

Water and Sewerage Services

Cost and Performance Report 2013-14

An assessment of NI Water's costs and performance

October 2014



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 the 1st year of its second regulatory price control, PC13, covering the period from April 2013 to March 2015. A more detailed assessment will take place at the end of this price control.

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 2014 in relation to our price control.

Cost & Performance Report 2013-14

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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 first regulatory price control of PC10 began on April 2010 and ran until March 2013. PC10 was a challenging price control with extreme weather conditions. However, in overall terms, NI Water successfully delivered against the PC10 final determination and Monitoring Plan for the period. The company succeeded in reducing prices and improving service to consumers. NI Water's second price control period (PC13) commenced on 1 April 2013 and runs for the two-year period until 2015. This 2013-14 Cost and Performance Report (CPR) assesses performance in the first year of PC13. Next year's report will be a more detailed assessment of NI Water performance over the entire two-year price control period.

Key Findings

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

- NI Water's opex costs reduced in nominal terms from £191.7m in 2012-13 to £190.7m in 2013-14. Although this only translates into a £1.1m nominal fall, given that inflation over the last year stood at 2.9%, this represents a 3.3% real terms reduction in the day-to-day running costs of the business.
- Capital investment has been delivered to budget. Our assessment of current and projected investment indicates that the company will deliver value for the capital committed over PC13.
- Service levels in NI Water have improved over the year. The company achieved its highest ever overall performance assessment or OPA¹ score of 216 and outperformed the annual OPA target of 202. However, scope remains for further service improvement, 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 for the current year including 12 out of 16 consumer service measures and all water and sewerage quality KPIs. It is also 'on track' to deliver the vast majority of output measures having delivered all serviceability KPIs.

¹ The OPA was introduced in our first Cost and Performance Report on NI Water in 2007-08. A fuller explanation of its current measurement can be found in our most recent PC15 price control, see: www.uregni.gov.uk/uploads/publications/UR_PC15_DD_Annex_E_-_Overall_Performance_Assessment.pdf

1.0 Costs and Efficiency

1.1. Overall Financial Performance

Turnover

- 1.1.1 Regulated turnover for 2013-14 was £361.3m compared to the PC13 forecast of £356.8m. The over-recovery can be attributed to a number of reasons including higher RPI inflation, higher domestic customer numbers, increased volumes and under recoveries from PC10.

Operating Profit

- 1.1.2 The current cost operating profit of £19.8m was below the PC13 prediction of £52.6m. This is due to increases in predicted depreciation. However, this is partially offset by lower opex costs and higher than projected turnover. The largest single variation was the level of current cost depreciation which was £135.5m compared to £98.3m in the PC13 business plan. This deviation is largely due to accelerated depreciation on decommissioned assets of £25.6m.

Dividend

- 1.1.3 The dividend to the company's shareholder DRD in respect of 2013-14 was paid post year-end in July 2014 (as dividends are paid one year in arrears) and equated to some £24m. This was in line with PC13 projections.

