

EXECUTIVE NOTE

THE PROVISION OF WATER AND SEWERAGE SERVICES (REASONABLE COST) (SCOTLAND) REGULATIONS 2011

SSI 2011/119

The above instrument was made in exercise of the powers conferred by Section 6 of the Water (Scotland) Act 1980 and Section 1 of the Sewerage (Scotland) Act 1968. The instrument is subject to negative resolution procedure.

Policy Objectives

1.1 This note sets out: the legislative background to the expansion of the public water and sewerage networks to enable new development, the policy of the Scottish Government in this area and how this policy is enacted.

1.2 This Executive note has been prepared by the Scottish Government in order to assist the reader of the Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2011. It does not form part of the Regulations and has not been endorsed by Parliament. The note should be read in conjunction with the Regulations as it is not a comprehensive description of them.

2. *Legislative background*

2.1 Section 6 of the Water (Scotland) Act 1980 and Section 1 of the Sewerage (Scotland) Act 1968 require Scottish Water to extend its water and sewerage network so as to enable buildings for which a supply is required for domestic purposes to be connected at a reasonable cost. Scottish Water's requirement to do this is subject to a reasonable cost limit. Section 6 of the Water (Scotland) Act 1980 and Section 1 of the Sewerage (Scotland) Act 1968 provide for Scottish Ministers to make regulations to determine reasonable cost, both for developers and Scottish Water.

3. *Scottish Government Policy*

3.1 The Scottish Government's policy is that:

- Scottish Water's duty to extend the public network ends at the point where premises can connect to the network by means of a water supply pipe or drain – that is a Part 1 connection (see paragraph 3.2).
- The reasonable cost limit for Scottish Water to extend its network for new connections is most appropriately determined by an assessment of the future income that Scottish Water is likely to receive from that connection in the medium term;
 - When assessing the cost of for a new connection for these purposes the costs of enhancements required to the local water and sewerage infrastructure should be included but the costs of upgrading strategic infrastructure, which can not normally be attributed to an individual development, should not be; and

- Where it is not practicable for Scottish Water to extend the network to enable a new connection to be made within the reasonable cost limit and the developer commits to meeting the full cost of the connection Scottish Water should make a contribution to the developer which is the lower of the costs reasonably incurred in extending the network and the reasonable cost limit.

3.2 The component parts of a new connection can be split into four distinct elements:

- Part 1: the connection from individual premises to a water main or sewer (i.e. a water supply pipe or drain);
- Part 2: the water mains and sewers that connect developments (for example, a street of houses) to trunk mains and trunk sewers and some sustainable urban drainage systems (SUDS);
- Part 3: the local bulk infrastructure, such as trunk mains and trunk sewers, water service reservoirs, water and wastewater pumping systems and some SUD systems;
- Part 4: the strategic assets such as raw water intakes, water impounding reservoirs and aqueducts, and water and wastewater treatment works.

Local infrastructure includes refers to parts 2 and 3 above. Strategic Infrastructure refers to part 4 above.

3.3 The Scottish Government's policy is also that Scottish Water shall levy an infrastructure charge for each connection at every new property. This is because there are situations where it can be difficult to attribute the requirement for growth in local infrastructure to any individual developer or development. The funds Scottish Water raises from this charge will be used to help address demands on capacity that cannot be attributed to particular developments.

3.4 These arrangements are broadly similar to that for other utilities and the water sector in England & Wales.

4. *Enactment of Government Policy*

4.1 This Scottish Government's policy is enacted through the following four instruments, each of which is described in more detail below:

- The Principles of Charging Statement for 2010-2015,
- The Scottish Water (Objectives for 1st April 2010 to 31st March 2015) Directions 2009, as amended
- The Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2011, and
- The Scottish Water (Payment of Reasonable Cost Contributions) Directions 2011.

Principles of Charging Statement

4.2 A Principles of Charging Statement is required under Section 29D of the Water Industry (Scotland) Act 2002. It sets out the Scottish Government's charging

principles which must be applied by Scottish Water and the Water Industry Commission for Scotland when making annual charges schemes.

