

## Investment report 2008-09

PERFORMANCE



### Overview

This report examines Scottish Water's progress during 2008-09 in delivering investment outputs to improve water quality, environmental performance and customer service.

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# INTRODUCTION

## Context

Investment in maintaining and improving the assets to provide water and sewerage services accounts for around half of the money that Scottish Water spends each year. We are determined to make sure that customers receive value for money and so we monitor Scottish Water's overall progress on investment delivery very carefully. In this regard we are part of the Output Monitoring Group (OMG), which is chaired by the Scottish Government and includes representatives from the Scottish Environment Protection Agency (SEPA), the Drinking Water Quality Regulator (DWQR), Waterwatch Scotland and Scottish Water.

The investment programme is designed to deliver significant environmental, drinking water quality and customer service improvements as well as ensuring that Scotland's network of pipes and treatment works has sufficient capacity to respond to growth.

For much of the programme SEPA or the DWQR are asked to confirm if Scottish Water has delivered the required outputs. Achieving this 'sign-off' is critical. It is only at this point that customers can be assured that they will receive the benefits they have paid for. We therefore put particular emphasis on the sign-off of outputs, where relevant, as confirmation of satisfactory output delivery.

This report summarises our view of performance in 2008-09 based on our analysis of all of Scottish Water's regulatory information.

## Associated documents

- 'Investment report 2007-08', October 2008.
- 'The Strategic Review of Charges 2006-10: The final determination', November 2005.
- 'The Strategic Review of Charges 2010-14: The draft determination', June 2009.

## KEY MESSAGES

### How Scottish Water performed in 2008-09

Scottish Water increased the pace of delivery of the capital investment programme during the final quarter of the year, although delivery fell behind target for the first three quarters of 2008-09. We are concerned that the improvement during the final quarter appears to have been achieved, in part, by bringing forward projects from the following year's programme. It is important that any projects that have been delayed to date are delivered as quickly as possible in 2009-10.

During 2008-09 Scottish Water improved its focus on completing projects to the point where the independent quality regulators are able to sign them off. By the end of the year around two-thirds of the output categories for the 2006-10 investment period had achieved their 'sign-off' targets. However, significant scope remains for Scottish Water to improve the rate at which projects achieve sign-off.

The forecast cost of delivering the overall investment programme has risen from £2,446 million to £2,557 million during the regulatory control period. We have been assured by Scottish Water that sufficient financing remains to complete the programme. It is important that Scottish Water does not rely solely on outperformance of the regulatory contract in other areas to complete the programme.

Leakage is an important issue for customers and the environment. Scottish Water's efforts to detect and repair leaks are starting to pay off, and it exceeded the leakage reduction target for 2008-09.

### Looking forward

We will continue our role as part of the multi-stakeholder OMG to monitor progress in delivering outputs to the sign-off stage very closely. In the coming months we shall also be working with Scottish Water to make sure that the information provided to the OMG and to Scottish Water's Board concerning output delivery is presented in a consistent format.

We are now in the final year of the 2006-10 regulatory control period. We have recently consulted on our draft determination for 2010-15, which included consideration of the investment programme going forward. It is important that the programme can be delivered efficiently. Our draft determination suggested an annual programme of around £480 million<sup>1</sup>. Our proposals also include an 'early start' element to ensure that benefits for customers are delivered as early as possible. We will publish our final determination on 26 November 2009.

<sup>1</sup> This is in line with the findings of research that we commissioned into the size of the investment programme that can be delivered efficiently – see 'Factors to be considered when determining the appropriate size of the capital programme' at [www.watercommission.co.uk/view\\_research](http://www.watercommission.co.uk/view_research).