Loan Profile

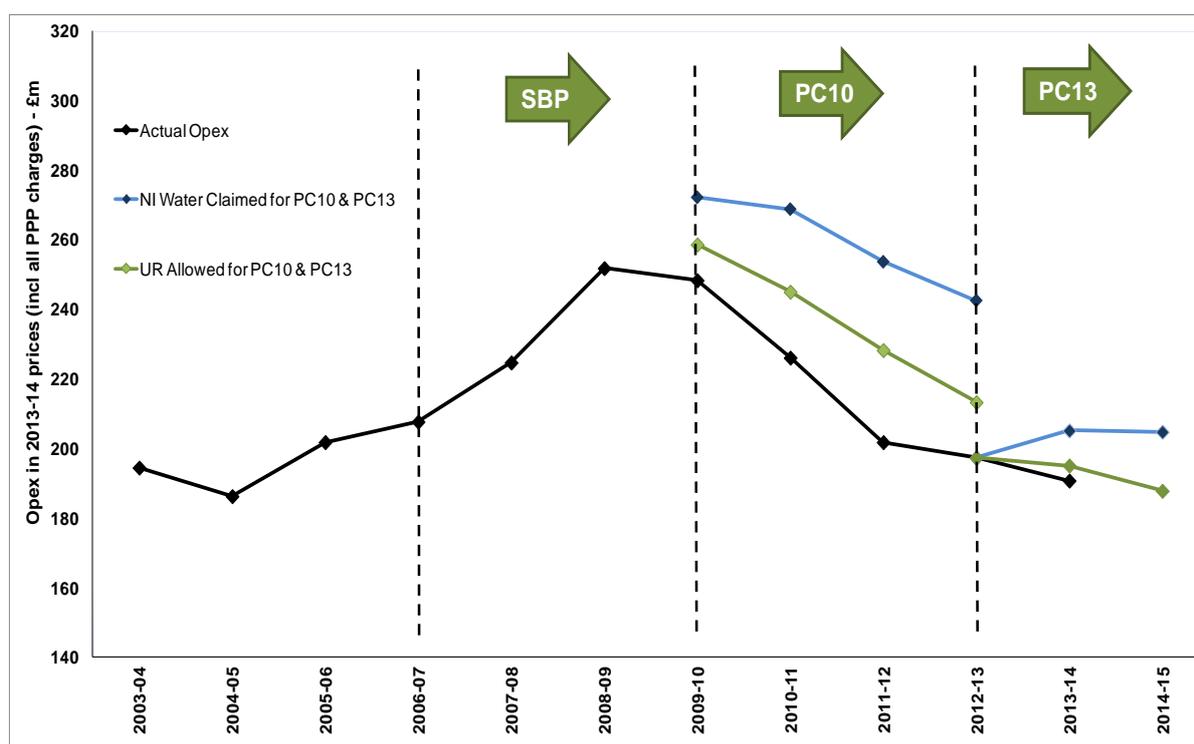
- 1.1.4 The level of DRD loans reached £912m as compared to the £973m PC13 prediction. This reduced level of borrowing resulted in a gearing level of 49.1% which is well below the upper guideline in the PC13 final determination.
- 1.1.5 More detailed information on NI Water's financial information is set out in the company's statutory and regulatory accounts. These can be found in NI Water's website. (www.niwater.com/reports/)

1.2. Operational Expenditure

- 1.2.1 NI Water's opex costs reduced in nominal terms from £191.7m in 2012-13 to £190.7m in 2013-14. Although this only translates into a £1.1m nominal fall, given that inflation over the last year stood at 2.9%, this represents a 3.3% real terms reduction in the day-to-day running costs of the business.
- 1.2.2 For the 2013-14 year, we allowed NI Water opex of £195.0m in current prices. Comparison against actual spend shows an outperformance of some £4.3m in-year. This figure rises to £5.6m if VER/VS is excluded from actual spend.²

² We consider £5.6m to be the more appropriate outperformance figure as VER/VS (Voluntary Early Retirement / Severance) spend was supported in principle but not funded through charges.

Figure 1.1: NI Water's opex profile in real terms (2013-14 prices)³



1.2.3 NI Water's cost profile over the last five years has been one of reducing real opex. This is shown in the figure above.

1.2.4 Over the year, sizeable reductions in real opex have been seen in the categories of wages and salaries, power costs, and rates. In addition, there have been other noteworthy falls in accommodation costs and bad debt.

1.3. Closing the Efficiency Gap

1.3.1 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. NI Water has closed the efficiency gap to the 'frontier' from around 49% in 2007-08 to a provisional estimate of 18%⁴ in 2013-14.⁵

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 £1.22.

³ The chart represents actual expenditure (including VER/VS) and the regulated allowance (excluding VER/VS), so will not be totally consistent with outperformance of £5.6m.

⁴ Our PC15 draft determination uses a 2012-13 base year, the year prior to this report. The PC15 efficiency gap is then some 23% compared to the current provisional estimate of 18%.

⁵ Figures for the 2013-14 year may change as updated information becomes available.

2.0 PC13 Monitoring Plan Performance

2.1.1 Tables 2.1 and 2.2 report progress against the PC13 Monitoring Plan output targets⁶. Colour coding has been used to indicate whether NI Water met or outperformed its target for 2013-14 (green), or failed its annual target (red).

