Northern Ireland Fiscal Council
Bringing transparency to NI's public finances

Sustainability Report 2025:

special focus - Water

June 2025

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Foreword

The Northern Ireland (NI) Fiscal Council was established in 2021 to bring greater transparency and independent scrutiny to the region's public finances, focusing in particular on the finances of the NI Executive. In doing so we hope to inform both public debate and policy decisions to everyone's benefit.

Within this mission, our Terms of Reference require us to "prepare [an] annual report on the sustainability of the Executive's public finances, including the implications of spending policy and the effectiveness of long-term efficiency measures.". This allows us to look at long-term opportunities and challenges confronting the NI public finances alongside the short- to medium-term issues covered by our reports on the Executive's (Draft) Budgets.

Our first Sustainability Report was published in September 2022 and was in effect two reports. The first examined how we should think of fiscal sustainability at an aggregate level for a devolved administration with limited borrowing powers. The second focused on the fiscal sustainability of the NI health system, the largest single component of the Executive's budget.

Our second/third Report has been delayed by the unexpected demands of analysing the Executive's Budget when the Stormont institutions were suspended and then informing and analysing the financial support package and interim fiscal framework that were agreed with the restoration of the institutions in early 2024. The package and framework both drew directly on the conclusions of our initial sustainability work, specifically our estimate of the relative need for public spending per head in NI relative to England.

Reflecting discussions with stakeholders about issues of interest, our second stream of sustainability work focuses on infrastructure, where policy choices and objectives are necessarily long-term ones that extend beyond shorter-term budget cycles. We begin in this report with an assessment of NI's water and sewerage services, where the need for more investment in infrastructure to support residential and commercial development is widely accepted and where questions around NI Water's corporate form and charging for domestic water supply remain highly contentious but poorly understood. Next, we plan to publish a report on infrastructure spending in general.

The Fiscal Council members are responsible for the content of this report, but we have relied on the hard work and expertise of our colleagues Jonathan McAdams, Roisin Kelly, Karen Weir, Colin Pidgeon, Philippa Todd, Julie McIlhatton, Tristan Huegelschaefer and Tamara Ferguson. We are also very grateful for the time and patience of officials from NI Water, the Department for Infrastructure, the Utility Regulator, the NI Audit Office, the Department of Finance, HM Treasury, Ofwat and the Northern Ireland Office and for invaluable comments from many outside stakeholders. But what follows is our independent assessment. We have come under no pressure from NI Executive or UK Government Ministers, advisers or officials to include, exclude or change any material.

The report is structured as follows:

- Chapter 1 is an **Executive Summary**.
- Chapter 2 describes **the creation of NI Water** and the origins of its unusual mixed funding model of subsidy and non-domestic charges.
- Chapter 3 sets out **the role, institutional status and finances of NI Water**.
- Chapter 4 explains the way in which **NI Water is regulated** and how obligations are set for it in multi-year 'Price Controls' (PCs).
- Chapter 5 explores **whether NI Water is given sufficient resources** simply to meet the regulatory obligations set out in the PCs.
- Chapter 6 examines **whether the funding recommended in PCs is sufficient** given the company's performance and the need for greater infrastructure investment to support economic development.
- Chapter 7 concludes by reviewing various **options put forward to support greater infrastructure investment**, including changes in NI Water's corporate form and its ability to borrow on private markets, as well as greater funding through existing budgetary mechanisms.

1 Executive summary

- When thinking about the sustainability of NI's public finances, the provision of water and sewerage services is an important sectoral story. As regards the Executive's budget, NI Water accounts for a significant proportion of its capital spending and also receives a considerable amount of day-to-day subsidy income. Water and sewerage infrastructure affect the potential for economic growth and services provided matter for public health and the environment.

- Towards the end of Direct Rule in 2007, the UK Government created NI Water as the new publicly owned monopoly supplier of water and sewerage services in NI. It had planned to introduce domestic and non-domestic water charges at the same time, but the restored Executive ultimately deferred the domestic charges and chose to pay NI Water a subsidy in lieu of the foregone revenue. This remains the case today and diverts resources from other potential uses in the Executive's budget.

- Understanding the finances of NI Water is complicated by the fact that they can be viewed through two lenses: corporate accounting and the Treasury's public expenditure control framework. NI Water's accounts reflect the fact that it is a Government-owned Company (GoCo) – a statutory trading body owned by central government but operating under company legislation to undertake commercial activities on behalf of the Executive. For public expenditure control purposes, NI Water is classified as a Non-Departmental Public Body, which has implications for how much it can spend and what borrowing it undertakes.

- The Department for Infrastructure (DfI) is NI Water's sole shareholder and the Infrastructure Minister appoints or approves the members of its Board. The Board must ensure that NI Water "fulfils the aims and objectives set by the Department and approved by the Minister" as well as "conducting its operations as economically, efficiently and effectively as possible". The Board must also ensure that NI Water meets a series of statutory obligations, for example relating to water quality.

