

14<sup>th</sup> July 2004

Circular Letter: WSP7/04

*To each local authority*

**RE. WATER SERVICES PRICING POLICY IMPLEMENTATION  
- Elaboration of Water Services Pricing Policy 2004 -**

This circular is in response to the County and City Managers Association 'Report on Water Pricing' dated January 2004. The report highlights local authority concerns regarding the practical implementation of water services pricing policy. Following a detailed review of the Report we have identified those proposals which come within the parameters of the Government Water Services Pricing Policy Framework and which can be implemented as of now. There are further proposals in the Report that would require a fundamental change in the policy framework and/or necessitate a return to Government. Such proposals will be considered at a later date and in the context of the wider review of local government funding which the Minister for the Environment, Heritage and Local Government has initiated.

Roll Out of Pricing Policy Framework

As you know, the Government's water services pricing policy framework was determined in the autumn of 1998. It was the subject of extensive consultation with all stakeholders, including the CCMA during 1999. The marginal capital cost requirement was introduced with effect from March, 2000 and the operational cost element, involving *inter alia* the achievement of universal metering of the non-domestic sector, must be fully implemented by 2006. As the implementation process has unfolded the Water Services Policy Unit has and will continue to work closely with local authorities' and provide support and assistance as required.

Response to the CCMA's Report on Water Pricing

Circular L16/2002 (WSP) dated 26<sup>th</sup> September 2002 on the implementation of the water services pricing policy framework consolidated the previous water services pricing policy circulars and also provided for the application of the policy for residential development, development levies and other matters. Having considered the CCMA Report, I am to advise on the following:-

***1. Transparency***

The CCMA Report raises the issue of transparency and how this requirement should be interpreted and applied. It is considered, given the experience and knowledge of local authorities' in the management of water services and other key areas, that sanitary authorities' are best placed to interpret and implement any transparency requirements necessary for the effective implementation of

water services pricing policy. The CCMA Report states that this should be "in a manner that will be defensible, acceptable and that will not bring a local authority into conflict with consumers or consumer representative groups".

## ***2. Unaccounted for Water (UFW)***

Given the absence of robust data and proposals to resolve the high volumes of unaccounted for water (UFW) arising nationally, the water services pricing policy has maintained a 20% cap for cost recovery on non-domestic UFW as a reasonable holding position. We acknowledge that in the interim period, local authority data collection, operational management and charging mechanisms have become more sophisticated and a national water conservation programme has been rolled out. It is now considered that the recoverable cost of water services should include the level of UFW that is appropriate to the supply, determined as a target to be achieved in the context of an effective and planned water conservation programme. Authorities should, having regard to their water conservation programme, set realistic medium and long term targets for reducing their UFW and advise non-domestic customers of these programmed reductions. Authorities should in this regard, commit to the capping of the costs to be recovered for UFW in accordance with scheduled medium and long-term targets. Targets for reductions in UFW supported by credible water conservation data should in future form the basis for the UFW element of the water services consolidated change.

It is acknowledged as outlined in the CCMA Report that remedial works associated with the water conservation programme would be subject to the consideration of agreed economic levels of leakage and established economic and environmental justification criteria.

## ***3. No Profit Principle***

Paragraph 5.11 of Circular L16/2002 (WSP) sets out the "no profit" principle as follows:

*The Government Decision S.21336 establishing the Water Pricing Framework requires that local authorities fully recover non-domestic costs. This involves the quantification of all costs or elements of costs that can reasonably be considered applicable and chargeable to water services. The Framework also provides for the recovery of domestic capital cost from the Exchequer and domestic operational costs through the Local Government Fund. It is implicit in this arrangement that local authorities do not make a profit from the provision of water services.*

This does not require authorities to operate on the basis of a zero operating surplus for water services. In recognition of the practical difficulty of predicting demand, costs and revenue, it is accepted that local authorities may aim for a small operating surplus in any one year, to protect against the risk of under-resourcing. This includes costs of water services provision for the non-domestic sector. Surplus income should however be ring-fenced and credited against operational costs in the subsequent year thus reducing the consolidated costs/charge. It would be at variance with water services pricing policy to divert such surpluses to fund water services new development capital projects.

