

Investing in and Paying for Your Water Services from 2021

An Invitation to Provide Your Views

July 2018

Contents

FOREWORD	3
Purpose of Engagement	4
INTRODUCTION	5
Scottish Water - Performance since 2002	5
The Strategic Review of Charges	6
Ministerial Inputs	6
Policy Framework.....	7
Looking Beyond the Regulatory Period.....	7
PRINCIPLES OF CHARGING	8
Proposals for Change - Addressing issues of Affordability	8
Financing New Capacity.....	10
DETERMINING THE INVESTMENT REQUIREMENTS.....	11
Draft Objectives for 2021-27 and beyond.....	11
SUMMARY AND NEXT STEPS.....	12
Annex A – Commissioning letter	13
Annex B – Principles of Charging	17
Annex C – Statement of Proposals.....	23
Responding to this Consultation	26
Annex D – Respondent Information Form	28

FOREWORD



Scotland is enjoying the real improvements to drinking water quality, the environment and customer service since Scottish Water's creation in 2002.

Our collective focus on the need to improve the quality and standards of services, our determination to keep charges affordable, and the commitment shown by our water industry has resulted in Scotland's drinking water quality, environmental performance and levels of service reaching their highest levels ever.

These are impressive achievements over a period in which average charges have fallen in real terms and remain amongst the lowest in the UK.

However significant challenges lie ahead and we must plan carefully to address these and ensure that the progress made is maintained so that we continue to have a sustainable high performing water industry meeting customers' needs at affordable prices.

The process of determining charges for the period 2021-27 is now underway. The Scottish Government plays a central role in determining the key policy parameters to guide that process.

This paper invites your views on key issues central to the development of that framework.

A handwritten signature in black ink, appearing to read 'R. Cunningham'. The signature is fluid and cursive.

**Roseanna Cunningham
MSP**

Purpose of Engagement

The availability of wholesome drinking water and the safe disposal of wastewater are crucial to public health and a clean environment. In this paper we consider the investment needs and how customers should pay for the water and wastewater services provided in the regulatory period 2021-27 and beyond.

Views are invited on:

- Scottish Ministers' key policy objectives for the next regulatory period.
- The principles which govern how Scottish Water charges its customers for the services that it provides.
- A draft set of Ministerial investment objectives for Scottish Water.

If you would like to comment on the issues raised in this paper please respond via Citizen Space at <https://consult.gov.scot/energy-and-climate-change-directorate/water-services-from-2021>. The closing date for responses is 28 September 2018.

Information gathered from this process will inform Ministers' decisions on the policy framework that should apply to the Scottish water industry in the next regulatory period.

We welcome early responses.

INTRODUCTION

Scottish Water - Performance since 2002

Scotland is enjoying the real benefits that have been delivered to drinking water quality, the environment and customer service since Scottish Water's creation in 2002. As a result of the Scottish Government's focus on the need to improve the quality and standards of services, the determination to keep charges affordable and the commitment shown by the Scottish water industry, drinking water quality, environmental performance and levels of service are at their highest levels ever.

The achievements in the previous regulatory period were published in a [report](#) by the water industry. Since then progress has continued. At 31 March 2018 – half-way through the 2015-21 regulatory period:

- Average household charges remained £42 lower than the average in England and Wales.
- Scottish Water's service performance (as measured by the basket of measures including low pressure, leakage, drinking water quality and security of supply) in the Overall Performance Assessment is now comparable to the leading UK water companies – and on some measures it outperforms them.
- Scottish Water has reduced its energy consumption by 5% and has managed to cut its operational carbon emissions by more than 30% since it was first reported in 2006/07. Furthermore it now generates and facilitates more than double its electricity consumption from renewable sources.
- Scottish Water continued to reduce leakage from 738 to 492 megalitres per day. Leakage has now reached its economic level, that is where it costs more to make further reductions in leakage than to produce and supply water to customers.
- Scottish Water provided connections to 59,269 new homes and businesses since 1 April 2015. Additional capacity has been provided to cater for all new developments.
- Drinking Water continues to be at record levels of compliance at over 99.9%.
- There were no failing Wastewater Treatment Works in 2017. This compares to over 70 in 2002.

Looking to the future, it is important to build on these achievements and to ensure that the policy framework supports Scottish Water's continuing improvement in the standards of service it provides all customers.

The Strategic Review of Charges

The Strategic Review of Charges is the process undertaken by the Water Industry Commission for Scotland – Scottish Water’s independent economic regulator - which determines the charges payable by Scottish Water’s customers for a defined regulatory period.

The Strategic Review of Charges for 2021-27 will be the sixth undertaken in the Scottish water industry. Ministers initiated the review by means of an official letter to the Water Industry Commission for Scotland (WICS) in January 2017 (Annex A). This set out the policy framework and timetable which WICS and stakeholders during the Review. A timetable showing the key dates for the review is shown below.

Commissioning Letter to (WICS)	January 2017
Publication of WICS methodology	April 2017
Publication of Draft Scottish Water Strategic Projections	March 2018
Draft Principles of Charges*	Summer 2018
Draft Objectives*	Summer 2018
Scottish Water Draft Business Plan 2021-27	May 2019
WICS Draft Determination	November 2019
Final Principles of Charges	December 2019
Final Objectives	December 2019
WICS Final determination	March 2020

* These documents are the subject of the present consultation

A significant amount of preparatory work has now been undertaken by WICS and by Scottish Water including the publication by Scottish Water of its strategic projections [<http://www.scottishwater.co.uk/about-us/publications/strategic-projections/strategic-projections>] and by WICS of its methodology and subsequently of a number of ‘Decision Papers’ [https://www.watercommission.co.uk/view_Decision_Papers.aspx] which offer its initial view on issues key to the review. The Customer Forum has also been appointed to represent the views of customers generally and to promote and embed the customer interest within the Strategic Review of Charges process. It will have a formal role in facilitating effective customer engagement throughout the process. This builds on the innovative approach of the previous review and will ensure that customers’ priorities and views are fully considered in the Strategic Review of Charges.