- NI Water's accounts show that it had revenues of £550 million in 2023-24, around 70 per cent of which came from the subsidy in lieu of domestic charges, 20 per cent from non-domestic charges, 5 per cent from DfI Roads (for road drainage) and 5 per cent from other sources. Its expenses were £480 million, mostly depreciation, staff costs, bought-in services and power. This left a profit of £70 million from which it paid DfI a dividend of £21 million as the company's sole shareholder which (along with interest on loans) offsets the subsidy payment. (Not paying a dividend would not give NI Water additional spending power under the public expenditure control framework but could affect DfI's net cash requirement.)

- NI Water 'borrows' from DfI to help finance capital investment. It has agreed loan notes of up to £3.63 billion from which it had drawn down £1.81 billion by the end of 2023-24. The first loan is due to mature in March 2027. NI Water pays interest on its borrowings but the loans were not structured to include principal debt repayment. Given DfI's dual role as shareholder and creditor this borrowing in some respects looks more like additional ongoing subsidy than conventional investment finance, although the English water companies have not been repaying debt either.

- Given the extensive networks of pipes and other infrastructure needed to deliver drinking water and treat wastewater, NI Water is a classic natural monopoly and is necessarily subject to regulation in the absence of effective competition to protect consumers. Quality regulators such as the Drinking Water Inspectorate define NI Water's outputs for drinking water standards and environmental standards. The efficiency with which NI Water has to deliver these targets, the operating and capital efficiency it has to achieve, the charges it can levy, the level of 'profit' it can take from its funding streams and the spending it should undertake are determined by the Utility Regulator (UR) in contractual 'Price Controls' (PCs), informed by proposals from the company and guidance from DfI.

- The first two PCs focused – with considerable success – on narrowing the gap between NI Water's operational efficiency and that of relatively well-performing companies in England and Wales. (That achievement is qualified by recognition that the performance of these peer companies has been subject to significant criticism.) In addition to seeking further performance and efficiency improvements, the subsequent two PCs have focused more on long-term planning and sustainability, with a big jump in capital spending projected in PC21. The PC21 period runs from 2021-22 to 2026-27, but has recently been extended to 2027-28.

- The UR and DfI are required by legislation to ensure that NI Water can finance its statutory obligations, but not necessarily to provide budget cover for all the spending that the UR deems appropriate. PC21 recommended £2.1 billion of capital spending over its original six-year time frame of which £850 million had been spent by the end of 2023-24. Following a Mid-Term Review, and adjustments to reflect higher-than-expected inflation, the UR now believes that NI Water needs to invest £1,465 million over the second half of PC21. But DfI has recommended that NI Water plans the investment within a "reasonable worst-case scenario" for capital funding of just £992 million.

- Providing budget cover to NI Water in a robust and flexible way is hampered by the fact that while regulatory determinations are made over a six or now seven-year period, NI Executive and departmental budgets have been single-year for a decade and will at best extend over three years (with a one-year overlap) in future. NI Water's budget is also often topped up in-year, while unspent financing cannot reliably be carried forward from one year to the next under Treasury budgeting rules. The resulting uncertainty encourages cautious spending early in the financial year and 'use-it-or-lose-it' surges towards the end.

- To date NI Water has met most of the output targets set for it by the UR and the NI Audit Office concludes that it has demonstrated “a trend of long-term improvement in performance”. The efficiency gap with the leading companies in England and Wales has continued to narrow, but in some dimensions, such as major pollution incidents, NI Water lags the leading companies in England and Wales.

- Notwithstanding the improvements in NI Water’s efficiency relative to its English and Welsh peers, the UR tells us that “there is potentially a relative service performance gap that currently exists between NI and GB and that we need more investment in NI to fill this gap”. Meanwhile, Ofwat has concluded that the absolute performance of those peers is not good enough and in December 2024 sanctioned large real increases in average domestic and non-domestic bills over the next five years to finance more investment. Assuming that this is effective, NI Water would need additional resources simply to keep up. Note though that NI Water’s statutory public health and environmental imperatives are defined in absolute terms, not relative to its peers.

- A further strong rationale for giving NI Water greater resources and budget cover to invest is the impact of poor wastewater infrastructure on scope for residential and commercial development. The investment plans in PC21 aimed to halve the number of big towns with “severely compromised sewerage infrastructure”, but NI Water says it would take another 18 years of above-average funding to solve the problem fully.

- DfI estimates that domestic water charging would have freed up around £300 million of its resource and capital spending envelope in 2022-23 and therefore in essence this means that introducing domestic water charging could potentially free up roughly this amount, although set-up and ongoing administration costs could be significant, and money would presumably need to be spent cushioning the impact on low-income households. The latest notional average household charge agreed by the UR is expected to rise to around £590 in 2025-26 a year, reflecting unexpectedly strong inflation. If this were imposed on households, the average combined bill for water charges and rates would probably still be lower in NI than the average bill on a per dwelling basis for water charges and Council Tax in other parts of the UK, but after 17 years the Executive still shows no appetite for doing so.

