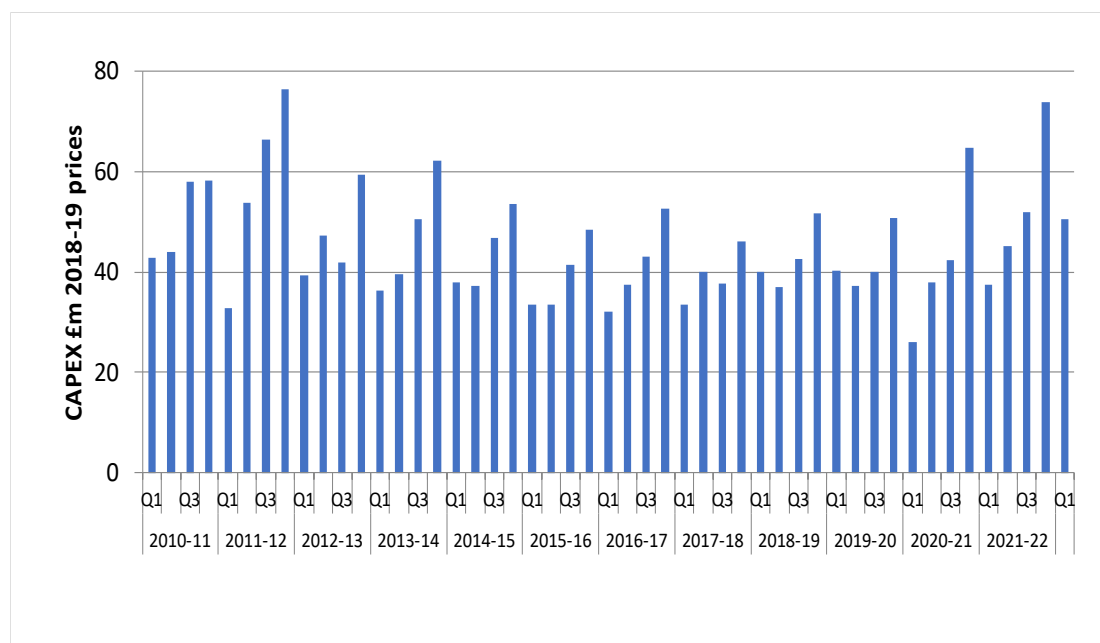


Figure 4.2: Capital investment from 2010-11 to 2021-22 Q1 by quarter¹⁵

¹⁵ The 2021-22 capex figures in Figure 4.2 also include the Interreg and IFRS figures (see footnote 14 for details).

5. Development Objectives

- 5.1 The promotion of long-term planning continues to be a key component of our approach in PC21 and the 25 development outputs specified for the price control are set out in Table 3.3 of our PC21 final determination main report. This identifies the key areas where we expected the company to provide additional information on its plans to develop capability.
- 5.2 This follows on from the approach adopted in PC15, where we identified the need for the company to be more specific in defining the steps it will take over the long term to improve planning and the delivery of improved service.
- 5.3 The process for monitoring delivery of each development objective has also been retained for PC21, with NI Water reporting delivery against the associated project milestones in its Annual Information Return. In addition we have been engaging directly with NI Water on individual objectives to better understand the progress being achieved.
- 5.4 Our interpretation of the reported status for each of these outputs in the first year of PC21 can be seen in Table 5.2 below. Within the final determination we recognised the potential for NI Water's delivery plans to change as a consequence of the time that would have passed between the company's business plan submission and any further development and planning work that would have been completed in the intervening period. We therefore asked the company to submit updated delivery plans for its development objectives in the first year of PC21. The status reported in Table 5.2 below is based on these updated plans which will be used as the basis for reporting progress for the remainder of PC21.
- 5.5 Where an output is designated as 'On Track', there is good evidence of alignment with our monitoring expectation (as outlined in the final determination) and the individual milestones set for each output are on track or have been met. 'Complete' means that all the original requirements of the objective have been met¹⁶. Outputs needing 'Further Work' require further evidence to prove alignment with the monitoring expectation set out in our final determination. 'Delayed' means that targets have not been met due to factors outside the company's control.

¹⁶ It is recognised that additional milestones may have been identified during delivery which will be assessed on an ongoing basis as required.