4.3 The Principles of Charging Statement for the 2010-15 period states that:
“Where enhancements to the local infrastructure are required to enable new developments to be connected to the public networks, developers should meet the net cost to SW of such enhancements. The detailed aspects of the arrangements are contained in the Reasonable Cost Regulations and a Ministerial direction to Scottish Water.”

and

“The Commission should continue to provide for SW to levy infrastructure charges for each new property connected to the water or sewerage infrastructure.”

The Scottish Water (Objectives for 1st April 2010 to 31st March 2015) Directions 2009, as amended

4.4 These directions are issued under Section 56A of the Water Industry (Scotland) Act 2002 and are known as the ‘Objectives Directions 2010-15’. They set down the standards that Scottish Water should achieve over the regulatory period. With regards to providing strategic capacity for new developments in the 2010-15 period, the direction states that Scottish Water shall:

“provide new strategic capacity to meet all new housing development and the domestic requirements of commercial and industrial customers.”

Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2011

4.5 These Regulations are made under Section 1(3C) of the Sewerage (Scotland) Act 1968 and Section 6(2D) of the Water (Scotland) Act 1980. They define the reasonable cost limit of extending Scottish Water’s network so as to enable a new connection to the public sewerage and public water supply systems as the lower of:

- the costs reasonably incurred in making the connection, or
- a figure (specified in the regulations) which reflects an assessment of the future income that Scottish Water will receive from the connection in the medium term due to the domestic water and sewerage demands.

Defining reasonable cost in this way ensures that, when combined with the Payment of Reasonable Cost Contributions Directions (see below), Scottish Water will not make a contribution to a developer that exceeds the costs to the developer of extending the network.

4.6 The regulations clarify that Scottish Water’s duty to extend the public network ends at the point where premises can connect to the network by means of a water supply pipe or drain. Accordingly, the costs of this final stage of connection are not taken into account when determining the reasonable cost to Scottish Water of extending the public networks. The regulations also clarify that in relation to the costs of any strategic capacity which may be needed for a development, the calculation of reasonable cost must take into account the finance that is made available to Scottish Water to provide this strategic capacity. This requirement is included because Scottish Water is financed to deliver the outcomes required by the

Objectives Direction 2010-15 and these include the provision of new strategic capacity to meet all new housing development and the domestic requirements of commercial and industrial customers. Consequently any costs to Scottish Water of providing such new strategic capacity will have been met through the financing of the Objectives Directions. By requiring that this finance is taken into account, the regulations neutralise the costs of any strategic capacity and effectively exclude them from the calculation of the reasonable cost limit for Scottish Water.

4.7 The assessment of the future income that Scottish Water will receive from the connection in the medium term due to the domestic water and sewerage demands is set down in a series of tables in the regulations. Broadly the income is calculated as:

- for household developments, twelve years discounted average charges, and
- for non-household developments six years discounted income from the domestic water and sewerage demands of the development.

The shorter time horizon for non-household developments reflects the greater vacancy rates that tend to occur for such developments. The formulae that calculate the values in the tables in the regulations are included in an Annex to this note. The tables in the regulations show a reduction, in real terms, of this assessment of future income that Scottish Water will receive from the connection in the medium term over the 2010-15 period. This is due to the real terms reduction in non-domestic water charges that occurs over this period and also the unwinding of cross subsidies from wastewater charges to trade effluent.

4.8 Under Section 1(4) of the Sewerage (Scotland) Act 1968 and Section 6(3) of the Water (Scotland) Act 1980 a developer can request that the Water Industry Commission for Scotland determines whether reasonable cost has been properly determined by Scottish Water in accordance with these Regulations and whether Scottish Water has discharged its duty to make network connections available.