## ASSESSMENT OF INVESTMENT PERFORMANCE

### Scottish Water's 2006–10 investment programme

The Scottish Government sets Scottish Water objectives to improve water quality, environmental performance and customer service, and to respond to growth. Scottish Water's current investment programme is designed to deliver a series of specific outputs that will allow it to achieve these objectives by 2010. These outputs include:

- improving drinking water quality for 1.5 million customers,
- improving water disinfection control for 4 million customers,
- removing a large number of unsatisfactory discharges from the sewer network, and
- upgrading waste water treatment works to meet compliance requirements.

We assess Scottish Water's progress by monitoring the delivery of the outputs of investment (ie the benefits to customers and the environment). For much of the investment, it is only when the quality regulators have signed off projects that customers can be assured that the required outputs have been delivered.

### Progress in delivering the investment programme

#### Delivering outputs

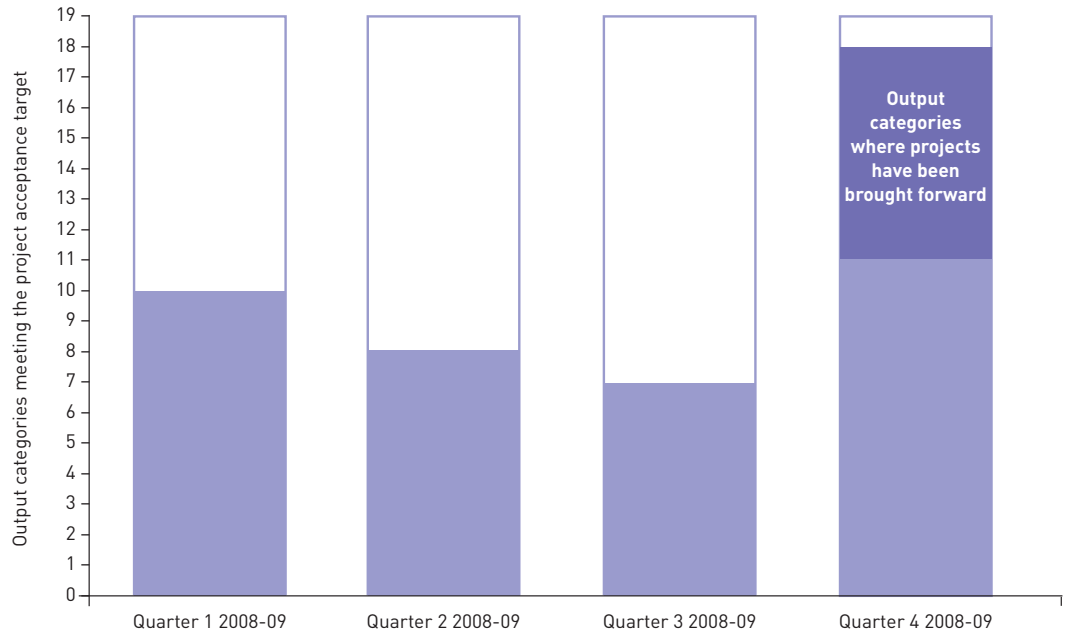
Figure 1 (overleaf) shows how many of the 19 output categories that we monitor met their 'project acceptance' target<sup>2</sup> for each quarter of 2008–09. During the first three quarters of 2008–09, delivery fell behind target, although performance improved during the last quarter.

While we welcome this recovery it appears to have been achieved, in part, by bringing forward projects from the following year's investment programme to replace outputs from projects that were delayed. Some flexibility in the delivery profile of any investment programme is to be expected. However, there is a risk that easier to deliver projects are brought forward while other, more difficult, projects are being delayed. If customers are to receive the full benefits to which they are entitled, it will be important that delayed projects are delivered as quickly as possible in 2009–10.

<sup>2</sup> 'Project acceptance' is a key delivery milestone which indicates that all works are complete. This milestone precedes the formal 'sign-off' of projects by the quality regulators.

PERFORMANCE

**Figure 1: Number of output categories that met their 'project acceptance' target during each quarter of 2008-09**



During the year Scottish Water improved its focus on completing projects to the point where the independent quality regulators can sign them off. Around two-thirds of the output categories for the 2006-10 investment period achieved their 'sign-off' targets at the end of 2008-09.