Ministerial Inputs

Scottish Ministers must make 2 specific inputs to the Statutory Review in the form of statements which set out:

- the Principles that should underpin charges for water services; and
- the Investment Objectives which will define the standards of services to be delivered in the 2021-27 period.

The Scottish Government wishes to ensure that the policy framework set out at a strategic level in these two documents takes full account of the views and concerns of customers and

stakeholders. This document therefore seeks views on drafts of these documents and a number of key issues arising.

Responses to this paper will complement other processes including the work of the Customer Forum and Scottish Water's own engagement and research to ensure that the widest range of customer views is available to inform Ministers' decisions on the finalisation of these documents. They will be issued in final form in December 2019.

Policy Framework

The following features of the policy framework have been key to previous regulatory periods and the Government considers that they remain appropriate.

Charges for Customers - Charges for all customers should ensure the sustainable funding of the water industry whilst remaining affordable and broadly stable.

Size and Nature of the Investment Programme - Overall, investment priorities must support the Scottish Government's core purpose of creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth. In particular the investment programme should be:

- Developed such that the industry's capacity for investment is recognised and efficiency of delivery is optimised.
- Programmed in a manner so as to avoid excessive peaks and troughs in investment.
- As indicated above include the development of well-informed plans for capital maintenance including repair, refurbishment and replacement, to ensure the continued serviceability of Scottish Water's assets.

Government Financing - Scottish Water is financed from customer charges and borrowing from Government. For planning purposes it should be assumed that borrowing by Scottish Water will be at a similar level to that available in the present period. The levels will be confirmed at a later stage.

Consultation question

1. Do the key policy objectives provide a sound basis on which to plan the delivery of services from 2021?

Looking Beyond the Regulatory Period

The Government considers that the present 6 year regulatory period has proved effective in enabling better long-term planning for the industry and its supply chain; and giving customers certainty of pricing over a number of years. It is therefore requested that WICS determines prices for the 6 year period 2021-27.

In addition the Government is aware of significant longer term challenges presenting to the industry – many of which have been identified and analysed in Scottish Water's Strategic Projections. Significant among these is the need to plan for the replacement of major assets in the years ahead. Work is underway to understand the detail of these requirements but stakeholders recognise that this challenge will present a significant additional investment requirement. The Government is keen to avoid any shocks or significant movement in

charges to customers over future periods. It has therefore asked WICS as part of this review to give indicative profiles of prices for subsequent regulatory periods in the light of the developing understanding of continuing investment requirements.

PRINCIPLES OF CHARGING

The charges that customers pay provide the finance required to sustain Scottish Water's operations and to deliver improvements to services through a programme of capital investment. The level of charges is determined through the Strategic Review process undertaken by WICS. The manner in which charges are calculated for individual customers is governed by a set of principles issued by Ministers which are known as the Principles of Charging Statement (PoC).

The draft PoC statement for 2021-27 at Annex B.

Views and comments from customers and stakeholders are sought on all aspects of the principles to ensure that these continue to be appropriate and respond to the needs of customers, whilst ensuring that Scottish Water is funded properly for the services provided.

While there has been significant continuity in the principles adopted for previous regulatory periods, changes have been made in order to improve the cost reflectiveness of charges and to remove elements of cross subsidy within the charging structure. In the present regulatory period changes have been made to the treatment of vacant properties in the non-household sector and the rateable values of properties used to assess bills. Revisions were also made to the scheme of exemption for charities and community amateur sports clubs.

The Government considers that for the most part, the statement of principles set for the present regulatory period are satisfactory and should continue for the next period. The draft statement therefore provides that charges should:

- Be Stable.
- Cover the full costs of providing services to customers.
- Be Harmonised across Scotland.
- Be Cost-reflective.

For households, the structure of charges should continue to be set by reference to Council Tax bands (as set in 2015) and charges should be collected with Council Tax bills by local authorities.

While these principles should continue, the Government considers there is a case for change in the following areas.

Proposals for Change - Addressing issues of Affordability

The Government recognises that water and sewerage services are essential to every household in Scotland and that it is important that these services not only meet the expectations of customers but also remain affordable. Ministers consider that geographical harmonisation, linking household charges to Council Tax bands and the availability of discounts and exemptions for specific categories of customers has ensured some of the

most affordable water charges for low income families in Great Britain. There is, for example, no discount on water charges in England and Wales equivalent to that available to recipients of Council Tax Reduction in Scotland.

In line with Council Tax, discounts and exemptions are offered to certain categories of households depending on number and/or type of occupant. Single occupant households receive a 25% discount. Vacant properties are exempt. In addition, further discounts are applied to those in receipt of Council Tax Reduction.

Around 50% of customers benefit from one or more discounts. The overall costs of all the discounts is currently worth £146 million – about 18% of total household revenue.

The costs of these discounts is recovered through the charge structure so that customers pay more than they would were these discounts not in place.