In the same way a shortfall in water services non-domestic income in one year is recoverable by a corresponding increase in the water services charge in the subsequent year.

#### ***4. Full Cost Recovery***

Proposals in the CCMA Report regarding full cost recovery, which include depreciation and a rate of return exceed the parameters of the water services pricing policy framework and are not being considered at this time. It might in this context be useful to outline in general terms what is intended by full cost recovery for water services. In this regard, full cost recovery is considered as the recovery of all reasonable non-domestic direct costs, to include average operational cost and the marginal capital costs along with the relevant indirect costs associated with the provision of water services by a Sanitary Authority. A methodology has been piloted by the CCMA to assist the determination of such costs.

#### ***5. Non-Domestic Metering***

The Government's water services pricing policy framework requires the universal metering of the non-domestic sector by 2006. On the basis of information received from authorities in 2004 we consider that the implementation of this requirement has advanced significantly and is achievable. While we are pleased with the level of progress I would again emphasise that non-domestic metering is an explicit requirement of Government which must be fully implemented by the end of December 2006 at the latest.

Universal non-domestic metering is a central and critical element of non-domestic water services pricing policy implementation. It is considered that metering will deliver equality of treatment and support and underpin environmental, conservation and general confidence building measures. Once implemented the national metering programme will facilitate a transparent, fair and equitable method for recovering water services costs and provide for the treatment of all non-domestic customers in an even-handed manner. Metering will in addition enhance the consideration of water services as a utility and provide a commonality with the other major utilities. I would emphasise that business groups including IBEC and the Chambers of Commerce in Ireland have raised no particular concerns and readily accept the implementation of universal non-domestic metering.

Given the relatively short period (i.e. 30 months) left for metering implementation we are concerned that any slippage or delay in progressing the planning and/or installation phases of metering programmes could adversely affect local authorities' ability to deliver on universal metering on time. I am accordingly very pleased to note the obvious commitment of authorities' to delivery on this requirement. I would however ask that all measures necessary to secure non-domestic metering within the Government timeframe be implemented. I would also suggest that universal metering by 2006 should be a

prerequisite of your authorities non-domestic metering programme and a requirement for all associated contracts.

## ***6. Development Levies and the Recovery of Marginal Capital Cost***

Paragraph 5.14 of Circular L16/2002 (WSP) sets out the mechanisms for the recovery of marginal capital costs as follows:

*Marginal capital costs will be funded initially by the local authority through borrowing, as necessary, and will be recovered, as appropriate, by way of -*

- Reserved/assigned capacity agreements with significant non-domestic users.*
- Development contributions under the Planning and Development Act, 2002.*
- Consolidated water services charges on general non-domestic users.*

Each local authority is, in the context of the statutory deadline, determining the level of development contributions that will apply in their administrative area. This in turn will determine the capital contribution that such schemes will make to water services infrastructure provision, including requirements in respect of future residential development. It is necessary, in this regard, to stress that the relevant marginal capital cost of all schemes, including the cost of future residential development, must be fully funded through a combination of the three mechanisms cited above. Given that reserved/assigned capacity agreements are fixed, the determination by a local authority of the development contribution will also affect the balance of marginal capital cost to be recovered through the consolidated charge and accordingly the charge necessary to secure full cost recovery.

It may be noted that the principles of the Serviced Land Initiative will continue to be applied in respect of new housing development.

## ***7. Implementing the Marginal Capital Costs Requirement***

The CCMA Report indicates that difficulties are being experienced by authorities in the determination of marginal capital costs on new water services schemes and describes the methodologies developed for this purpose as "exceptionally onerous". Following the roll-out of this requirement and in order to assist this process we have provided a continuous stream of information, workshops and guidance along with the ongoing technical support of the Water Services Inspectors. We would therefore be interested in receiving details of the specific problems that have arisen and in this regard invite authorities to suggest those areas where the Department might provide assistance on this matter.