Figure 2 shows in more detail the cumulative progress of Scottish Water's investment projects (by value) through the major milestones of the delivery process. It can be seen that, while progress has been made over the last year, a significant delivery challenge remains, with only around 30% of projects (by value) completed.

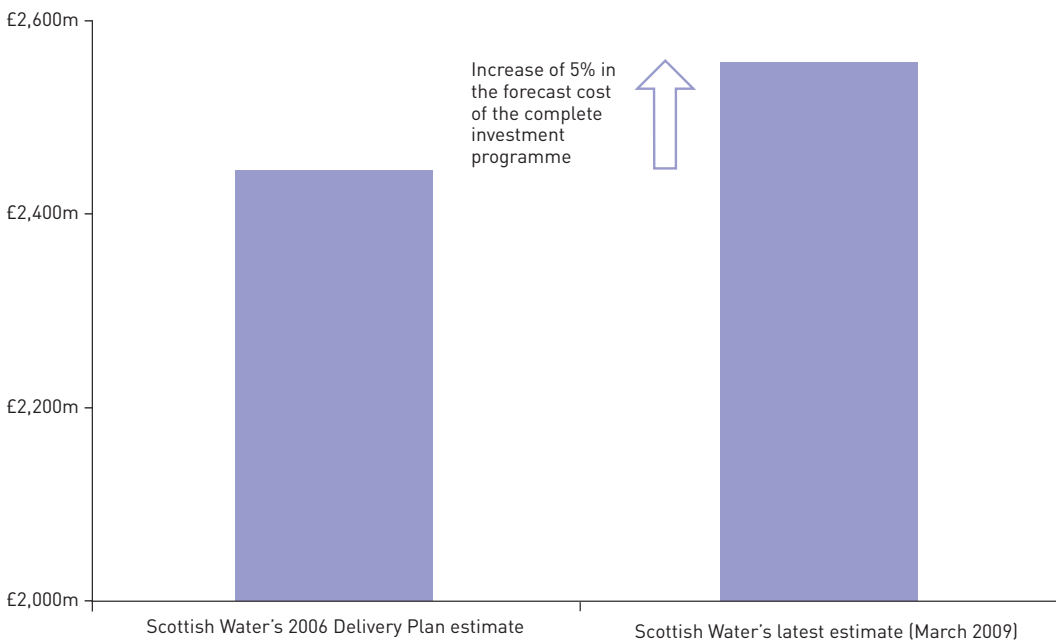
**Figure 2: Cumulative progress (by project value) of the 2006-10 investment programme<sup>3</sup>**



**Cost of delivering the programme**

The level of expenditure during 2008-09 was £687 million. This is within the range forecast by Scottish Water, albeit at the high end. However, the forecast cost of delivering the overall 2006-10 programme has increased from an initial estimate of £2,446 million (Scottish Water’s estimate at the start of the regulatory control period) to the latest estimate of £2,557 million. As Figure 3 shows, this represents an increase of some 5%.

**Figure 3: Increase in the forecast cost of the total investment programme**



<sup>3</sup> Excludes the remaining projects from the 2002-06 programme.

<sup>4</sup> Not all projects require sign-off by the quality regulators. This explains why the percentage of projects that have achieved this milestone by March 2009 is marginally higher than the percentage of projects at the ‘project acceptance’ stage.