It is important therefore that these discounts should be consistent with the principles of cost reflectivity and offer as much assistance as practicable to customers who face difficulty in paying their bills while not being an inappropriate burden on other customers. Between 10-15% of households pay more than 3% of net household income after housing costs on water charges (the commonly accepted point at which affordability constraints apply). There are families facing affordability constraints in all Council Tax bands – households in higher banded properties may pay a higher proportion of their income on water charges than those in the lowest bands.

Following examination of the discounts and discussions with stakeholders, Ministers therefore wish to consider changes to the present framework of discounts, reductions and exemptions provided for certain customers.

- The cost of the single occupant status discount is large - £85m. It is also increasing as the upward trend in single occupancy continues. Census data shows that between 1961 and 2011 Scotland's population grew by 4.7%. However in the same timeframe, the numbers of households grew by 51%. In 1961, 14% of households were single occupants compared to 35% today. In some Local Authority areas over 40% of all households are single person.
- The cost of the exemption for vacant household properties is £20m.
- There is no service-related cost justification for providing discounts for single occupancy or for vacant properties. Whilst these properties may use less water, most costs in the industry are fixed (in the form of pipes and another infrastructure) and drainage costs are not dependent on the number of occupants.
- Many single person households do not face issues of affordability – the discount is therefore simply a subsidy to them from other customers.
- The exemption for vacant properties in the non-household sector has been removed in the current regulatory period.

Ministers therefore consider that there is a strong case for reducing or removing these discounts. They wish to consider reducing the single occupant status discount from 25% to 10% and remove altogether the vacant property exemption.

Scottish Ministers wish to consider how the additional revenue this would raise can best be used to give further assistance to those genuinely facing difficulty paying.

Ministers consider that the best option to achieve this objective would be to increase progressively the reduction given to those on full Council Tax Reduction (CTR). Reducing

the single person status discount to 10% could fund an increase in the maximum discount that those on full CTR receive from 25% to 50%. This would provide additional help for over 340,000 households on full CTR and another 160,000 on partial CTR. This proposal is simple to administer since it uses existing processes.

An alternative approach would be to introduce a specific scheme designed to reduce a household's spending on water to 3% of disposable income. This would target households across all Council Tax bands but is administratively extremely complex – it would require a new additional process of application for relevant households. Means testing of this sort is controversial and intrusive and many families might not wish to apply for those reasons. In addition there is no appropriate agency to oversee such a process. The Government is not therefore attracted by this option.

Consultation questions

2 Do you agree that the current Principles of Charging remain broadly appropriate for the next regulatory period?

3 Do you agree the vacant household premises exemption should be removed?

4 Do you agree with the proposal to reduce the single occupant status discount from 25% to 10%, using the revenue to improve support for customers facing affordability constraints?

Financing New Capacity

Access to water and wastewater services is fundamental to economic development.

The current arrangements through which additional capacity is added to the network to support development are complex and, by common agreement, do not provide the right incentives to ensure that asset additions are in the long-term interests of customers. Currently, developers pay no contribution towards the costs of expanding strategic assets such as treatment works, pay a £346 infrastructure charge per connection and, in most cases, are fully reimbursed for the costs of providing local infrastructure required for the development.

Over recent regulatory periods the demands of growth have in many areas, particularly in Eastern Scotland, used up all the available capacity of networks and treatment works. The industry is now facing a significant pressure to provide new capacity. For example, new wastewater treatment works are required for Edinburgh, Stirling and Perth. The total cost of this new capacity is forecast to be in the region of £250-£300 million in the period 2021-27 – a significant increase from the £110 million in the period 2015-21.

The draft PoC includes a Ministerial request to Scottish Water and WICS that a review be undertaken by the end of 2019 to:

- assess the costs of providing additional capacity to deliver Scotland's growth plans;
- understand the incentives that the current arrangements drive and whether they lead to the correct behaviours and approaches;
- provide a comparison with other utilities across the UK; and

- provide recommendations for change that better allocate the costs and provide better levels of service to developers.

The conclusions of that review will be used to provide an updated policy on developer contributions which, following further consultation on detailed proposals, would be included in the final version of the document.

Consultation question

5 Do you agree that the costs of meeting the demands of growth on the water and wastewater infrastructure should be reviewed?

DETERMINING THE INVESTMENT REQUIREMENTS

Scottish Ministers are required to set the investment objectives for the water industry in Scotland. It is important that these fully support the Government's core purpose - to create a more successful country, with opportunities for all of Scotland to flourish, through increasing inclusive sustainable economic growth and the circumstances facing the industry in the medium to long term.

Draft Objectives for 2021-27 and beyond

Over the past year the Government has, together with Scottish Water, the regulators and customer representatives, worked to formulate a draft set of Ministerial Objectives. These are based on progress made to date, studies undertaken in the current regulatory period and known legislative requirements. This is attached at Annex C.

The draft statement of investment sets out Ministers' policies in relation to the standards of service that must be delivered in the period 2021-27. In particular these set the priorities for investment in relation to customer service, standards of service, drinking water, the environment, flooding, climate change and security. This Statement largely builds upon the investment requirements for previous regulatory periods and challenges Scottish Water to maintain its trajectory of improvement.

It therefore sets objectives in the following areas

1. Standards of service – Scottish Water should maintain current levels of service.
2. Asset Maintenance – Scottish Water should develop an evidence-based strategy that will inform the long term capital maintenance needs of the industry.
3. Supporting Sustainable Economic Growth – Scottish Water should continue to invest in water, sewerage and drainage infrastructure to provide capacity to enable development .
4. Drinking Water - Scottish Water should maintain compliance with drinking water quality standards and plan to remove any remaining lead pipes in its network.
5. Environment - Scottish Water should maintain compliance with its current environmental licences and address risks of impacts on the environment from its assets.
6. Flooding/Surface Water Management - Scotland needs to focus on surface water management to address customer flooding, water quality issues, climate change and growth.