2.1.2 Some targets were set for PC13 as a whole. We will report performance against these targets on a cumulative basis. Delivery against these cumulative targets is shown in hatched colours.

Table 2.1 – NI Water PC13 Key Outputs for Water Services for 2013-14

Line description		2013-14 Target	2013-14 Actual	Comments
A	Consumer Service Water			
1	DG2 Properties at risk of low pressure removed from the risk register by company action	118	132	On track
2	DG3 Supply interruptions > 12hrs (unplanned and unwarned)	0.19%	0.14%	Target met
3	DG3 Supply interruptions (overall performance score)	1.12	0.97	Target met
4	DG6 % billing contacts dealt with within 5 working days	99.90%	99.92%	Target met
5	DG7 % written complaints dealt with within 10 working days	99.25%	99.72%	Target met
6	DG8 % metered customers received bill based on a meter reading	98.50%	99.11%	Target met
7	Call Handling Satisfaction score (1-5)	4.70	4.63	Marginally below target
8	DG9 % calls not abandoned	99.00%	98.40%	Marginally below target
9	DG9 % calls not receiving the engaged tone	99.90%	100.0%	Target met
10	Overall Performance Assessment (OPA) score (11 Measures)	202	216	Target met
11	Total Leakage (MI/d)	169	167	Target met
12	Security of supply index	97	100	Target met
13	% NI Water's power usage derived from renewable sources	18.5%	33.1%	Target met
B	Water Quality			
14	% mean zonal compliance with drinking water regulations	99.70%	99.85%	Target met
15	Operational Performance Index (Turbidity, Iron & Manganese)	99.10	99.30	Target met
16	% Service Reservoirs with coliforms in >5% samples	0.00%	0.00%	Target met
C	Water Outputs			
17	Water mains activity - Length of new, renewed or relined mains (km)	214	226	On track
18	Completion of nominated trunk main schemes	0	0	No outputs planned for PC13 Year 1
19	Completion of nominated water treatment works schemes	0	0	
20	Completion of nominated improvements to increase the capacity of service reservoirs and clear water tanks	0	0	
21	Completion of nominated Major Incident Mitigation schemes	3	3	On track
D	Serviceability			
22	Water infrastructure serviceability	Stable	Stable	Target met
23	Water non-infrastructure serviceability	Stable	Stable	Target met

⁶ www.uregni.gov.uk/uploads/publications/PC13_Monitoring_Plan_20130327_-_FINAL.pdf

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

- It did not achieve its call handling satisfaction target score, although this was only a marginal failure. A score of 4.63 out of 5 is the company's highest call handling satisfaction score since the survey began.
- The company also missed the calls not abandoned target of 99.00%. NI Water attributes this to the introduction of a new High Volume Call Answering (HVCA) system. Had we treated all automated calls as answered, they would have achieved a 99.13% rate.

Table 2.2 – NI Water PC13 Key Outputs for Sewerage Services for 2013-14

Line description		2013-14 Target	2013-14 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.	23	11	See Section 5.3 ⁷
B	Quality Sewerage			
2	% of WwTWs discharges compliant with numeric consents	88.6%	92.0%	Target met
3	% of total p.e. served by WwTWs compliant with numeric consents	97.2%	98.0%	Target met
4	Number of high and medium pollution incidents attributable to NI Water	46	26	Target met
C	Sewerage Outputs			
5	Sewerage activity - Length of sewers replaced or renovated (km)	9	25	On track
6	Delivery of improvements to nominated UIDs as part of a defined programme of work	12	12	On track
7	Delivery of improvements to nominated WwTWs as part of a defined programme of work	19	19	On track
8	Small wastewater treatment works delivered as part of the rural wastewater investment programme	18	7	Catch-up expected in Year 2
D	Serviceability			
9	Sewerage infrastructure serviceability	Stable	Stable	Target met
10	Sewerage non-infrastructure serviceability	Stable	Stable	Target met

2.1.4 NI Water has met or exceeded most of the sewerage service outputs set for PC13. The company has not met its targets in two areas:

- Not as many properties were removed from the flooding register by company action in 2013-14 as planned. The company has attributed 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 issue is explored further in Chapter 5.0.

