

Utility Regulator's Cost and Performance Report for NI Water

Price Control 2010 to 2013

Summary

The role of the Utility Regulator is to protect the short and long-term interests of consumers as well as ensuring adequate levels of funding for NI Water. A key focus is on ensuring that consumers receive value for money water and sewerage services. This report reflects our assessment of NI Water's performance over the company's first regulatory price control period, PC10 which covers the period 1st April 2010 to 31st March 2013.

NI Water has performed well against our price control determination which allowed nominal revenues of £1.099 billion for the three-year period, £91 million less than that sought by the company. As part of the process we benchmarked NI Water's costs and levels of service to other water companies and set challenging targets for improvement.

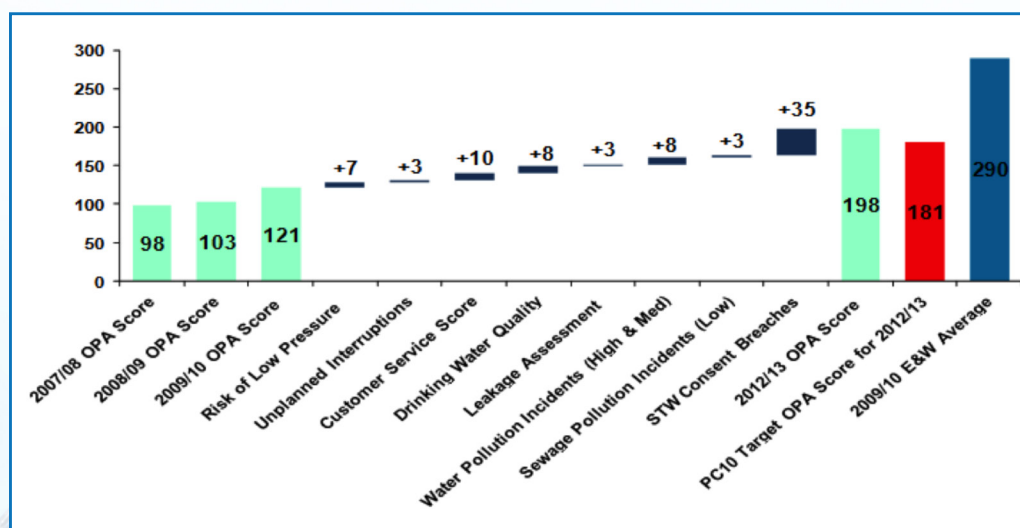
During this timeframe NI Water has faced some significant challenges which include a number of extreme weather events, the freeze/thaw of 2010/11, flooding in June 2012 and the snowfall of March 2013. A significant lesson from the freeze/thaw event was the need for an enhanced focus on communicating effectively with consumers.

During PC10, NI Water has been affected by delays and changes in the available capital funding, arising from its Non-Departmental Public Body status. The combined impact was to reduce the planned and prioritised capital investment over the period by £61 million.

We are pleased to report that in overall terms NI Water has successfully delivered its first regulatory price control, reducing prices and improving services to consumers, as assessed against the PC10 determination and Monitoring Plan for the period.