7. Security & Resilience – Scottish Water should develop strategies and plans to ensure that the resilience and security of networks and supplies are maintained and improved.
8. Climate Change, Adaptation and Mitigation - Scottish Water should understand the impacts of climate change on its assets and implement plans for adaptation measures necessary to protect services. It should also continue to invest in renewable energy where it is economic to do so and to develop strategies for delivering low carbon water and wastewater services.
9. Private Finance Initiative funded contracts - Scottish Water should develop plans to manage its PFI contracts to secure the best value for money for the future operation of these facilities.

Consultation question

6 Do the draft investment objectives outlined above and set out in Annex C identify all areas where investment will continue to be necessary?

The draft also places additional requirements on Scottish Water:

- to develop a long-term plan for the maintenance and replacement of its assets;
- to engage with SEPA on the need to control plastics entering the environment;
- to work with stakeholders to deliver improvements to storm water management; and
- to present plans to manage the three maturing PFI contracts.

Further detail on these requirements can be found in the Annex. At this stage the document is set at a very strategic level. Following consultation it will be developed into a statutory direction to Scottish Water and drive the preparation of detailed investment projects.

Consultation question

7 Do you agree that that Scottish Water should be directed to address these additional requirements?

SUMMARY AND NEXT STEPS

The Scottish Government is committed to ensuring that Scottish Water continues to provide the services that customers require and for which they are prepared to pay. The participation of customers and stakeholders is essential to ensuring this outcome.

This paper has set out, and seeks views on, the key elements that make up the Government's policy framework in relation to Scottish Water for the next regulatory period and beyond. In addition, it has identified some specific aspects of the charging framework that require further consideration and has offered, for discussion in the form of Draft Objectives, an initial view on the improvements which will be required to services.

The Government would welcome your views on these issues. If you wish to comment please complete the form at <https://consult.gov.scot/energy-and-climate-change-directorate/water-services-from-2021>.

Annex A – Commissioning letter

Environment and Forestry Directorate

Water Industry Division

T: 0300-244 0246
E: Bob.Irvine@gov.scot



Professor Gordon Hughes
Water Industry Commission for Scotland
First Floor
Moray House
Forthside Way
Stirling
FK8 1QZ

31 January 2017

Dear Gordon,

STRATEGIC REVIEW OF WATER CHARGES: 2021-27

The Water Industry (Scotland) Act 2002, as amended by the Water Services etc. (Scotland) Act 2005, places duties on both the Scottish Ministers (Ministers) and the Water Industry Commission (the Commission). In particular it requires Ministers to specify the time period for the Strategic Review of Charges (SRC) and the date by which a Determination must be made. In furtherance of these powers I am writing to inform you of the broad arrangements that Ministers wish to be followed in the next Strategic Review of Charges.

The Commission is to undertake a Strategic Review of Charges for the six-year period 2021 to 2027. The Final Determination of Charges should be published by the end of March 2020.

In conducting the Review, Ministers look to the Commission to work with Scottish Water, Consumer Advice Scotland and other regulators and stakeholders to build on the arrangements put in place successfully in previous regulatory periods. Those arrangements have developed and evolved over successive reviews. They have ensured stability and continuity in financing and investment planning and have created a framework within which Scottish Water has significantly improved levels of efficiency and service delivery. This has ensured that the water industry has made an essential contribution to the Government's purpose of increasing sustainable economic growth.

It will be important that these regulatory mechanisms continue to evolve. In particular Ministers invite the Commission to ensure the processes of the Review give customers an enhanced voice in the consideration of levels of charges and service priorities. Ministers also recognise that the coming regulatory period will present some important challenges to Scottish Water and accordingly invite the Commission to work with Scottish Water to ensure they are properly addressed. These include most significantly:

- **Capital Maintenance** - Over this and future regulatory periods, Scottish Water should continue the transition to a risk based approach to maintaining the overall condition and performance of the assets so as to ensure no deterioration of service levels to customers over the long term. Ministers recognise the increasing importance of capital maintenance in achieving and maintaining service levels and statutory obligations in relation to drinking water quality and the environment and to reflect customer priorities that may affect longer term asset planning. This requires to be efficiently planned and delivered within successive regulatory periods. They wish the Commission to ensure that there is a stable and sustainable funding regime for this important part of the investment programme.

Resilience – Ministers recognise the progress Scottish Water has made in developing a strategic approach to identifying the work required to ensure the resilience of the network and requests that the Commission provides assurance that Scottish Water’s approach is proportionate, fit for purpose over the long term and represents value for money for customers.

Strategic Capacity – Ministers wish to ensure that Scottish Water is properly financed and incentivised to provide water and sewerage assets in a manner that does not place a constraint or restriction on the achievement of their housing and economic development targets. To achieve this Ministers look to the Commission to ensure that finance is available to Scottish Water for this purpose over the regulatory period and that the funding arrangements for additional capacity (including the Reasonable Cost Contribution) remain fit for purpose and strike the correct balance of cost between existing customers, new customers and borrowing.

Private Finance Initiative funded Projects - Ministers recognise that 3 of the 9 PFI contracts mature in the period 2021-27. They have asked Scottish Water to consider the options and costs for the future operation and funding of these assets. They request that the Commission undertake a full examination of Scottish Water’s approach to establishing the options and costs.