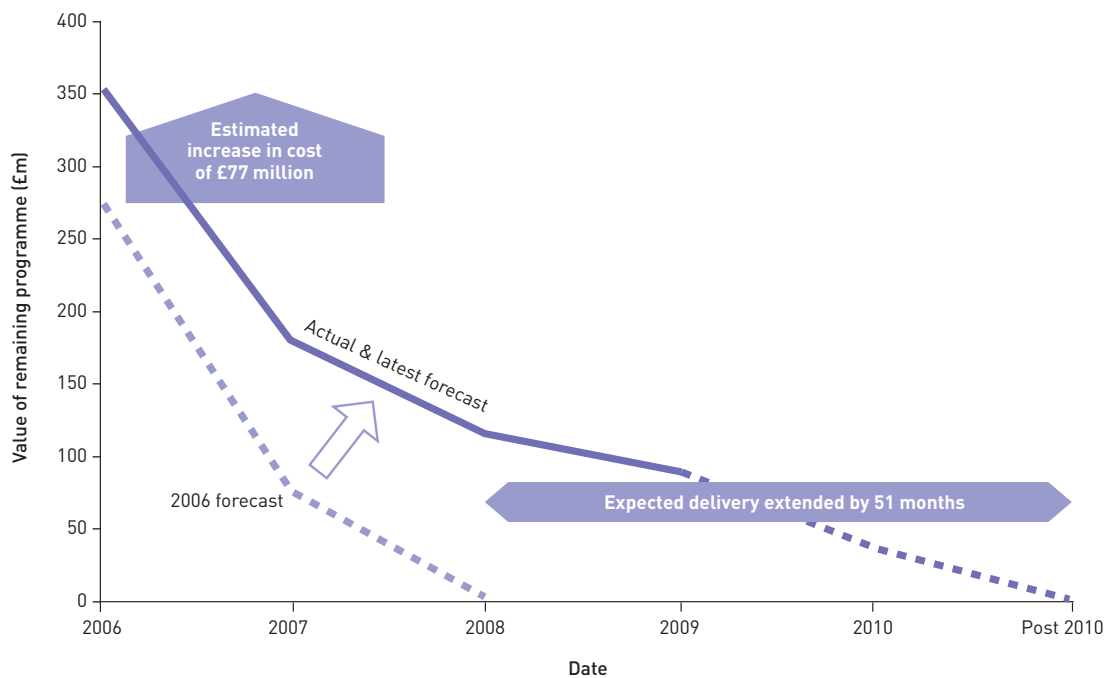
Given the number of outputs still to be delivered, we have sought and been given assurances by Scottish Water that sufficient financing remains to complete the investment programme. We are concerned that it is relying solely on outperformance of the regulatory contract in other areas to ensure that there is sufficient finance to complete the programme. Scottish Water has committed to deliver the investment programme within the financing allowed and we have received assurances from the Scottish Government that any underperformance will not be funded through customer charges.

#### Delivering projects from the 2002-06 programme

Thirty-nine projects from the previous investment period (2002-06) are not yet complete. It is forecast that completion of at least four of these projects will now fall into the next investment period (2010-15). Figure 4 indicates the extent to which delivery of this 'overhang' of projects from the previous regulatory control period has been delayed and the degree to which costs have risen since the start of the current regulatory control period.

The longer these outputs are delayed the greater the impact of inflation on costs and the longer customers are required to wait for the benefits promised. Customers should be re-assured, however, that they will not be required to pay any more for these projects as a result.

