



Briefing 08/05 February 2008

# Principles of charging for water services: a consultation

To: All Chief Executives, Main Contacts and Email Contacts (Scotland)

CC: All Chief Executives, Main Contacts (England, Northern Ireland and Wales)

A consultation by the Scottish Government on the principles of charging for water services

## **Key issues**

Scottish Water's average household charges are at present lower than the average in England and Wales and in 2010 are expected to be among the lowest in the UK

The Government wants to set out clearly the principles that it considers should govern future water charges

It reviews the basis of current water and sewerage charges and the principles that have underlain previous charge reviews

## 1. Introduction

Scottish Water is a vital part of Scotland's life. The services it provides are essential to every individual and community in Scotland. It is making major improvements to the quality of drinking water and the water environment. Its investment programme is one of the largest ever undertaken in the UK and is a major part of the work of the construction industry in Scotland and makes a significant contribution to the Government's strategic objectives.

The past few years have seen a period of significant improvement in Scottish Water's performance in terms of efficiency and service delivery. Fundamental to the achievement of this picture of improvement is the framework through which charges are determined by the Water Industry Commission for Scotland.

Scottish Water's average household charges are at present lower than the average in England and Wales and in 2010 are expected to be among the lowest in the UK, while non-household charges are set to reduce by over 6% in real terms by 2010. APSE believes that the amount charged needs to be fair and transparent as well as being set at a level which ensures that Scottish Water improves its efficiency.

The Government is seeking to set out clearly the principles that it considers should govern future water charges and this consultation paper seeks your views on these issues. These principles will guide the work of the Water Industry Commission in determining charge levels for 2010-14. The Government is committed to the continued success of Scottish Water your views on them are essential to ensuring that Scottish Water can continue to be successful and maintain its significant contribution to the Government's strategic objectives for Scotland.

This consultation paper seeks views on those binding principles of charging that the Scottish Government will require the Water Industry Commission for Scotland to apply to the determination of water and sewerage charges during the next regulatory period 2010-14. It reviews the basis of current water and sewerage charges and the principles that have underlain previous charge reviews.

Since its creation in 2002, Scottish Water has undergone, and will continue to undergo, substantial modernisation delivering much improved services more efficiently. These improvements include:

- the delivery of nearly £1bn of efficiency savings by 2006 with a further £500m savings targeted by 2010;
- over £2bn of investment in the water industry, delivering substantial improvements to services provided to customers - better drinking water quality and a cleaner environment;
- over 25,500 new housing connections made in 2006/07 - Scottish Water will provide new strategic capacity in every case where it is required, and;

- a 38% improvement in customer service performance in 2006-07.

These results have been achieved while:

- Average household charges are £15 lower in Scotland for 2007-08 than in England and Wales and will rise by less than inflation. By 2010 Scottish Water's charges are expected to be the third lowest in the UK
- Non-household charges will reduce by over 6% in real terms by 2010, and
- Customers pay the same rate for the same service wherever they are in the country

The Scottish water industry is being further improved by the introduction of a new competitive charging framework for business customers. Fundamental to achieving these improvements has been the framework through which charge levels are determined by the Water Industry Commission. The period of the present determination ends in 2010.

## **2. SUMMARY OF CURRENT PRINCIPLES OF CHARGING 2006-10**

Charges should cover costs. Public expenditure support to Scottish Water in the provision of its core services would only be in the form of government lending - no grant would be paid. Further, customers would only be asked to meet additional costs beyond those allowed for in a charges determination, where these arose as the result of external factors beyond the control of Scottish Water. This arrangement protects the position of customers and ensures that they do not pay twice for the same services or compensate the company for inefficiency or poor management.

### *Stable and affordable charges*

Charges should be affordable. Both during the charging period and sustainable in the long-term. In setting this principle, Ministers wished to ensure that Scottish Water would have the resources to deliver the maximum affordable improvements in public health and environment protection standards, support housing and economic growth through investment in new water and sewerage capacity.

Financial sustainability. As a minimum, Scottish Water's financial strength should be maintained during the period and if possible, slowly improved. Levels of borrowing should be consistent with long-term financial sustainability and be consistent with the optimum maximum size of the capital programme. Customers in any part of Scotland would pay the same rate for the same service.

### *Affordable charges for low income households*

Charges paid by low-income households. Should be affordable as far as possible, the 25% discount on water and sewerage services charges available to single-adult households should remain in place. Households with two or more adults and in receipt

of Council Tax Benefit should also have their charges reduced by up to 25%. These measures are now in place.