	Development Output	Status
1	Consumer Engagement	On Track
2	Consumer Protection / Customer Care Register	On Track
3	NI Water Alpha Ltd - WTWs Treatability Improvements	On Track
4	DWD Recast & Emerging Issues Study	Delayed ¹⁷
5	Refresh of DG2 Register	On Track
6	Targeted Mains Renewals in High Leakage Areas	On Track
7	Leakage Innovation	On Track
8	Smart Networks – ITS Strategy	On Track
9	WwPS / CSO Quality (UID) and WwPS (Capacity increase)	Further work needed ¹⁸
10	Event Duration Monitors WwPS/CSOs	On Track
11	Cranfield Catchment, Killeel Storm Separation	Further work needed ¹⁸
12	Storm Water Separation	On Track
13	Real Time Network Modelling	On Track
14	Urban Drainage Modelling - Live Models for IOC	On Track
15	Innovation Initiatives	On Track
16	Urban Drainage Modelling - Studies to Inform PC27 - Top 271 Priority Drainage Areas	On Track
17	Raw Water Trunk Main Rehabilitation	On Track
18	Culmore DA KL554 - Skeoge Link Road	On Track
19	LWWP Networks	Further work needed ¹⁸
20	LWWP Wastewater Treatment Works	Further work needed ¹⁸
21	AD - Asset Strategy - Wastewater Asset Performance Modelling	On Track
22	AD - Asset Strategy - Water Asset Performance Modelling	On Track
23	Facilities H&S Compliance	On Track
24	Smart metering	On Track
25	Addressing scope uncertainty for the Mid-term Review	Further work needed ¹⁸

Table 5.2: Progress against PC21 Development Outputs

¹⁷ Uncertainty over the extent of implementation of the recast Drinking Water Directive in Northern Ireland has resulted in delay in this DO. This was outside NI Water's control.

¹⁸ Although the batch 1 and 2 submissions were received on time, NI Water deferred the submission of a lot of the information to later batches. The reported status is reflective of the extent of the deferral that occurred. The company indicated that it still planned to submit all necessary information within the overall timeline for the scope/certainty 'batch' submissions.

- 5.6 Nineteen of the 25 development outputs are on track to be delivered within the designated timeframe, reflecting the good progress outlined in NI Water's Annual Information Return commentary.
- 5.7 The reasons for any exceptions are detailed in the relevant footnotes to the table. We have not commented more fully on progress at this point of time as we are only in the first year of the price control and it is difficult to draw any firm conclusions at this early stage. We anticipate that our commentary will become more extensive as the price control progresses and NI Water's success in meeting its development objective delivery programmes becomes clearer.
- 5.8 For some development objectives, funding for the second half of the price control period is contingent on the outcomes achieved in the first half of the period. NI Water is therefore expected to submit a summary of the technological performance and a cost/benefit appraisal for the smart metering and leakage innovation development objectives at the PC21 mid-term review for consideration. A decision will be taken on whether these are retained as development objectives and are funded for the remainder of PC21 following the conclusion of the mid-term review process.

6. Other Financial Matters

Turnover

- 6.1 We determine price limits (referred to as K factors) to be applied over the price control period. The K factors are the annual percentage increase or decrease in charges above or below inflation. An annual approval process is then undertaken to ensure tariffs are in line with the determination. The 2021-22 tariff was approved in advance of the PC21 final determination. This was unusual and due to the delay in its publication. However, the approved tariff was then assumed within the final determination, meaning any resulting changes fed into years two to six of PC21.
- 6.2 Actual turnover will vary from determination forecasts over time as inflation, volumes and accounting adjustments impact on the final reported turnover within the annual accounts. Actual regulated turnover of £416.7m was slightly higher than the PC21 forecast of £413.1m.

Operating profit¹⁹

- 6.3 The operating profit of £101.2m during 2021-22 is lower than £115m in 2020-21. Changes in operating costs have been highlighted in Section 2, earlier in this report.

Dividend

- 6.4 A dividend of £31.2m was paid to the company shareholder, Dfl, during 2021-22. This compared to £29.9m in 2020-21.

Loan profile

- 6.5 Dfl loans increased from £1.270 billion at the end of 2020-21 to £1.440 billion at the end of 2021-22.

Regulatory capital value

- 6.6 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 investment in new assets and reduced by the value of assets that have been depreciated or sold off in the year. NI Water's RCV has grown steadily from the start of its first price control

¹⁹ Regulatory Accounts, Appointed Business only

(PC10) and stands at £2.832 billion at the end of 2021-22. This has increased from £2.611 billion at the end of 2020-21 and reflects the ongoing level of investment in infrastructure.

- 6.7 More detail on NI Water's financial information is set out in the company's statutory and regulatory accounts. These can be found on NI Water's website²⁰.

²⁰ <https://www.niwater.com/publications/>