- Introducing a significant level of domestic water charging, while retaining some government control and accountability, would likely result in NI Water being reclassified as a Public Corporation (like Translink and Scottish Water). The public expenditure budgeting rules mean that if NI Water finances investment from a combination of borrowing, charging income and subsidy, it would make a smaller claim on DfI’s capital budget as a Public Corporation than as an NDPB, freeing some additional budget cover for investment. Conversely, it might have less room for manoeuvre on resource spending as any subsidy it receives from DfI would count towards the Department’s resource budget, which is not the case while NI Water is an NDPB. Becoming a

Public Corporation would also allow NI Water to run a reserve, which would give it greater flexibility in financial planning.

- Moving NI Water into the private sector would allow it to finance more investment through external borrowing, but not without risk. Public and political concern about the behaviour and performance of the privatised water companies in England means there is little enthusiasm for this model in NI, although mutualisation is viewed more favourably by some (even though Ofwat says that the 'mutual'[1] Welsh Water is a relatively poor performer even by the standards of the privatised companies). But the current and former Infrastructure Ministers (the latter now Finance Minister) are opposed to both models, because moving NI Water outside the public sector in any form would require charging domestic customers for water – as in Wales.

- NI Water could be given more funding through existing budgetary mechanisms. But raising the Regional Rate (perhaps through an Infrastructure Levy) would squeeze household finances and/or put more pressure on business. The Executive could seek additional Block Grant funding from the Treasury (as it often does) plus greater flexibility from the Treasury around capital borrowing. But the Treasury would be very reluctant to provide additional support of sufficient scale without assurance (which would be hard to provide) that it would be well spent and sustainable. Even then it would likely also be concerned that the rest of the UK would see this as preferential treatment. At a minimum it would presumably insist on domestic charging. Multiple entities across the private and public sector would benefit eventually if improved infrastructure boosted growth. Getting them all to contribute would be desirable but difficult to achieve.

- From the public policy point of view the fundamental constraint on NI Water is a budgetary one. This means that even if NI Water has cash on hand (or access to borrowing), the funding cannot be spent unless NI Water is given budget cover by DfI to do so. Under the current arrangements, especially in the absence of domestic water charging, NI Water is competing with all the other demands on the Executive's resource and capital budgets. With the Treasury unlikely to agree to provide significant additional Block Grant funding, additional revenue raising by the Executive – from domestic water charges and/or from other sources – appears inescapable if NI Water is to be given the resources necessary to deliver high quality and environmentally sustainable services and to be able to support residential and commercial development needs. Various other policy interventions have been suggested, such as allowing more capital borrowing from the Treasury, mutualisation or hypothecating a proportion of the domestic Regional Rates. But without raising more revenue in aggregate none of these is likely to ease the budget constraint sufficiently.

[1] Welsh Water is owned by Glas Cymru, and is a company limited by guarantee with no shareholders.

2 The creation of NI Water

Water and sewerage services in England and Wales were restructured in 1989. The 10 regional water authorities were privatised (with the National Rivers Authority being carved out and eventually becoming the Environment Agency) and restrictions on share ownership in the 19 statutory water companies were lifted. But in NI, by contrast, water and sewerage services remained in public ownership.[2] At this time, they were managed by the NI Water Service (NIWS), an Agency of the then Department for Regional Development. The NIWS was funded from the Department's share of the Executive's budget, which was in turn (and continues to be) funded largely from the Block Grant, plus Regional Rates and capital borrowing.

Following the suspension of the Executive and the move to Direct Rule from Westminster in 2002, the Northern Ireland Office (NIO) announced in 2004 that it would create a new Government-owned Company (GoCo) to replace NIWS as the monopoly provider of water and sewerage services. A GoCo is a statutory trading body owned by central government but operating under company legislation to undertake specific commercial activities.

At the same time, the NIO proposed to introduce a charging system to pay for water and sewerage services. Most businesses were to pay for metered water use, while households were to pay a standing plus a variable charge based on the net capital value of their homes. The public funding for the NIWS paid from the Executive's budget could then be reallocated to other priorities.

But the proposals faced opposition from local parties and campaigners. This was partly because of concern that creating the GoCo would be a stepping-stone to privatisation, as well as the widespread but formally erroneous public perception that households were already paying for water services through the rates. Through the Water and Sewerage Services (Northern Ireland) Order 2006, the NIO pressed ahead with the creation of Northern Ireland Water (NI Water) as the GoCo in April 2007. But it put domestic charges "on hold" when the DUP and Sinn Féin agreed to return to Stormont on 26 March 2007, just a week before the first bills were due to be sent out.