⁷ The Reporter has advised that 5 of the 11 properties were protected by a drainage rehabilitation scheme completed in 2012.

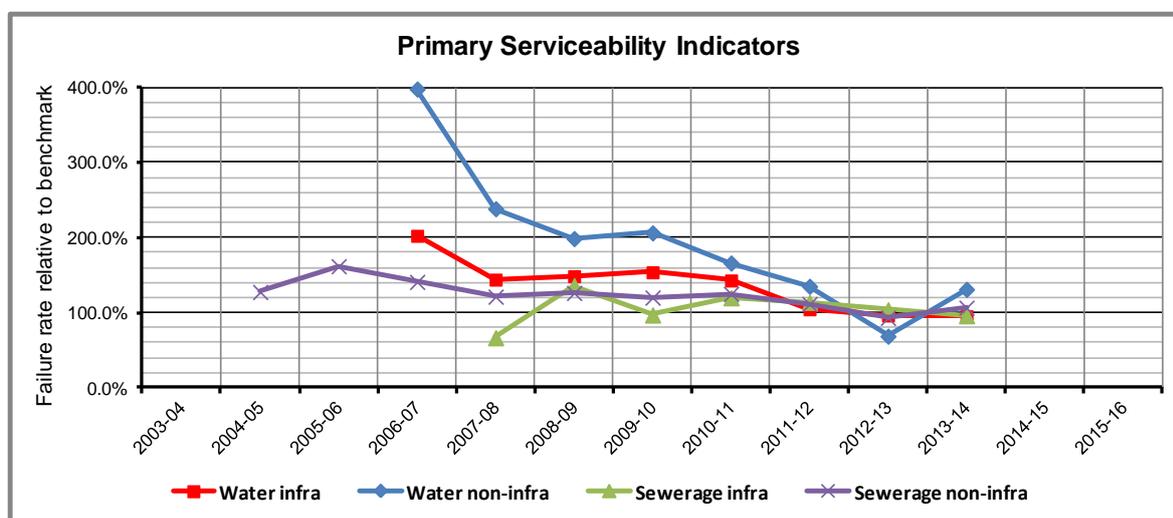
- Fewer upgrades to small wastewater treatment works (WwTWs) than intended in the first year of PC13. The company has plans in place to recover the shortfall in year 2 to deliver the cumulative output for PC13.

2.1.5 Performance against some key targets can be affected by things outside the company’s control, such as the weather or sampling regimes. In PC13 we identified the range of performance which the company might achieve for water and wastewater quality to reflect this inherent variability. The PC13 targets were set at the lower limit of these ranges. In the 2013-14, the company has performed at the upper limit of these ranges.

2.1.6 In our draft determination for PC15, we published our first assessment of serviceability.⁸ We concluded that serviceability was stable in four service areas. The trend of the primary service indicators for each area is shown below.

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 trends⁹



2.1.7 The trends in the primary indicators show that overall serviceability is stable, confirming the individual assessments for each sub-service area.

⁸ www.uregni.gov.uk/uploads/publications/UR_PC15_DD_Annex_G_-_Asset_Serviceability.pdf

⁹ A score of 100% represents operation at the reference level benchmark.