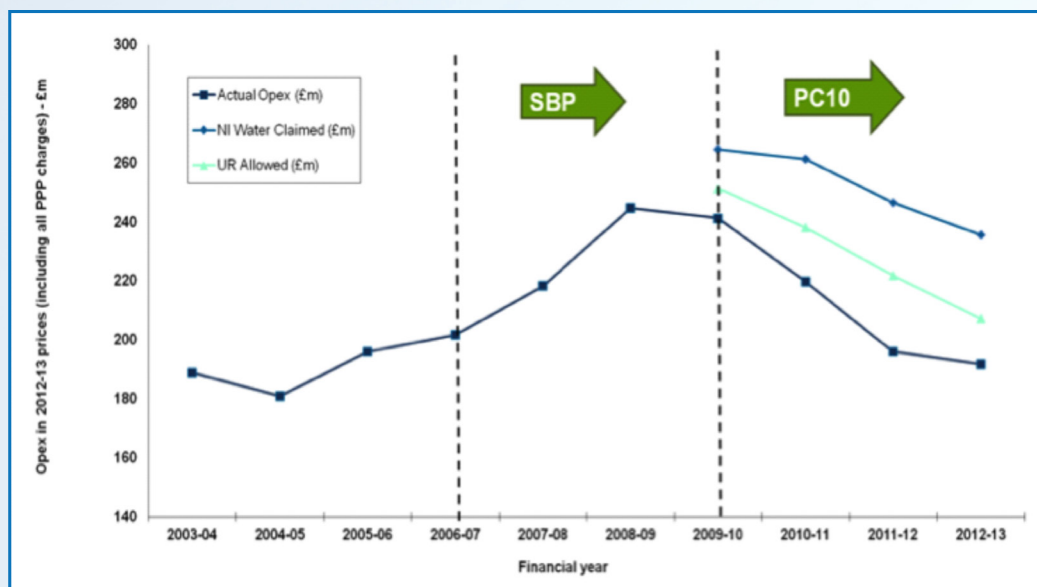
Overview of PC10 Costs and Performance

Improved levels of service - NI Water has improved its Overall Performance Assessment (OPA) - a composite measure of a range of targets (e.g. pressure, leakage, water quality) from 121 at the start of PC10 to 198 at the end - outperforming its target of 181.



Improved efficiency - NI Water has outperformed its PC10 efficiency targets and continues to lower the relative gap to the benchmark companies. For every £1 spent by the frontier benchmark, NI Water spends £1.32 - compared to £1.66 at the start of PC10.

Lower operating costs - NI Water has reduced its operating costs in 2012-13 prices from £241 million at the start of PC10 to £192 million at the end, as depicted in the graph below:



PC10 delivery assessed against the Monitoring Plan

The regulatory contract for PC10 is based on a Monitoring Plan in which NI Water set out its commitments to consumers and specific delivery targets. These delivery targets were developed from the overall priorities and objectives for PC10 set out in Social and Environmental Guidance which the Department for Regional Development issued to the Utility Regulator. They included a blend of three different types of output measure:

- Service level measures to reflect the service as experienced by consumers and/or impact on the environment.
- Nominated outputs which are commitments to deliver specific upgrades such as an improved wastewater treatment standard or a new water trunk main.
- Activities such as the length of new or replaced water main.

NI Water met 26 of 33 key outputs with some failures outside management control, being attributable to extreme weather events and reductions in capital funding.

Key areas where performance did not meet the target include: interruptions to supply and delivery of reservoir engineer inspection recommendations where investment will continue into PC13. Further detail on NI Water's performance against the Monitoring Plan and Social and Environmental Guidance may be found in the Annexes to our full Cost and Performance report which may be accessed at: www.uregni.gov.uk

Changes to planned capital expenditure

NI Water's Non-Departmental Public Body status means that it is subject to public expenditure regimes. Consequently, capital funding is confirmed on an annual basis and expenditure restricted to the specific year.

During PC10, NI Water has been affected by delays and changes in the available budget. The key delays and changes were:

- In 2010-11, NI Water was unable to spend £31 million of its capital budget.
- A public expenditure Comprehensive Spending Review (CSR) completed at the end of 2010-11 increased the available capital budget in 2011-12 by £4 million and reduced the capital budget available for 2012-13 by £46 million.
- Half- way through 2012-13 a further £12 million capital funding was made available to NI Water which was invested in the last quarter of the year.

NI Water, as a NDPB is unable to move planned expenditure between years to accommodate delays or changes in budget. Money which cannot be spent in one year is a lost opportunity to invest in improvements to water and sewerage services.

During PC10 the impact of delays and changes meant that capital investment was reduced by £61 million (11%).

The impact on the various investment drivers can be seen below.