Once in office, the Executive deferred the domestic charges for 2007-08, paid NI Water a subsidy in lieu of the foregone revenue, declared that privatisation was not an option, and commissioned an Independent Water Review Panel to look at the structure and funding of the industry. Following the Panel's report, the Executive planned for the phased introduction of domestic charges with an adjustment for the contribution that it viewed (not necessarily formally) as coming from the Regional Rate. But when the global financial crisis began putting pressure on household finances, the Executive extended the deferral of domestic charges and this remains the policy of the Executive today.

During the most recent suspension of Stormont, the NIO ordered a public consultation on options for domestic water charging in 2023, but did not attempt to

[2] Welsh Water was subsequently formed in 2001. It was acquired by Glas Cymru, a company limited by guarantee with no shareholders and run exclusively for the benefit of its customers rather than maximising profits. See Chapter 7.

impose any of them. Following its restoration in February 2024, the Executive was required to agree a Budget Sustainability Plan, including proposals to raise £113 million in additional revenue. Conspicuously, it did not list domestic water charges as an option it would be prepared to consider. The current Ministers for Infrastructure and Finance have also ruled this out.

This leaves NI Water with an unusual mixed funding model. As we shall see below, about 20 per cent of its revenue comes from non-domestic charges, 70 per cent from the subsidy in lieu of domestic charges and 10 per cent from other sources. The spending financed by the subsidy continues to divert resources from the Executive's budget that could be spent on other priorities.

3 NI Water's status and finances

NI Water has two main areas of service delivery: providing safe drinking water and operating a sewerage system to ensure the safe return of wastewater to the environment. To deliver these services, the company manages physical assets with a value of around £4 billion, including 27,000km of water mains and 16,500km of sewers.[3] The mains provide 605 million litres of water per day to around 920,000 households and businesses. Over half this volume is then collected by the sewerage network and is treated at over 1,000 wastewater treatment works before being returned to the environment.

Institutional status

As a GoCo, NI Water is bound by the Companies Act 2006 and UK Corporate Governance Code. The Department for Infrastructure (DfI) is sole shareholder, and it appoints the Chair and five Non-Executive members of the Board as well as approving the four Executive members. The Board "has corporate responsibility for ensuring that NI Water fulfils the aims and objectives set by the Department and approved by the Minister, and for promoting the efficient, economic and effective use of staff and other resources by NI Water".[4]

With sales of goods and services covering less than 50 per cent of its costs of production, NI Water fails the so-called 'market test' and is therefore deemed by the Office for National Statistics to be a 'non-market producer'. As a result, it is classified as a Non-Departmental Public Body (NDPB) within central government rather than as a Public Corporation (unlike Translink, for example, which passes the market test and is deemed a Public Corporation). As an NDPB NI Water is bound by NI public sector pay, procurement and budget rules. As we shall see, the interplay between NI Water's monopoly role, its GoCo structure and its NDPB classification helps dictate how it is funded and managed.

Finances

Table 3.1 and Chart 3.1 summarise NI Water's finances since 2016-17. The figures are taken from successive Annual Reports and Accounts, but are shown in 2023-24 prices by using the GDP deflator to adjust for inflation.

[3] https://www.niwater.com/annual-report/#downloads
[4] https://www.niwater.com/siteFiles/resources/2023/PartnershipAgreement.pdf

Table 3.1 – NI Water's financing and expenditure in 2023-24 prices

£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Revenue (of which):	**532**	**501**	**506**	**509**	**472**	**500**	**507**	**549**
Subsidy	358	360	365	368	354	361	366	398
Non-domestic charges	93	95	96	96	77	93	97	106
Road drainage	26	26	27	27	26	26	27	29
Other	55	20	19	19	15	20	18	16
Plus								
Other income	1	1	1	0	0	3	1	1
Minus								
Expenses (of which):	**412**	**436**	**427**	**452**	**420**	**539**	**465**	**479**
Operating costs (of which):	**324**	**343**	**335**	**335**	**340**	**383**	**398**	**393**
Depreciation	99	100	100	100	99	104	105	110
Staff costs	73	79	80	83	83	90	93	98
Services	77	71	67	68	76	75	71	84
Power	34	37	42	38	37	70	88	58
Rates	33	33	33	33	32	32	31	28
Other expenses	8	23	13	13	13	12	10	15
Finance costs	**80**	**77**	**74**	**75**	**67**	**67**	**62**	**62**
Corporation Tax	**8**	**16**	**18**	**43**	**13**	**89**	**6**	**24**
Equals								
Profit/loss (pre-dividend)	**121**	**66**	**80**	**58**	**53**	**-36**	**43**	**72**
Minus								
Dividend	29	30	32	34	34	35	20	21
Equals								
Profit/loss (post-dividend)	**92**	**35**	**48**	**24**	**19**	**-71**	**23**	**51**

Source: NI Water Accounts, HMT GDP deflators (March 2025)