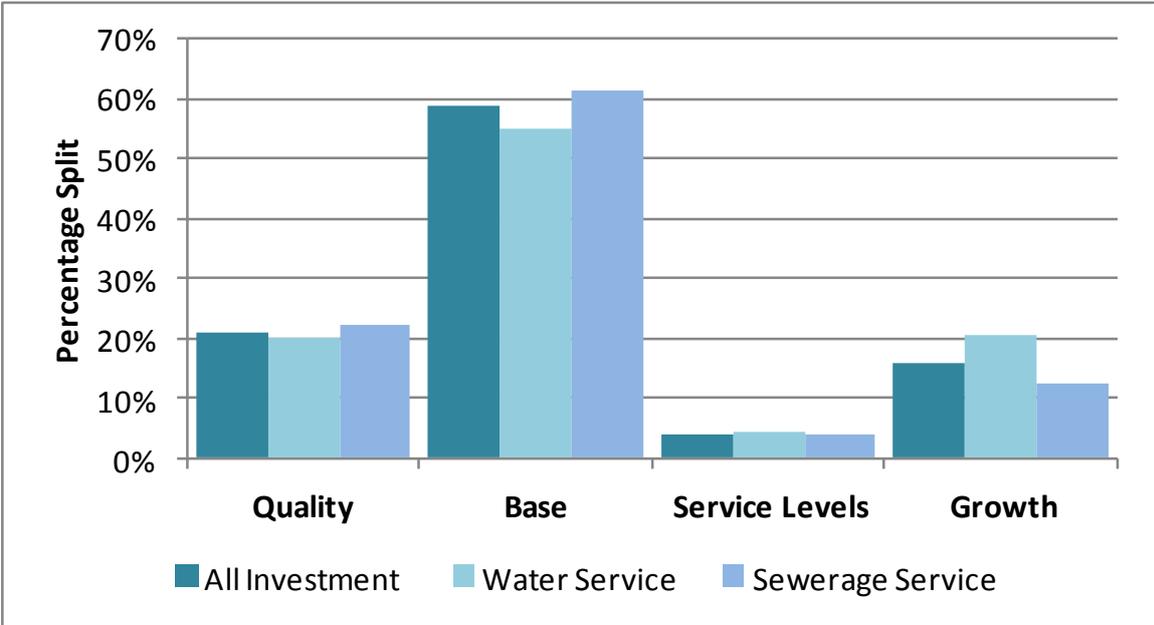
3.0 Capital Expenditure

3.1. Investment by Service and Purpose

3.1.1 In 2013-14, NI Water invested £168m 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.

3.1.2 The allocation of investment by purpose is shown in Figure 3.1 below. Investment of £98m 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’s forward plans indicate that this will reverse in 2014-15. The proportion of investment in base maintenance over PC13 as a whole is expected to be 51%.