**Figure 4: Change in the cost and delivery profile of the uncompleted projects from the 2002-06 period**



### Progress in tackling leakage

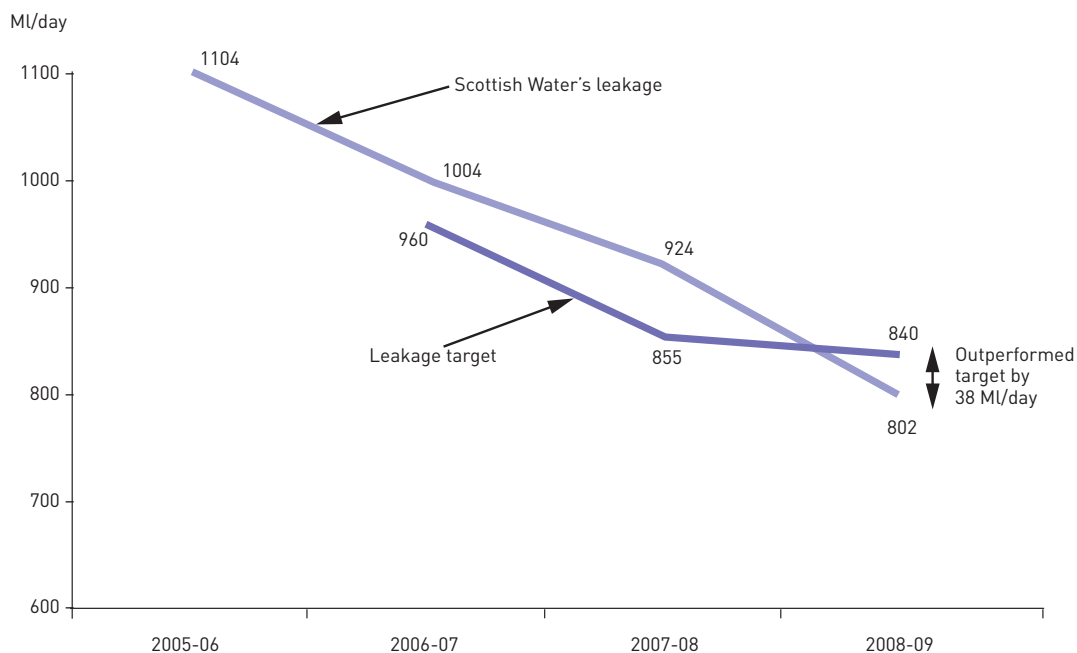
Leakage is the water lost in the water network before it reaches customers. It can arise from, for example, bursts in pipes or poor connections. In our view reducing leakage is not only economically justifiable – reducing operating costs and capital expenditure – but will also contribute to Scottish Water delivering its obligations with regard to sustainable development, and reducing its carbon emissions.

In 2006 we set Scottish Water pragmatic targets to make annual reductions in its leakage. These targets were designed to be a first step towards Scottish Water reaching its economic level of leakage – the point at which the cost of reducing leakage is the same as the value of the water lost.

We are pleased to report that Scottish Water's work to reduce leakage is starting to pay off, and it outperformed its leakage reduction target for 2008-09 by 38 ML/day, as Figure 5 shows.

We will continue to work with Scottish Water to determine a more reliable estimate of its economic level of leakage. More work is still required, but our current view is that it could be reasonable for Scottish Water to reduce its current level of leakage of around 800 ML/day to something well under 500 ML/day by the end of the next regulatory control period.

**Figure 5: Scottish Water's leakage performance**



## LOOKING FORWARD

We are now in the final year of the current 2006-10 regulatory control period. During the rest of this period the multi-stakeholder OMG will continue its role in ensuring that all of the benefits paid for by customers are delivered. We will report on Scottish Water's performance in 2009-10 in the next 'Investment report', which is due to be published in October 2010.

We shall also be working with Scottish Water to ensure that the information concerning output delivery that is reported to its Board is presented in a format consistent with the information provided to the OMG.

In last year's report we explained that we were working to devise a single measure for output delivery. This followed the success of the overall performance assessment (OPA) in driving customer service improvements. We are pleased to say that our recent trials of a new, high-level measure of output delivery have been a success. This measure will be put to use as an additional tool in monitoring output delivery in the next regulatory control period.

Finally, the scale of Scottish Water's investment in recent years has been significant – one of the largest investment programmes in the UK water industry. Going forward, it is of critical importance that the investment programme for the 2010-15 period can be delivered efficiently. Our recently published draft determination suggested an annual investment programme of around £480 million. Our proposals also include an 'early start' element to ensure that benefits for customers are delivered as early as possible. We will publish our final determination on 26 November.



04.11.09



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