Partnership Projects – Ministers recognise the progress that Scottish Water has made in delivering improvements in partnership with other stakeholders, and in particular Local Authorities. They consider that, increasingly, delivering outcomes particularly in relation to the reduction of flood risk and compliance with bathing water standards will require Scottish Water to work closely with Local Authorities and communities. Ministers therefore request that the Commission ensures that the funding arrangements are sufficiently flexible so that Scottish Water can deliver to agreed timetables.

Supporting innovation – Ministers look to Scottish Water to contribute to inclusive and sustainable economic growth to which end they are encouraged to be innovative in their operation and with regards to capital enhancement and maintenance. In addition, Scottish Water is expected to support the Hydro Nation programme through their renewable energy and energy efficiency programmes and by working with communities and customers in Scotland and, through SWI, overseas. Ministers therefore request that the Commission ensures that the financing and funding arrangements for Scottish Water’s regulated elements create appropriate incentives towards efficient delivery of these objectives.

Principles of Charging:

Ministers recognise that their Principles of Charging for past regulatory periods have provided a framework which has secured significant stability and clarity for Scottish Water, its customers and stakeholders. Ministers will confirm the Principles of Charges to be applied by December 2019 following consultation.

Ministers expect that the Principles for the period 2021-27 will be broadly consistent with previous versions which may therefore be useful in guiding the initial stages of the review.

Ministers will consider the advice from the Long-Term charging group on the modernisation of water charges so as to ensure that these continue to deliver the principles of cost reflectivity and cost recovery. As in previous periods, the Principles of Charging will indicate the level of finance they are willing to make available in support of the investment programme. Their present expectation is that this will be lower than in previous periods.

Statement of Objectives

Ministers will present their draft objectives in April 2018 and finalise their objectives in December 2019.

Ministers expect that the objectives for the period 2021-27 will be broadly consistent with those set in 2014. They expect that the programme of outputs identified to achieve these objectives should reflect the best possible value for money in terms of the improvement in outcome achieved for the investment made. They will look to the Q&S4 Project Management Team, and the Output Monitoring Group, for advice on this matter and to develop the outputs necessary to secure this aim.

The current objectives recognise the importance of the security of Scottish Water's physical assets, the evolution of new threats to public services requires also that, relevant security standards in relation, IT systems and personnel, as advised by Scottish Government Resilient Essential Services, should be met.

Average annual expenditure on the investment programme should remain of a size that allows efficient delivery.

Ministers expect the Q&S4 Project Management Team, with advice from the Output Monitoring Group, to develop the outputs necessary to deliver these objectives. Consistent with Ministers' policy of continuity of investment, draft objectives for the subsequent period 2027-33 should also be developed. As for previous investment periods, these must demonstrate how they will contribute to the Government's purpose of increasing inclusive and sustainable economic growth. Scottish Water will also be required to continue to meet their statutory obligations to respond to future climate change making necessary climate change related adaptations to operational practice and assets and should ensure systematic monitoring of carbon emissions.

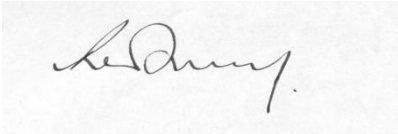
Timetable

In agreeing the timetable for this SRC, Ministers ask that all parties ensure that, in keeping with good practice, sufficient time is made available to ensure appropriate consultation with the wider stakeholder group, communication with customers and for the Government's own public engagement.

Ministers look forward to receiving regular reports on the progress of the strategic review.

I am copying this letter to the Chair of Scottish Water, the Chair of Scottish Environment Protection Agency, the Drinking Water Quality Regulator for Scotland, the Chair of Consumer Advice Scotland and the Chair of the Competition Commission.

Yours sincerely

A rectangular box containing a handwritten signature in black ink. The signature is cursive and appears to read 'Bob Irvine'.

Bob Irvine

Annex B – Principles of Charging

Scottish Government

GENERAL STATEMENT OF POLICY - PRINCIPLES OF CHARGING FOR WATER SERVICES 2021-27

Scottish Ministers make the following statement of the principles that must apply to water charges for 2021-27. This statement supports the delivery of the Government's Purpose of focussing government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable and inclusive economic growth. The following principles will guide the Water Industry Commission for Scotland when determining the maximum charge limits with which Scottish Water (SW) must comply during 2021-27 regulatory period.

Principles

Principle 1 – Stable charges

1. Ministers recognise the importance that customers attach to stability and certainty in charging. The Commission will determine charges having regard to the level of inflation, as measured by the Consumer Prices Index, that give customers certainty about the maximum level of charges they will face over the regulatory period.

Principle 2 - Full cost recovery

2. Charges should cover the full costs of providing services to customers.

Principle 3 - Harmonised charges

3. Ministers require that charges should, for similar services provided to customers of a similar category, be the same for each customer in that category regardless of location in Scotland.

Principle 4 - Cost-reflective charges

4. Charges should remain broadly cost-reflective. In particular charges for given services (for example drinking water) to particular customer groups (for example households) should be set to recover the cost to SW nationally of providing that service to that group as a whole. They recognise that charges for particular services such as developer connections may have to change in the light of the reviews instructed in this document.

Additional Requirements

Household charges

5. Ministers confirm that, in relation to unmetered households, the collection arrangements and the tariff structure applying to charges in 2015-21 should continue for the period 2021-27, that is in general:

- Local Authorities will continue to bill and collect unmeasured household water and sewerage charges - Ministers will ensure that an order under section 37 of the Water Industry (Scotland) Act 2002 is in place to secure this.
- The bandings for household water and sewerage charges should replicate council tax bandings as set in 2015 and apply the discounts that apply to council tax subject to the provisions below.
- In line with Ministers' principle on cost reflective charging (5 above) **Ministers confirm that they intend to examine, through a separate consultation, the appropriateness of discounts and exemptions offered to certain households. They propose that support for low income households should be improved as a consequence of any changes.**
- Subject to the outcome of the consultation, reductions related to Council Tax Reduction applied to water and sewerage charges will remain, as a minimum, in line with the provisions set out at Annex A to this statement.