The table shows that:

- NI Water's **revenues** have been relatively stable at a little over £500 million a year in 2023-24 prices, with a dip in the pandemic year of 2020-21 and a relatively sharp 8 per cent increase in 2023-24. Their composition has been even more stable, with the subsidy from DfI in lieu of domestic charges typically accounting for 72 per cent of revenue and the non-domestic charges accounting for 18 per cent. Around 5 per cent comes from DfI Roads (and thus from DfI's and the Executive's Budget) to cover the cost of dealing with run-off from roads and footpaths. The jump in revenue in 2023-24 reflected a nominal 14 per cent weighted average rise in non-domestic and notional domestic tariffs, reflecting the rate of retail price inflation at the time. Announcing the increase, NI Water noted it faced "significant financial pressures from rising energy prices and other cost increases".[5]

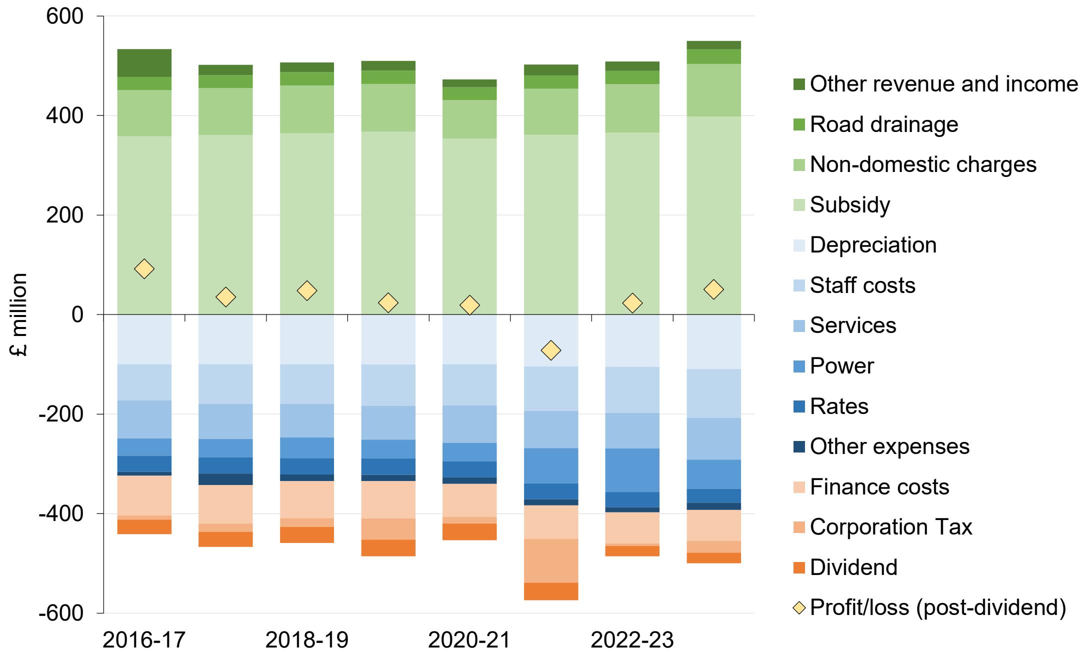
- NI Water's **operating costs** are typically dominated by depreciation, staff and bought-in services. They were relatively stable at around £340 million a year from 2017-18 to 2020-21 but jumped to almost £400 million in each of the subsequent three years. This reflected a sharp increase in power costs as the Ukraine war put upward pressure on gas and oil prices – NI Water is the biggest user of electricity in the region. **Finance costs** have been on a steady

[5] https://www.niwater.com/news-detail/12264/NI-Water-announce-202324-charges/

declining trend in real terms, from around £80 million to £60 million a year, with rising cash interest payments on borrowing from DfI being offset by falling notional finance lease interest payments and a rise in the amount of interest capitalised. **Corporation tax** payments are volatile but usually in the low tens of millions, although they spiked to £90 million in 2021-22 as the Government increased the tax rate from 19 to 25 per cent and this was applied to a relatively large deferred liability.

- NI Water's accounting **profits** – the difference between its revenues and total expenses – have varied between £43 million and £80 million over the last seven years, except for a loss of £36 million in 2021-22 because of the unusually large tax charge. From its profits, NI Water pays a **dividend** to its shareholder DfI based on a percentage of the value of its asset base minus its net debt but ultimately decided by the NI Water Board. This was around £30-35 million a year up to 2021-22 but dropped to around £20 million a year in 2022-23 and 2023-24 in light of changing market conditions[6] – the minimum return that the shareholder should expect to earn on existing assets without wishing to invest elsewhere. NI water's profits are not really analogous to those of a typical private sector company, as they are in effect largely determined by the regulator. It is also worth noting here that because of the public expenditure budgeting rules within which NI Water operates, removing the dividend would not give it additional budget cover to spend.

