

## Meeting demand from new customers

**This note summarises issues arising from Scottish Water's Service Improvement Report on the future capital investment required to meet increased demand arising from new customers connecting to the water and wastewater networks<sup>1</sup>. We will comment in more detail on Scottish Water's proposals in these areas which will be set out in its draft Strategic Business Plan (due to be published in October 2013).**

### Introduction

Scottish Water has a statutory duty to provide water supplies to, and remove wastewater from, properties in Scotland. Growth in the number of properties connected to the network places investment requirements on Scottish Water in relation to:

- providing a contribution to the cost of the local network connection for the property; and
- developing the overall network to accommodate the demands from these new properties.

### Summary of the information provided in the report

In its Service Improvement Report Scottish Water sets out the statutory framework and associated ministerial objectives that underpin the investment requirements in this area. It notes the requirement to take account of local authority development plans and the Government's population forecasts when identifying the requirement for new network capacity.

Scottish Water is required to provide additional capacity in support of committed development; it is not required to provide capacity for speculative or uncertain projects. This approach minimises the likelihood of redundant assets and should ensure that connections are made in a timely way.

Scottish Water reports that the number of properties served by the water and wastewater networks is forecast to continue to rise for the foreseeable future. It says that the number of properties served has grown by around 8% in the past ten years and is forecast to grow by a further 21% by 2035.

In assessing future demands in this area, Scottish Water has forecast that 97% of new water demand and 80% of new wastewater demand will be met by existing surplus network capacity.

Scottish Water has provisionally estimated that it expects to invest £214 million<sup>2</sup> over the 2015-21 period to connect new properties to the network. Of this total, it expects to fund around £32 million through receipts from the 'infrastructure charge' paid by new connecting properties. The net cost to customers would be an estimated £182 million.

Scottish Water has based its estimate on an assumption that 110,000 new properties will be connected over the period, and that it will provide:

- additional water treatment capacity for 5,600 people;
- additional wastewater treatment capacity for 44,000 people; and,
- strategic network capacity for 40,000 people.

<sup>1</sup> The relevant Service Improvement Report is entitled 'Meeting demand from new customers' dated 21.01.13.

<sup>2</sup> The text of the draft report provided to the Customer Forum mentions an estimated range of £150 million to £170 million of investment, with a further £20-£30 million financed from the infrastructure charge. We have confirmed with Scottish Water that the figures in the table at the back of the report, which suggest higher estimated investment, are those that should be used.

Around 40% of the investment is associated with providing a contribution to the cost of the local network connection for new properties. The remainder is associated with developing the overall network to accommodate increased demand (for example by increasing the size of pipes and treatment works).

Scottish Water's report outlines the historic volatility of investment in this area. During the five-year periods 2000-05, 2005-10 and 2010-15 there was total investment in growth of around £150 million, £320 million and a forecast £105 million.

Scottish Water proposes to 'ring-fence' investment in this area, as is the case in the current period. This means that at the end of the regulatory control period an adjustment is made to the proposed allowances for investment in future periods in order to reflect actual expenditure in the previous period.

### Issues arising

The Customer Forum has a key decision to make, which is whether or not to agree to Scottish Water's proposal to ring fence investment in growth. There is uncertainty as to the level of investment that is required and ring fencing could be a sensible approach. Given the uncertainty that surrounded development in the aftermath of the financial crisis, the Commission considered that this was the most prudent approach when it set prices in 2009.

An alternative view is that the ring-fencing approach leaves two risks with the customer: how much expenditure is needed, and how efficiently the expenditure will be made. Scottish Water is best placed to control these two risks, accepting that the level of demand will be affected by external factors in the wider economy. There is scope for the efficiency of delivery to be determined through an audit process, for example by the Independent Assuror. Ring fencing is perhaps most beneficial if it keeps the amount that needs to be included in customers' bills immediately to a lower level and, as a result, frees up resources for projects that will be more valued by customers. The proposal to introduce a three-yearly 'rolling' update to the investment programme will assist by allowing a review of the size of the ring-fenced allowance in 2018 to take account of emerging circumstances.

In common with the other Service Improvement Reports, we consider that more specific and defined information on both outcomes and expenditure, of the type expected in the October business plan, is required before detailed comment is possible. There should be evidence about how Scottish Water has sought to innovate and to work with its retail partners to free up capacity in the water and waste water systems. There are existing incentives for such collaboration under Section 29E of the Water Services (Scotland) Act 2005.

We will review the information that Scottish Water provides in these areas in its Business Plan and will comment further at that time.

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