6. Full-time students will remain exempt from water and sewerage charges. Furthermore, purpose-built student accommodation is only brought into charge whilst it is not occupied solely by full-time students studying at a Scottish University or College.

7. Metered and unmetered household charges should continue to include appropriate elements to recover the cost to Scottish Water of draining:

- Roofs and other impermeable surfaces from household premises; and
- Those public roads that are connected to its sewers.

Business charges

8. Ministers confirm that, in relation to non-domestic charges, wholesale charges should continue to be set in line with the principles set out above and should take note of the following:

- *Paying for public roads drainage* - wholesale charges should continue to include an appropriate element to recover the cost to Scottish Water of draining those public roads that are connected to its sewers.
- *Paying for surface drainage* – wholesale charges should recover the costs to Scottish Water of dealing with rainwater that drains to Scottish Water's infrastructure from roofs and other impermeable surfaces within private properties.
- *Basis for calculation* – drainage charges should be calculated by reference to the Rateable Value as shown in the current valuation roll. A separate industry review of alternative methods is on-going and any proposal to change the current methodology would be subject to further consultation.

Financing

9. Ministers confirm that, in relation to the financing of SW, the following considerations should apply:

- *Financial Strength* - SW should be sustainably and prudently financed appropriate to the governance framework within which it operates.
- *Dividend* - The Government will not take a dividend from its ownership of SW.
- *Lending* - The Government will continue to make external finance available through lending to SW in the 2021-27 period in support of its investment programme.. Ministers will provide no less than [sum to be determined] per annum.
- *Financial Performance* - Financial performance should be monitored in line with the financial tramlines as set out by the Commission. These will also ensure that Customers will only be asked to meet additional costs beyond those allowed for in a charges determination where these arise as the result of external factors beyond the influence of SW. This arrangement protects the position of customers and ensures that they do not compensate SW for inefficiency or poor management. Any financial outperformance will be deployed in line with Ministers' decisions.

Paying for capacity

10. Ministers request that a review be undertaken into the arrangements for paying for additional capacity to ensure that the apportionment of costs between current and future customers is consistent with Principle 4 above. The review should consider the costs of:

- Extending local infrastructure to enable new developments to be connected to the public networks to ensure that the reasonable cost contribution made by current customers is appropriate;
- Strategic network upgrades required to connect new developments and to ensure that the infrastructure charge paid by developers is set to recover the costs incurred.
- Upgrading strategic infrastructure such as treatment works.

This review is to be completed in 2019. The conclusions of this review will be reflected in the final statement.

Assistance for Charitable organisations

11. Ministers recognise the contribution that charities make to Scotland's well-being and prosperity and confirm that the scheme implemented for 2015-21 period is continued. This Scheme will provide an exemption or a reduction on water and sewerage charges payable by charities or Community Amateur Sports Clubs subject to the conditions set out in Annex B. This scheme is to be funded by the generality of non-household customers.

Paying for regulation and customer representation

12. Ministers confirm that the cost of economic regulation and customer representation should be covered by an annual levy on SW funded out of charge income.

13. Ministers confirm that the costs of the Drinking Water Quality Regulator in regulating Scottish Water's core functions should be funded out of charge income.

14. Ministers confirm that the SEPA's costs in regulating Scottish Water should be funded from charges levied by SEPA in accordance with SEPA's charging regime.

Preparing for Future Regulatory Periods

15. Ministers require that preparatory work be undertaken for the 2027-33 period. The charging policies as contained within this document will be reviewed to ensure that they meet the Government's overall policy priorities.

[date]

Reductions to apply to water and sewerage charges at unmetered Households

The following text is taken from the present Principles of Charges which apply for the period 2015-21.

Ministers are proposing changes to this framework to remove the exemption for vacant households and to reduce the single occupant status discount. They are also proposing to raise the discount for recipients of Council Tax Reduction.

Subject to further consultation these changes will be reflected in revised text.

1. Reductions to water and sewerage charges at unmetered households should apply in relation to dwellings (where "dwelling" has the same meaning as in part II of the Local Government Finance Act 1992) where all the following circumstances apply:-
 - a. A person is liable to pay water and/or sewerage charges under a charges scheme; and
 - b. The dwelling in respect of which the charges are payable is not one to which the Council Tax (Discount for Unoccupied Dwellings) (Scotland) Regulations 2005 apply.

2. Where the dwelling is subject to a Council Tax discount under section 79 of the Local Government Finance Act 1992, the discounts to be applied to unmetered water and sewerage charges shall be the same as those applied to Council Tax charges. If there is no such discount under section 79, but a person receives Council Tax Reduction in respect of the dwelling, the following formula should be used to calculate the level of reduction for which that dwelling is eligible.

$$R = 25 \times A \div B$$

Where:

- R is the percentage discount to be applied to water and/or sewerage charges;
- A is the amount of Council Tax Reduction which a person receives in respect to that dwelling in that year; and
- B is the council tax for which that person is liable in respect to that dwelling in that year.

3. No reduction in water charges should be applied for 2nd homes, vacant homes or to dwellings supplied through a water meter.