Chart 3.1 – NI Water's financing and expenditure in 2023-24 prices



Source: NI Water Accounts, HMT GDP deflators (March 2025)

[6] The dividend payable is calculated as the product of the equity level in the Regulatory Capital Value (RCV), calculated annually as average RCV less average debt and an agreed dividend yield calculated based on the weighted average cost of capital (WACC) determined by UR.

Borrowing and debt

NI Water borrows from DfI to help finance its capital investment programme. (Hence the finance costs referred to above, which are thus simply a flow of cash back to the Department.) Capital investment as recorded in NI Water's Accounts – as distinct from the way it is recorded under the Treasury's budget framework – was running at around £200 million a year up to 2020-21 (Table 3.2) but then jumped with the transition to a new regulatory Price Control period (see Chapter 4). By 2023-24 it had reached more than £340 million. This jump in investment has largely been financed through additional borrowing from DfI as well as a smaller increase in the subsidy. Since 2016-17 maintenance of existing assets has accounted for 57 per cent of NI Water's investment on average and new assets for 43 per cent.

Table 3.2 – NI Water's capital investment as recorded in its Accounts in 2023-24 prices

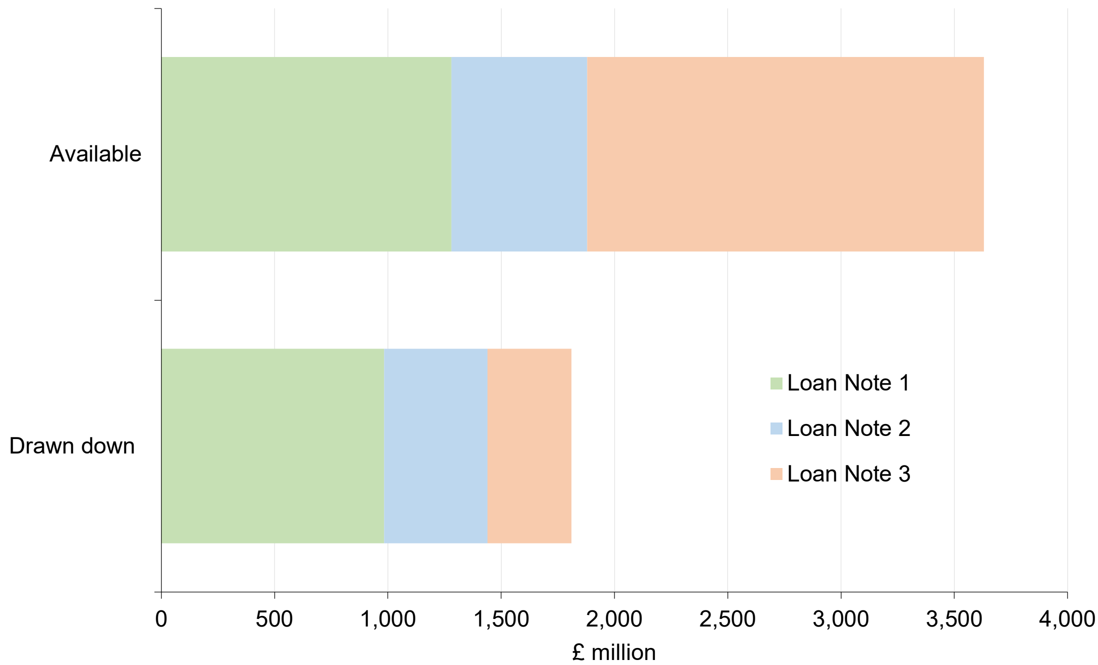
£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	Average ann. growth rate
Borrowing from DfI	38	86	78	47	94	193	164	215	28%
Subsidy/Revenue[1]	157	104	130	159	106	67	150	127	-3%
Total Investment (of which):	**194**	**190**	**208**	**207**	**199**	**260**	**314**	**342**	**8%**
New Assets	69	76	90	95	91	122	131	151	12%
Maintenance	126	114	118	112	109	137	183	191	6%

Note[1]: Cash flow from operating activities - balancing figure

Source: NI Water Accounts Financial Performance Report, HMT GDP deflators (March 2025)

By March 2024 NI Water's total loans and borrowings stood at £1,950 million, of which £1,810 million relates to capital loan notes – borrowing facilities agreed in advance with DfI. As shown in Chart 3.2, three loan notes have been agreed that would in theory allow NI Water to borrow £3,630 million.

Chart 3.2 – NI Water loans and borrowing 2023-24



Source: Department for Infrastructure

The budget that NI Water receives from DfI for capital investment comes from the Executive's overall capital budget, which is largely funded from the Block Grant plus borrowing under the Reinvestment and Reform Initiative (RRI). In the Executive's 2025-26 Draft Budget almost half of RRI borrowing (£105.7 million) was earmarked for water, but this was essentially presentational. There is no formal link between RRI borrowing and any specific capital allocation, with the former essentially topping up the overall capital budget.