Charges in general should be broadly cost-reflective - i.e. charges for given services to particular customer groups should be set to recover the cost to Scottish Water nationally of providing that service to that group as a whole. Achieving stable charges in real terms could be consistent with some charges rising above inflation and others falling, for example where tariff rebalancing is justified. Any increases in charges should be phased over the regulatory period unless there is a more effective means of minimising the adverse impact on customers. Ministers announced on 31 August 2004 that those premises which had been eligible for exemption from paying charges from 1 April 2002 to 31 March 2006 under the Water and Sewerage Charges (Exemption) (Scotland) Regulations 2002 should continue to be eligible in the period 1 April 2006 to 31 March 2010.

### 3. CHARGING STRUCTURE

Most household and non-household customers receive and pay for four water services:

- the supply of drinking water;
- the removal and treatment of sewage;
- the removal and treatment of drainage from private roofs and car parks including private roads (surface drainage), and;
- the removal and treatment of drainage from public roads (roads drainage).

Some non-household customers also dispose of trade effluent through the sewerage system and pay for this service separately. An aspect of the joint system of billing and collection is that many existing Council Tax discounts also apply to water charges - with the exceptions of second home discounts and Council Tax Benefit. Additionally, on 1 April 2006, Ministers introduced a water services charges reduction of up to 25% for households with two or more adults in receipt of Council Tax Benefit and no other discounts. The purpose of the reduction is directly to assist vulnerable households which had previously not been eligible for any or only a very limited reduction in their water services charges.

The table below shows domestic charges for 2007/08:

| <b>Council Tax Band</b> | <b>Water</b> | <b>Waste Water</b> | <b>Combined</b> | <b>Combined with 25% Discount</b> |
|-------------------------|--------------|--------------------|-----------------|-----------------------------------|
| <b>Band A</b>           | £114         | £129               | £244            | £183                              |
| <b>Band B</b>           | £134         | £151               | £285            | £213                              |
| <b>Band C</b>           | £153         | £173               | £325            | £244                              |
| <b>Band D</b>           | £172         | £194               | £366            | £274                              |
| <b>Band E</b>           | £210         | £237               | £447            | £335                              |

|               |      |      |      |      |
|---------------|------|------|------|------|
| <b>Band F</b> | £248 | £280 | £528 | £396 |
| <b>Band G</b> | £286 | £324 | £610 | £457 |
| <b>Band H</b> | £343 | £388 | £732 | £549 |

Average household charges in Scotland are now lower than in England and Wales. While charges in England and Wales are due to rise by more than inflation, in Scotland they will rise by less. This means that by 2010, Scottish Water will have lower water and sewerage services charges than 8 out of the 10 privatised water and sewerage companies in England and Wales.

There are approximately 130,000 non-household customers in Scotland. Of these roughly 80,000 currently pay for their water services on a metered basis and 50,000 are un-metered.

#### **4. Conclusions**

APSE shares the view that in a number of areas the principles of charging require careful consideration. The size of Scottish Water's investment programme is a key determinant of the levels of revenue required to be delivered through its charges to customers. Scottish Water's investment programme must maintain its assets, improve the system in order to comply with statutory requirements in relation to environmental and quality performance and accommodate growth in the system. That programme must be deliverable.

Scottish Water and the Commission have made their view known to Ministers that maintaining this level of investment beyond 2010 is not sustainable and to attempt to do so would risk non-delivery and inefficiency. Ministers therefore, propose that the investment programme for this period should be set at a level that is efficiently manageable by a company of Scottish Water's size. It is essential that Scottish Water is able to finance the investment programme.

Scottish Water has two sources of funding - customer charges and borrowing from the Scottish Government. Unlike other owners, the Government does not extract any funds in the form of a dividend from its ownership. Any surplus on revenue over operating costs, interest and tax is reinvested and supports the capital programme. Without such surpluses maintaining the investment programme at desired levels would require higher levels of lending by the Government or increases in customer charges.

Views are invited on the following proposals:

- The existing principles of charging that are critical to delivering water services efficiently at fair and affordable cost to customers should be maintained. These include full cost recovery, cost reflectivity, geographical harmonisation of charges, phasing of increases, paying for increased local capacity and stable charges

- Scottish Water's capital programme for 2010-14 should be set at a level that is efficiently manageable by a company of its size
- Charges should be set at a level which will maintain and improve the level of financial sustainability and resilience of Scottish Water
- There should be further movement towards more obviously cost-reflective charges within the next 4 year regulatory period but this should be done in the manner least disruptive to customers
- Whether there should be plans to further extend the water services charges exemption scheme on its expiry in 2010
- Recovery of roads drainage charges with water services charges on the basis of the rateable value of individual premises should be maintained

Views on these issues should be sent by **29 February 2008** to:

Email to: [waterdivision@scotland.gsi.gov.uk](mailto:waterdivision@scotland.gsi.gov.uk)

APSE would welcome any comments this, which should be sent to [ptaggart@apse.org.uk](mailto:ptaggart@apse.org.uk)

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