Assistance for Charitable organisations

Ministers confirm that there is to be a scheme to assist charities with the payment of water and sewerage charges. Assistance is to be provided to an organisation which meets the following criteria:

- It is either registered:
 - with the Office of the Scottish Charity Regulator as a charity; or
 - with HMRC as a Community Amateur Sports Club (CASC) operating in Scotland.
- Where it has a gross annual income of less than £200,000 as disclosed in its most recent set of accounts submitted to the relevant regulatory body it will be exempt from the payment of water and sewerage charges.
- Where it has a gross annual income of more than £200,000 but less than £300,000 it will be eligible for a 50% reduction in wholesale water and sewerage charges. Water and sewerage retail charges will be subject to a cap to be determined by the Water Industry Commission for Scotland.

Other conditions:

1. Any eligible charity or CASC seeking exemption or a reduction must:
 - Apply to their Licensed Provider.
 - Renew their request for exemption annually.
2. Where organisations are awarded charity or CASC status, exemption or a reduction will be granted from date upon which charity or CASC status is awarded.
3. Exemption or a reduction will only be awarded where the records held by OSCR or HMRC are up to date and in line with the regulator's expectations.
4. Charities or CASCs in possession of permanent alcohol licence will not qualify for assistance.
5. Charities or CASCs which operate a full-time retail outlet will not qualify for assistance.

Annex C – Statement of Proposals

STATEMENT OF PROPOSALS – Investing in Water and Wastewater Services 2021-27

Investment Areas

1. Standards of service

Ministers expect that current levels of service, expressed in terms of the overall quality of services and customer experience, shall be maintained over the long term. They expect Scottish Water to engage with stakeholders and customers to establish appropriate standards of service for the 2021-27 regulatory period, and beyond, and to report annually on performance against these standards. They also request that performance assessment criteria are reviewed to ensure that these remain fit for purpose and adequately reflect Ministerial priorities, quality of services and customer views.

2. Asset Maintenance

Ministers recognise that maintaining high levels of performance are dependent on adequate maintenance, and when appropriate, replacement of existing assets. They request that Scottish Water develops an evidence-based strategy that will inform the long term capital maintenance needs of the industry. The strategy should also set out the programme being undertaken to understand the condition of assets in particular those of a critical nature for maintaining service delivery. This strategy must command the confidence of Scottish Water's regulators and ensure that asset maintenance is fully integrated with other areas of the investment programme.

3. Supporting Sustainable Economic Growth

To support the Scottish Government's purpose to increase levels of sustainable economic growth, Ministers confirm that Scottish Water should continue to invest in water, sewerage and drainage infrastructure to provide capacity to enable development.

Ministers recognise that, in a number of locations in Scotland, the levels of headroom available to accommodate new demand is not sufficient to support future forecast demand for capacity. They ask Scottish Water to work with stakeholders to influence strategic development in areas where there is already capacity and to consider all possible measures to release capacity in existing assets before requiring enhancement of water and wastewater infrastructure.

Ministers recognise that a small percentage of Scotland's population currently relies on private water and sewerage arrangements. In line with their commitment to delivering the United Nation's Sustainable Development Goal 6, Ministers expect that Scottish Water will work with the Scottish Government to support the Government's objective of ensuring reliable and sustainable rural water and waste water services.

Ministers wish Scottish Water to consider opportunities highlighted in Scotland's strategy "Making things last" <http://www.gov.scot/Resource/0049/00494471.pdf> and to apply the principles of a circular economy to water and wastewater services, in particular exploring the potential for resource recovery from sludge.

4. Drinking Water

Ministers expect Scottish Water to maintain compliance with drinking water quality standards and, in the interests of public health, ensure that plans are in place to address failures, including the risk of failures, of standards. They also request that the plans already developed to address the resilience of supplies be updated and that progress be made to secure further improvements.

In the light of expert advice from the World Health Organisation that lead should be removed from drinking water supplies, Ministers request that Scottish Water develops investment plans to remove contact of potable water with lead pipes in its network. They also request that Scottish Water works with the Scottish Government and other stakeholders in respect of lead pipes within customer properties so that everyone can access a lead-free water supply.

5. Environment

Ministers expect Scottish Water to maintain compliance with its current environmental licences and to continue to develop investment plans that address risks of impacts on the environment from its assets.

Ministers have set out, their objectives for Scotland's water environment in their River Basin Management Plan , in particular, how public bodies, businesses and land managers will work together to protect and improve the environmental quality of Scotland's rivers, lochs and seas over the period to 2027. They request that Scottish Water, as a key player in the delivery of these objectives, sets out how improvements to water and sewerage infrastructure in the period 2021-27 will contribute to these objectives through annual updates to its Delivery Plan.

Ministers commend Scottish Water's efforts to develop drainage and wastewater management plans so as to gain a better understanding of the performance of sewer networks and to plan for improvements. They expect these to be further developed with a view to limiting the amount of plastics reaching the water environment through these routes.

Ministers recognise that pollution of the water and marine environment arises, not only from assets but also from product design and customer behaviour. They request that Scottish Water supports SEPA in working with the manufacturing sector, the Government, customers and stakeholders to control, at source, macro and micro plastics and priority substances.

6. Flooding/Surface Water Management

Scotland needs to focus on surface water management to address customer flooding, water quality issues, climate change and growth. Ministers commend the partnership working between Scottish Water and Local Authorities to develop a greater understanding of the performance of drainage and sewerage networks. Ministers request that Scottish Water works with Local Authorities and other stakeholders to

develop delivery and monitoring arrangements to secure improvements to storm water management, including those for which joint delivery solutions will be required.