When assessing the financial resilience of water companies, Ofwat, the water regulator for England and Wales, looks at their gearing – the ratio of net debt to equity plus net debt – as a measure of the risk that they might default on a loan. This stood at a little under 60 per cent for NI Water in March 2023, compared to an average of 68 per cent across the 17 largest companies in England and Wales. This looks reassuring but is presumably less relevant as a measure of resilience for NI Water as DfI is both its sole shareholder and its sole creditor (barring small Public-Private Partnership (PPP) liabilities).

DfI's dual role raises the more fundamental question of whether NI Water's capital borrowing is genuinely a means to spread the upfront cost of big investment projects over time – as it would be for water companies in the private sector, if they actually repay the loan principal themselves – or simply another source of ongoing subsidy. Managing Public Money Northern Ireland (MPMNI) says that loans to an Arm's Length Body should be repaid and formally NI Water's loan agreements are consistent with this. But there is no legal obligation on NI Water to repay its loans. Under the 2006 Order the loans were not structured to include principal debt repayment and none has yet been repaid. But the order does give provision for the treatment of debt finance, for example in transferring to additional share equity.

As the first loan note debts come to maturity in March 2027 NI Water will likely have two options that it would need to negotiate with DfI and Finance: refinancing the existing debt with new borrowing or a debt-for-equity swap in which the loan value is exchanged for share capital, increasing the stated value of DfI's already monopoly shareholding in the company. Agreement will be required in the near future so that the financing implications can be worked into the next regulatory Price Control agreement. The debt-for-equity option would reduce the flow of interest payments from NI Water back to the Department, while for the refinancing this would depend on the terms of the new loan relatively to those on the existing one. Either might suggest that DfI lending to NI Water is in effect an ongoing subsidy.

Reflecting the Treasury's Consolidated Budgeting Guidance,[7] as an NDPB all NI Water's resource spending scores in DfI's resource budget and all its capital investment scores in DfI's capital budget. (The subsidy that DfI pays NI Water does not score as DfI resource spending as this would double count. Similarly, DfI's lending to NI Water does not score as DfI capital spending.) Over the past four years NI Water's share of DfI's budgets has ranged between 33 and 37 per cent for resource spending and 34 and 43 per cent for capital.

Under the terms of MPMNI, NI Water could in principle borrow from the private sector if DfI agreed. But, as we discuss further in Chapter 7, in practice there would be little point. Borrowing externally would bring in additional cash, but it would not

[7] https://assets.publishing.service.gov.uk/media/65f0a26d9812270011f61417/CBG_2024-25.pdf

increase DfI's overall capital spending limit within which NI Water's spending is scored. (The same would be true of greater borrowing from DfI through drawdowns from the loan notes described above.) For a given DfI capital budget, NI Water can only invest more if others invest less – whatever the source of finance may be.

In the event that domestic water charging or sales of other goods and services allowed NI Water to pass the market test and become a Public Corporation, the company would (as now) be able to borrow from private sector lenders with DfI and Finance approval. At present, as an NDPB, any capital spending by NI Water scores against DfI's capital budget. But, as a Public Corporation, it would be NI Water's capital finance, including borrowing (both from private and public lenders) rather than its spending that counts towards the capital budget. As NI Water would expect (as now) to finance part of its capital spending from revenue and other income as well as from borrowing, the company argues that this would reduce its claim on DfI's capital budget and thus free up additional budget cover.

However, for as long as it is an NDPB, the resource subsidy that DfI provides to NI Water in lieu of domestic charges does not directly score against the Department's resource budget, but it would do so if NI Water became a Public Corporation. So NI Water would gain capital budget cover but lose resource budget cover to the extent that it still receives subsidy (for example to cover discounts against the domestic charges for low-income households). It would also have to pay interest on a higher volume of borrowing, although interest payments to any private lenders would not score against the resource budget. This suggests that the main budgetary gain from becoming a Public Corporation would probably be the domestic charging revenue that allowed that change of status in the first place rather than greater scope to borrow. And the total level of revenue from all sources would need to increase before this could produce a gain to NI Water's capital investment.

4 Regulation and Price Controls

Water and sewerage services are a classic natural monopoly. The scale and scope of the infrastructure required to deliver them means that it is rarely efficient to have multiple suppliers of these services in any given geographical area, especially for domestic customers. Given the potential to exploit its monopoly power at the expense of consumers, in the absence of competition, NI Water is subject to regulation. This task falls to the Utility Regulator (UR), which oversees regulated water, electricity and gas companies in NI.

In the case of a privatised monopoly, a regulator will typically take a view on the scope and quality of service that a regulated company should provide to consumers and then determine what prices it should be allowed to charge so that it can provide that service, invest sufficiently for the future and make a reasonable profit for its shareholders. These become conditions of its licence to operate. External benchmarking to comparable entities is generally used to determine the efficiency and performance that could and should be expected of the company when the regulator makes these judgements.