## ***8. Recovery of Capital Non-Construction Costs***

The determination of non-domestic marginal costs should be applied in a transparent and equitable way for all water services project costs and include non-construction as well as construction costs.

Capital non-construction costs embrace all the non-contractual costs such as consulting engineer fees, land acquisition, wayleaves, legal expenses, PPP Reports, archaeology, administrative costs, etc. The percentage of non-domestic marginal capital project costs determined for each project should be applied equally against all capital non-construction costs on the basis of the percentage split established in the PPP Report approved by the Department.

It is a matter for local authorities to identify exceptional cases where this apportionment would be considered inequitable and to seek Department approval to reduce the amount of the non-domestic marginal capital non-construction cost applied. To be considered as exceptional a local authority will have to establish that the non-capital item in question is a unique and distinct requirement of the scheme that is unaffected by its non-domestic capacity.

### ***9. Requirements of the Water Framework Directive***

The Water Framework Directive dated 23<sup>rd</sup> October 2000 and numbered 2000/60/EC concerns *inter alia* water pricing and, in particular, the need to have regard to environmental and resources costs and the economic analysis of water use (now being carried out in accordance Article 5 of the Directive). It may be noted that Article 9 of the Water Framework Directive provides the overall framework within which water-pricing policy is to be determined and implemented (by 2010).

Article 9.1 requires that -

- Account be taken of the principle of the recovery of the costs of water services, including environmental and resources costs, having regard to the economic analysis conducted according to Annex III, and in accordance in particular with the polluter-pays principle. This requirement is of general application and is not subject to the exemption specified in Article 9.4 as outlined below.
- Member States ensure that water-pricing policies provide adequate incentives to promote efficient use of water resources and are based on the economic analysis of water use and the polluter-pays principle.

In addition Article 9.4 provides for the non-application of Article 9.1 in relation to a "given water-use activity, where this does not compromise the purposes and the achievement of the objectives of this Directive".

A copy of Article 9 of the Water Framework Directive is attached for your information at Annex 1.

### Water Framework Directive - Economic Analyses of Water Use

Consulting Engineers Camp Dresser McKee have been appointed by the Department to carry out an economic analysis of water use in accordance with Articles 5 and 9 of the Water Framework Directive. The consultant's report, to be finalised in October 2004, will provide a valuable input of information to

policy on charging. We would ask that authorities would fully co-operate and assist any request for information from the consultants. Given that the study is only of six months duration you are also asked to expedite your response to all such queries.

#### Developing Water Services Pricing Policy

Water services pricing policy has been developed and rolled out through a series of circulars, detailed guidance, information notes etc. Our intent has been to demonstrate and foster a better understanding of national policy requirements and assist effective implementation by local authorities. This assistance is invariably qualified with a commitment that circumstances where policy implementation leads to a perverse or distorted result which penalise particular sectors or customers would be considered by the Water Services Policy Unit with a view to finding an equitable solution. In effect, our guidance is applicable in almost all circumstances but does not preclude adjustment or refinement where consistency and equity do not pertain.

For the reasons outlined in the first paragraph of this circular we are not at this time in a position to respond to all of the water services pricing policy issues and concerns raised in the Report. These include matters as diverse as the application of average capital costs, cross subsidisation, setting customer service targets and the transparent funding of domestic operational costs. We will as stated review all such matters in due course. We remain open to the consideration of any proposals that will assist or enhance policy implementation and welcome your comments in this regard.

#### Access to Circulars

It should be noted that this Circular and all Departmental Circulars are accessible through the new the Internet Sharepoint System at: <http://circulars.lgcsb.ie/doecirculars>.

Yours Sincerely,

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Liam Gleeson  
Water Services Policy Unit

To - Each County and City Manager and Director of Services (Water Services)  
Copy to - CCMA, GCCC, AMAI, Ombudsman's Office and Regional Authorities