

## **CER Decision on Irish Water Revenue (2017 to 2018)**

### **Summary Information Note**

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The Commission for Energy Regulation (CER) is the independent economic regulator of Irish Water. The CER's primary aim is to protect the interests of customers of Irish Water. The CER is responsible for setting the level of revenue which Irish Water can recover in order to cover its efficiently incurred costs. The CER does this by reviewing Irish Water's submission and thereafter setting appropriate revenue allowances for operating costs<sup>1</sup>, capital costs<sup>2</sup> and other items. In carrying out this role the CER seeks to ensure that Irish Water is run as efficiently as possible while providing appropriate water and waste water services to the public.

The CER is now issuing its decision regarding the level of revenue that Irish Water will be allowed to recover to run its business for the period 2017 to 2018. This follows a review and detailed analysis of submissions from Irish Water and a consultation process regarding the CER's proposals on this matter. In reaching this decision, the CER has sought to protect customers of Irish Water by ensuring that Irish Water only recovers efficient costs while delivering necessary improvements in service and performance over time.

This information note summarises the decisions set out in the CER's decision paper (CER/16/342).

#### **Main Points**

- Irish Water is on track to broadly remain within the costs allowed by the CER for the first revenue control period, October 2014 to December 2016, while delivering key outputs including:
  - 79 new or upgraded wastewater treatment plants;
  - approximately 700km of new or rehabilitated water pipes, *and*
  - 65 megalitres per day of drinking water saved through its Water Conservation and First Fix schemes.
- The CER has decided to allow Irish Water a total revenue of €1,843m (2015 prices) to fund capital investments and operations for the years 2017 to 2018. This represents a saving of €165m against Irish Water's request to the CER.
- The CER will monitor Irish Water's delivery of capital investments and associated targets for the allowed expenditure during the 2017-2018 period.
- The CER has set an efficiency challenge such that Irish Water is required to deliver efficiencies of circa 20% within its base controllable operating expenditure over the period from the start of 2015 to the end of 2018.
- The CER understands that it will take time for Irish Water to reduce its costs to a level that is comparable to established mature water utilities elsewhere. The CER expects Irish Water to do this while in parallel improving the service which it provides.

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<sup>1</sup> Operating costs are the day to day running costs of the utility. These costs are made up of line items such as staff costs, customer operations, asset management, insurance and licences amongst others.

<sup>2</sup> Capital costs relate to Irish Water's physical assets i.e. the water and wastewater network, treatment plants, vehicles, IT systems as well as the upgrade, repair and maintenance of the existing network and treatment plants.

## Context of this Revenue Control

The public water and wastewater services sector in Ireland is undergoing unprecedented change. In 2013 Irish Water was established as the single national, public utility for the provision of public water and wastewater services in Ireland. This replaces the previous model of service delivery by 34 local authorities and city councils. From an organisational perspective, a unified approach to operating water and wastewater services under one utility will lead to greater efficiencies and improved services to customers over time.

The challenge for Irish Water is to deliver a national approach to the delivery of these services to significantly improve the quality of service. Irish Water is required to ensure compliance with standards and environmental obligations, increase the cost efficiency associated with water and wastewater services provision and conserve our national water resource.

The role of the CER is to balance the level of operating cost efficiency required from Irish Water while ensuring Irish Water has sufficient funding to deliver service improvements for customers. This will need to be delivered alongside a significant programme of investment in new and refurbished infrastructure.

Irish Water inherited an asset base which has been acknowledged as suffering from historical under investment. With ageing and poor quality infrastructure in some areas, substantial investment is required to bring the standard of the assets up to the needs of a modern economy.

In the first Irish Water revenue control (IRC1, covering the period October 2014 to December 2016), the CER challenged Irish Water to reduce controllable operational costs and uncommitted capital expenditure by 13.5% by the end of 2016. Irish Water has forecasted that it will broadly remain within the costs allowed while delivering key outputs during IRC1. Irish Water has stated that it will have delivered 79 new or upgraded wastewater treatment plants and approximately 700km of new or rehabilitated water pipes during IRC1. In addition, Irish Water has stated that by the end of 2016 it will have saved 65 megalitres per day of drinking water through its Water Conservation and First Fix schemes.

## Regulatory Process

The CER has carried out a detailed analysis of Irish Water's IRC2 submission. The CER audited a sample of Irish Water's capital projects and programmes. The CER also benchmarked Irish Water's costs and performance against international best practice of other water utilities.

The process followed for this review is similar to that undertaken by the CER in electricity since 1999 and gas since 2002 and by other utility regulators (including water) worldwide.

## Allowed Revenue

<i>Revenue Allowance</i>	<i>Irish Water Request</i>	<i>CER Decision</i>	<i>Saving</i>
Total revenue for 2017 to 2018, €m	2,008	1,843	165

The CER set out its proposals in relation to the total revenue to allow Irish Water for the 2017-2018 period in a consultation paper which was published in September of this year (CER/16/267).

The CER received six responses to the consultation paper which can be viewed on the CER's website. Having reviewed these responses the CER has now published its decision regarding the total revenue to allow Irish Water for the 2017-2018 period.

The CER proposed to allow Irish Water a total revenue of €1,852m (2015 prices) for the two-year period. This has been reduced by €9m in the CER's decision paper. The CER will allow Irish Water to recover €1,843m in the period 2017 to 2018. This represents a saving of €165m against Irish Water's request. This includes an allowance for operating costs, depreciation and return on capital costs, and an adjustment for revenue relating to IRC1.

For the coming revenue control, it is noted that domestic water and wastewater charges are suspended until at least 31 March 2017. The CER is working on the basis that the revenue for 2017 and 2018 will be recovered through a mix of funding sources. The enduring funding model for Irish Water will be determined by the Oireachtas and is expected to be decided in 2017.

### Operating Costs Allowance

<i>Operating Cost Allowance</i>	Irish Water Request	CER Decision	Saving
Total revenue for 2017 to 2018, €m	1,523	1,395	128

The CER has reviewed Irish Water's submission and benchmarked its costs against comparable water utilities elsewhere. Irish Water's costs (inclusive of Service Level Agreement costs) are significantly higher than those of established utilities in other jurisdictions. The CER expects Irish Water to drive efficiencies over time at a level that is broadly comparable to those achieved by other utilities elsewhere.

The CER's decision represents a saving of €128m (or 8.4 %) relative to Irish Water's request. The CER has required that Irish Water delivers efficiencies of circa 20% within its base controllable operating expenditure over the period from the start of 2015 to the end of 2018.

### Capital Costs Allowance

<i>Capital Cost Allowance</i>	Irish Water Request	CER Decision	Saving
Total capex for 2017 to 2018, €m	1,288	1,152	136

Irish Water has adopted a risk-based approach to the development of its Capital Investment Plan. The approach takes into account a number of constraints that Irish Water faces. The approach also considers customers' preferences.

The CER considers that Irish Water should be challenged to deliver the outputs and outcomes of its investment plan submission more efficiently. The CER has imposed an efficiency challenge of €132m for the IRC2 period.

To ensure that Irish Water is delivering efficiently for its customers the CER will monitor Irish Water's capital expenditure and the delivery of associated outputs and outcomes and overall investment targets during the IRC2 period.

The CER has set Irish Water's Weighted Average Cost of Capital (WACC) at 5.2%. This is intended to cover the financing cost associated with capital expenditure. The WACC is used to derive a fair return for Irish Water on its efficiently incurred capital investments.

Further information regarding the CER can be viewed on [www.cer.ie](http://www.cer.ie). For further information on the above please see the CER's decision paper (CER/16/342).

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