Investment Driver	PC10 Final Determination (£ million)	PC10 Actual Capital Expenditure (£ million)	Difference (£ million)
Quality to ensure compliance with quality standards and EU directives	169	113	-56
Base Maintenance needed to maintain current levels of service	257	254	-3
Enhancement to improve current levels of service	42	29	-13
Growth to ensure development can be accommodated	110	121	+11
Total	578	517	-61

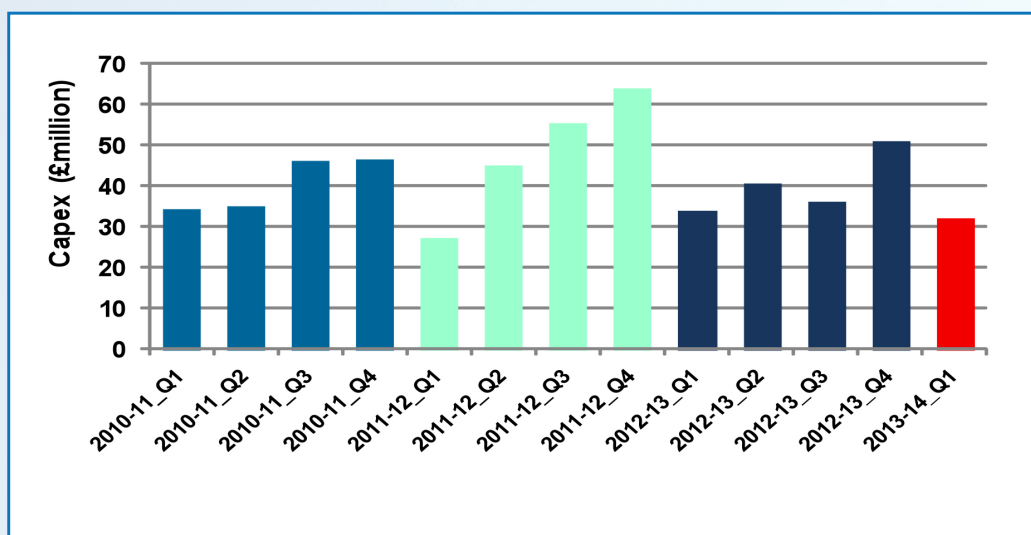
The capital expenditure fluctuations which occurred during PC10 are undesirable. A fixed and confirmed capital budget for a price control period is preferable for such a capital intensive business.

As part of our work on the price control for 2013-15 (PC13) we assessed the value of the outputs delivered in PC10. We concluded that the company has:

- delivered the capital efficiency challenge of the PC10 final determination;
- maintained the serviceability of its assets; and,
- broadly delivered the revised asset performance measures and nominated outputs for PC10.

Profile of capital expenditure impacting on delivery and efficiency

For each year of PC10, the peak level of expenditure was in the winter months and there was an abrupt reduction in expenditure between the last quarter of one year and the first quarter of the next (see graph below). In the transition between 2011-12 and 2012-13, expenditure per quarter reduced by 47%, in part reflecting the reduction in total budget for 2012-13. This cycle of investment is disruptive for the supply chain and detrimental to efficient delivery.



Given the constraints and challenges faced by the company, investment performance in PC10 was generally good, following a slow start in 2010-11. Addressing some of the issues raised by annual investment constraints would allow the company to further improve its investment performance.

Freeze/thaw resilience

The 2010-11 freeze/thaw event resulted in significant disruption to water supplies with around 450,000 consumers in 215,000 properties experiencing some supply interruption during the week after Christmas.

Following the freeze/thaw event the Utility Regulator reported to the Executive on NI Water's performance and recommended 56 actions to reduce the impact of similar events in the future. All but two of the short/medium-term actions have been delivered. These outstanding actions relate to developing revised asset standards for plant and fittings and we are satisfied they are being progressed.

A significant issue during the freeze/thaw event was the company's means of communicating with consumers. NI Water has since focused on and strengthened its emergency response capability, including its ability to gather information, communicate with consumers and mobilise mutual aid during an emergency.

The full version of the Cost and Performance Report for NI Water for PC10 may be accessed on our website at: <http://www.uregni.gov.uk/>. In addition, this document can be provided in accessible formats on request. Please contact Deirdre Matheson to request this (deirdre.matheson@uregni.gov.uk or 028 9031 6649).