The Scottish Water (Payment of Reasonable Cost Contribution) Directions 2011

4.9 These directions are issued under Section 56 (3) of the Water Industry (Scotland) Act 2002. They require Scottish Water to make a payment (typically known as a reasonable cost contribution) to a developer where it is not practicable at reasonable cost for Scottish Water to extend its network so as to allow a new connection to be made but the developer has agreed to meet the full cost of providing the connection. The amount of the payment is the reasonable cost to Scottish Water of providing connection as defined in the Provision of Water and Sewerage Services (Reasonable Costs) (Scotland) Regulations 2011, which is the lower of:

- the costs reasonably incurred in making the connection, or
- the figure (specified in the regulations) which reflects an assessment of the future income that Scottish Water will receive from the connection in the medium term due to the domestic water and sewerage demands.

The overall effect of these four instruments is to deliver the Government's policy as laid out in paragraph 3.1. If you would like further information please contact the Water Industry Team at the Scottish Government by e-mailing waterdivision@scotland.gsi.gov.uk.

Consultation

The following bodies have been consulted on a draft of the instrument:

- Scottish Water,
- Water Industry Commission for Scotland.

Financial Effects

The instrument confirms current practice and hence does not alter the financial position of the Scottish Government, local government or business.

Scottish Government Climate change, Greener and Water Industry Division
February 2011

Annex – Calculating the income Scottish Water is likely to receive due to the domestic water and sewerage demands of the development

Household Water Income

The formula is:

$$\text{£ cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^{12} \right]$$

Where:

“A” is the average of water charges calculated in accordance with the following formula–

$$A = \frac{X + Y}{2}$$

Where:

“X” is the water charges payable in respect of a Band B dwelling for the financial year in which the connection is requested;

“Y” is water charges payable in respect of a Band C dwelling for the financial year in which the connection is requested; and

“c” is the weighted average cost of capital of Scottish Water which for the 2010-15 period was calculated in the Final Determination of Charges as 4.2% real.

Household Sewerage Income

The formula is:

$$\text{£ cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^{12} \right]$$

Where:

“A” is the average of sewerage charges calculated in accordance with the following formula–

$$A = \frac{X + Y}{2}$$

Where:

“X” is the sewerage charges payable in respect of a Band B dwelling for the financial year in which the connection is requested;

“Y” is sewerage charges payable in respect of a Band C dwelling for the financial year in which the connection is requested; and

“c” is the weighted average cost of capital of Scottish Water which for the 2010-15 period was calculated in the Final Determination of Charges as 4.2% real.

Non-Household Water Income

The formula is:

$$\text{£ cost} = \frac{V_{dom} \times WAVI}{c} \left[1 - \left(\frac{1}{1+c} \right)^6 \right]$$

Where:

WAVI = Water Average Volumetric Income per m³ - WAVI (2008/09) was calculated by dividing non-household wholesale water revenue by non-household water volumes using data from Scottish Water's Annual Return (AR08) tables P15-13 inclusive. Average charge increases for 2009/10 and 2010/11 (+3.0% and -2.6% respectively) were applied to give the 2010/11 SAVI. K factors determined through the SR10 process, were used to generate WAVI for subsequent years (2011/12 to 2014/15).

V_{dom} = expected volume of water to be used for domestic purposes by developments per year (m³).

“c” is the weighted average cost of capital of Scottish Water which for the 2010-15 period was calculated in the Final Determination of Charges as 4.2% real.

Non-Household Sewerage Income

The formula is:

$$\text{£ cost} = \frac{V_{dom} \times SAVI \times 0.95}{c} \left[1 - \left(\frac{1}{1+c} \right)^6 \right]$$

Where:

SAVI = Sewerage Average Volumetric Income per m³ - SAVI (2008/09) was calculated by dividing non-household wholesale waste water revenue by non-household waste water and trade effluent volumes using data from Scottish Water's Annual Return (AR08) tables P15, P17 and P29. Average charge

increases for 2009/10 and 2010/11 (+3.0% and -11.20% respectively) were applied to give the 2010/11 SAVI. K factors for sewerage, determined through the SR10 process, were used to generate SAVI for subsequent years (2011/12 to 2014/15).

V_{dom} = expected volume of water to be used for domestic purposes by developments per year (m³).

“c” is the weighted average cost of capital of Scottish Water which for the 2010-15 period was calculated in the Final Determination of Charges as 4.2% real.