Figure 3.1: Allocation of investment in 2013-14 by service and purpose



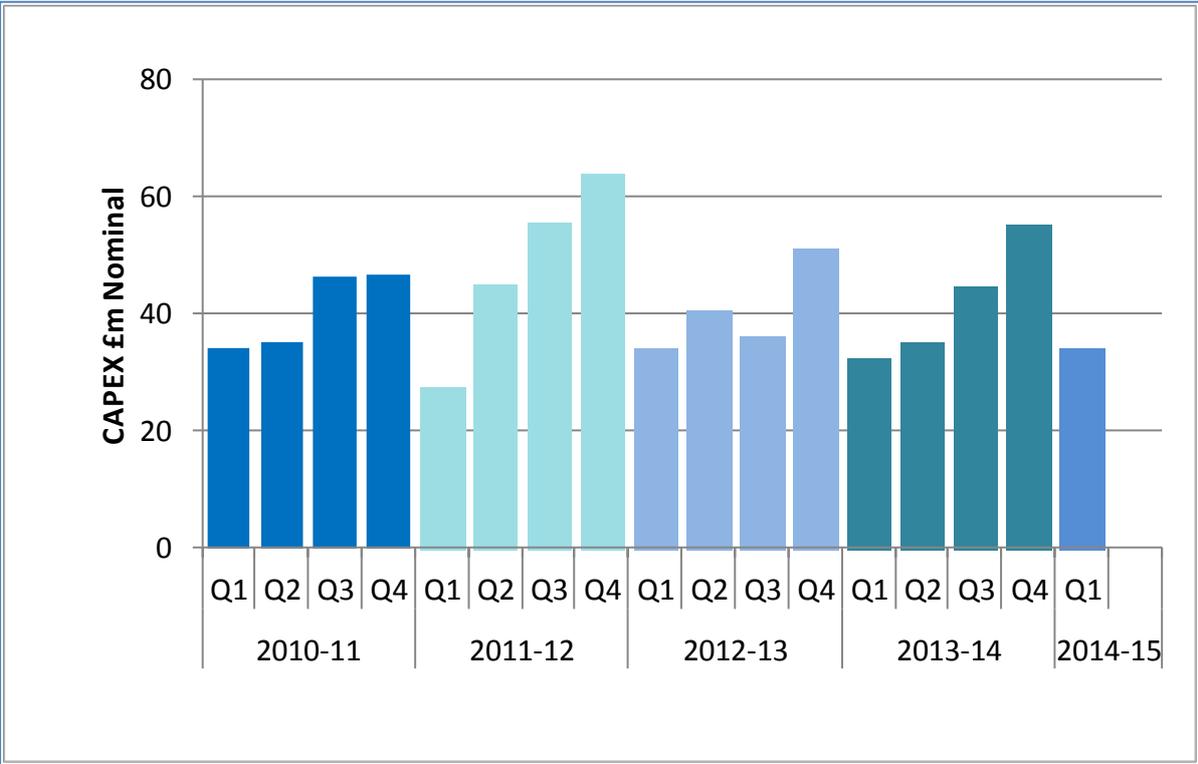
3.2. Capital Delivery

3.2.1 Our assessment of capital delivery provides us with confidence that the company is on track to deliver the PC13 capital programme.

3.2.2 In 2013-14 the company has invested the planned capital budget 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.

- 3.2.3 Where the company has had delays, it has worked with water industry stakeholders through an agreed Change Control Protocol to manage change. This ensures that necessary priority outputs continue to be delivered within the constraints of annual spending limits.
- 3.2.4 In our draft determination for PC15, we made an initial assessment of delivery of the PC13 capital programme. This early review, which takes account of capital inflation and changes to outputs, suggests that NI Water will deliver value for the capital invested over the period. Our on-going assessment of performance in 2013-14 and the company's plans for 2014-15 support this conclusion.
- 3.2.5 However, we are cautious of any conclusion based on the first year of a two year programme. The challenge for the company to deliver in 2014-15 remains. We will provide a more detailed assessment over PC13 in our 2014-15 CPR.
- 3.2.6 In the last CPR, we highlighted the consistent annual cycle of expenditure. This includes a relatively low level of investment in the first quarter of each year, increasing to a high level of investment in the last quarter.
- 3.2.7 Peak levels of investment occur in the winter months with expenditure in the first quarter typically 40% lower. Figure 3.2 shows that this trend has continued into 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

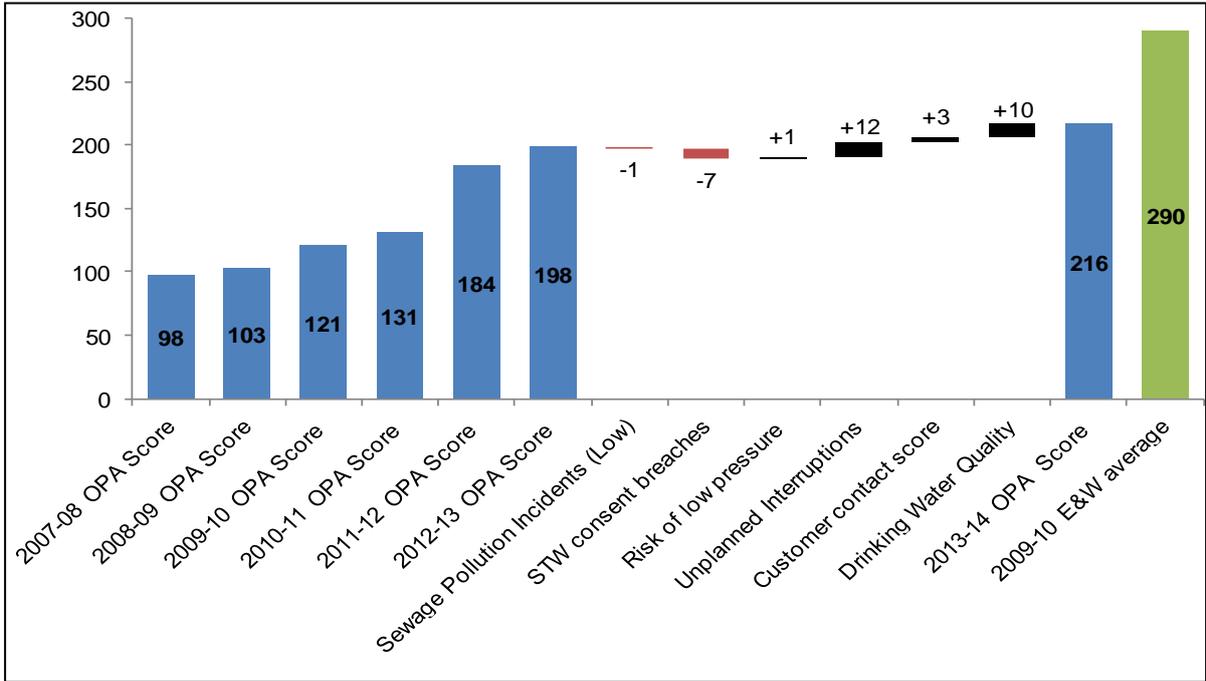
- 4.1.1 In order to fully assess how NI Water is performing, we have adopted the Overall Performance Assessment (OPA) framework. This monitors the overall level of service that NI Water provides to its customers.
- 4.1.2 Our OPA combines 11 individual service measures and scores them against a reasonable 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 historic OPA progress and the score shift in the past year. Key messages include:

- NI Water outperformed our OPA target (of 202) for 2013-14 by 14 points;
- Improvements have been seen in drinking water quality, risk of low pressure, unplanned interruptions and customer contact;
- While there may have been some year-on-year fluctuations in some individual measures, it is clear that NI Water have been steadily improving its overall service levels since 2007-08. Comparison with English and Welsh companies illustrate that the scale of the gap is closing.

Figure 4.1: OPA score movements in the past year for NI Water



5.0 Key Issues for 2013-14

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:

- Customer measures / customer satisfaction; and
- Internal flooding due to inadequate hydraulic capacity

5.2. Customer Measures / Customer Satisfaction

5.2.1 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.

5.2.2 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.

5.2.3 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.

5.3. Internal Flooding Due to Inadequate Hydraulic Capacity

5.3.1 All properties connected to a sewerage system are at risk of flooding if the sewer blocks or a pumping station fails. The risk to any one property is very low and it is very unlikely that the same property will be affected more than once. However, some properties are at risk of repeat flooding due to inadequate hydraulic capacity in the sewerage system. We ask NI Water to investigate each incident of flooding and maintain a register of properties which are at risk of flooding due to inadequate hydraulic capacity. For PC13, the company's target was to remove 67 properties from the flooding register by company action. This approach distinguishes real improvements in consumer service from better information which shows that the risk of property flooding was much less than originally thought.

- 5.3.2 Not as many properties were removed from the flooding register by company action in 2013-14 as planned. The company planned to remove 23 properties from the register in 2013-14 by company action but has only been able to complete work to remove 11 properties. The company does not expect to deliver the cumulative output for PC13 in this important area for consumers.
- 5.3.3 NI Water has advised us that the target for the number of properties removed from the flooding register by company action in PC13 was based on initial studies carried out between 2007 and 2012. As it completed more detailed investigations it found that fewer properties were at risk of flooding than it originally thought in the areas investigated. As a result, 45 properties have been removed from the at risk register in 2013-14 due to better information. The high proportion of properties removed due to better information reflects the quality of historic data which the company is working to improve.
- 5.3.4 The company has advised us that it is unlikely to be able to bring forward sufficient additional projects to meet the PC13 targets for properties removed by company action. Completion of this essential work will now carry over to the start of PC15. This emphasises the need to collect robust information on flooding problems and undertake investigations quickly to inform future investment which is essential to protect consumers.

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. PC10 (2010-13)

- 6.2.1 This price control has now been completed and a Cost and Performance Report covering the full three-year price control period is available at:

www.uregni.gov.uk/uploads/publications/Cost_and_Performance_Report_2010-13.pdf

6.3. PC13 (2013-15)

- 6.3.1 This 2013-14 Cost and Performance Report marks only the first year of PC13. There will be a more comprehensive report next year to establish performance against the entire two-year PC13 price control period.

6.4. PC15 (2015-21)

- 6.4.1 We are currently in the process of consultation on PC15 and will assess responses after the closing date of 15 October 2014. Our draft determination for this six-year PC15 can be downloaded from our website at the following link:

www.uregni.gov.uk/water/price_control/pc15/draft_determination/

- 6.4.2 Our final determination for this price control will be published in December 2014.