7. Security & Resilience

Ministers request that strategies and plans are developed to ensure that the resilience and security of networks and supplies are maintained and improved, in line with advice from Government security advisers and industry best practice. Such strategies and plans should cover the resilience of services in adverse conditions and the security of IT systems.

8. Climate Change, Adaptation and Mitigation

Scotland is already feeling the impacts of climate change. Ministers request that Scottish Water ensures that it understands the impacts of climate change on its assets and implements its plans for adaptation measures necessary to protect services.

In keeping with Scotland's strategy of transition to a low carbon economy, they request that Scottish Water continues with climate change mitigation by investing in renewable energy where it is economic to do so and to develop strategies for delivering low carbon water and wastewater services.

9. Private Finance Initiative funded Projects

Ministers recognise that 3 of the 9 PFI contracts mature in the period 2021-27. They request Scottish Water develops plans to manage these contracts to secure the best value for money for the future operation of these facilities. Plans should be prepared for contracts that end in the period following 2027.

Responding to this Consultation

We are inviting responses to this consultation by 28 September 2018.

Please respond to this consultation using the Scottish Government's consultation platform, Citizen Space. You view and respond to this consultation online at <https://consult.gov.scot/energy-and-climate-change-directorate/water-services-from-2021>. You can save and return to your responses while the consultation is still open. Please ensure that consultation responses are submitted before the closing date of 28 September 2018.

If you are unable to respond online, please complete the Respondent Information Form (see "Handling your Response" below) to:

Investing in and paying for water services
Water Industry Team
3F South
Victoria Quay
Edinburgh
EH6 6QQ

Handling your response

If you respond using Citizen Space (<http://consult.scotland.gov.uk/>), you will be directed to the Respondent Information Form. Please indicate how you wish your response to be handled and, in particular, whether you are happy for your response to be published.

If you are unable to respond via Citizen Space, please complete and return the Respondent Information Form attached included in this document. If you ask for your response not to be published, we will regard it as confidential, and we will treat it accordingly.

All respondents should be aware that the Scottish Government is subject to the provisions of the Freedom of Information (Scotland) Act 2002 and would therefore have to consider any request made to it under the Act for information relating to responses made to this consultation exercise.

Next steps in the process

Where respondents have given permission for their response to be made public, and after we have checked that they contain no potentially defamatory material, responses will be made available to the public at <http://consult.scotland.gov.uk>. If you use Citizen Space to respond, you will receive a copy of your response via email.

Following the closing date, all responses will be analysed and considered along with any other available evidence to help us. Responses will be published where we have been given permission to do so.

Comments and complaints

If you have any comments about how this consultation exercise has been conducted, please send them to waterindustry@gov.scot.

Scottish Government consultation process

Consultation is an essential part of the policy-making process. It gives us the opportunity to consider your opinion and expertise on a proposed area of work.

You can find all our consultations online: <http://consult.scotland.gov.uk>. Each consultation details the issues under consideration, as well as a way for you to give us your views, either online, by email or by post.

Consultations may involve seeking views in a number of different ways, such as public meetings, focus groups, or other online methods such as Dialogue (<https://www.ideas.gov.scot>)

Responses will be analysed and used as part of the decision making process, along with a range of other available information and evidence. We will publish a report of this analysis for every consultation. Depending on the nature of the consultation exercise the responses received may:

- indicate the need for policy development or review
- inform the development of a particular policy
- help decisions to be made between alternative policy proposals
- be used to finalise legislation before it is implemented

While details of particular circumstances described in a response to a consultation exercise may usefully inform the policy process, consultation exercises cannot address individual concerns and comments, which should be directed to the relevant public body.

ANNEX D – Respondent Information Form

INVESTING IN AND PAYING FOR YOUR WATER SERVICES FROM 2021: AN INVITATION TO ENGAGE WITH THE GOVERNMENT AND TO PROVIDE YOUR VIEWS

RESPONDENT INFORMATION FORM

Please Note this form **must** be completed and returned with your response.

Are you responding as an individual or an organisation?

- Individual
- Organisation

Full name or organisation's name

Phone number

Address

Postcode

Email

The Scottish Government would like your permission to publish your consultation response. Please indicate your publishing preference:

- Publish response with name
- Publish response only (without name)
- Do not publish response

Information for organisations:

The option 'Publish response only (without name)' is available for individual respondents only. If this option is selected, the organisation name will still be published.

If you choose the option 'Do not publish response', your organisation name may still be listed as having responded to the consultation in, for example, the analysis report.

We will share your response internally with other Scottish Government policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for Scottish Government to contact you again in relation to this consultation exercise?

- Yes No

Written Responses – Questions

Key Policy Objectives

1) Do the key policy objectives provide a sound basis upon which to plan the delivery of services from 2021?

Yes No

Comments

Principles of Charging

2) Do you agree that the current Principles of Charging remain broadly appropriate for the next regulatory period?

Yes No

Comments

3) Do you agree the vacant premises exemption should be removed?

Yes No

Comments

4) Do you agree with the proposal to reduce the single occupant status discount, using the revenue to improve support for customers facing affordability constraints?

Yes No

Comments

5) Do you agree that the costs of meeting the demands of growth on the water and wastewater infrastructure should be reviewed?

Yes No

Comments

Investment Requirements

6) Do the Draft Investment Objectives included at Annex C of this paper identify all areas where investment will continue to be necessary?

Yes No

Comments

7) Do you agree that that Scottish Water should be directed to address these additional requirements?

Yes No

Comments

Other

8) Please include any other comments you wish to make on paying for and investing in water services from 2021 below.

Comments



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