NI Water is a public rather than a private monopoly and regulation and policy-setting for the sector has to recognise a number of NI- and company-specific factors, several of which we have already highlighted:

- **NI Water** can only levy charges on non-domestic water users, which means that it raises only a fifth of its revenue directly from customers. And it cannot in practice finance additional investment by borrowing privately (despite powers which would allow it to do so in law).

- **DfI** is simultaneously NI Water's sole shareholder, its sole **creditor**, its main source of subsidy (in lieu of domestic charges) and its only other significant source of revenue aside from non-domestic charges (from drainage payments via DfI Roads). It therefore has a variety of potentially conflicting objectives.

- As an NDPB, NI Water's spending scores against **DfI's (and the Executive's) resource and capital budgets**. The subsidy in lieu of domestic charges (or, strictly speaking, the spending that it finances) is only one call among many on those budgets, so it is determined by broader fiscal considerations as well as by the amount that NI Water might like to charge domestic customers (or that the UR would approve) if they were unconstrained. The Executive's budget also evolves between and within years for reasons beyond its control (notably UK Government spending decisions), making funding less predictable.

- Inadequate provision of water and sewerage services is often cited by stakeholders as a constraint on economically desirable **residential and commercial development** in NI. So the public interest in NI Water's activity and performance extends beyond ensuring adequate service quality for existing customers. This wider impact is of concern not just to DfI, but to other Executive departments, local councils, private sector developers and other stakeholders.

Decisions on service provision, investment, charging and funding emerge from a complicated interaction between NI Water, DfI and the UR. The players naturally talk to each other, so the proposals advanced and decisions announced through the process presumably reflect informed judgements by each participant about what is ultimately likely to be achievable and mutually acceptable, while recognising their separate and independent roles.

The main instrument through which this interaction plays out is the Price Control (PC) framework. Multi-year Price Controls "result in a contract between the Regulator and the company which agrees the money the company requires to provide efficient services and how much it is allowed to charge". PC10 covered three financial years (2010-13) and PC13 two (2013-15) and they "focused on closing the efficiency and performance gap between NI Water and its comparator companies". This was pretty successful. The gap between NI Water's operational efficiency and that of a top performing company in England and Wales narrowed from 49 per cent in 2007 to 13 per cent by 2015. (The UR judges operating (in)efficiency by estimating the extent to which the company could reduce the day-to-day expenditure it requires to run its normal operations, without affecting its ability to operate an effective business and deliver the required level of service to consumers.)

The subsequent two PCs have initially covered six financial years each (2015-21 and 2021-27 now being extended to 2027-28), focusing more on long-term planning and sustainability. But thinking long-term is hampered because Price Control periods are not aligned to Whitehall or Executive budget periods.

The key milestones in the PC21 (2021-28) process were:

- NI Water published a **Business Plan** in January 2020, focusing on the deliverability of its investment plan and the affordability of tariffs (paid by non-domestic customers and covered by subsidy from DfI for domestic customers). As regards the latter, the judgement was that average bills should not increase in real terms. The Plan included operational and capital efficiency targets and an estimate of the number of towns where the proposed investment could address "severely compromised sewerage infrastructure" that hampers economic growth (in addition to maintaining existing assets and enhancing assets across other areas).

- DfI published its **Social and Environmental Guidance for Water & Sewerage Services** in June 2020. Under the 2006 Order, the UR must "have regard to" this guidance in setting the Price Control. In addition to meeting legal requirements for safe drinking water, wastewater and pollution control, DfI's guidance for PC21 included maintaining and "where possible" improving infrastructure, with specific reference to the need to support a strategic plan for Belfast. The budget for NI Water is set independently of the UR's Determination, and the Department warned that it "needs to be affordable within the NI budget expenditure process". Alongside the guidance, the Department gave the UR a projection of the resource and capital subsidy that it should assume might be available over the PC period.

- The UR scrutinised NI Water's Business Plan in light of the Guidance and published an independent Draft Determination for consultation in September 2020 and a **Final Determination** in May 2021 in line with its statutory requirements. The UR says that this assessment was based on what it considered NI Water needed to meet its obligations (i.e. not a lower figure constrained to the availability of government funding) but in a way that could be efficiently delivered and that would be affordable for consumers during the Price Control period. The UR decided to set price controls such that tariffs would be flat on average over the period in real terms, as NI Water had proposed. The UR required the company to close entirely the 6 per cent operational efficiency gap that it concluded was remaining in 2021 by 2025-26 (rather than four-fifths of it by 2026-27 as NI Water had proposed), but it accepted the company's ambition for capital efficiency. (The UR judges capital efficiency based on the extent to which it believes a company's investment proposals could be reduced without affecting its ability to maintain the service its existing asset base provides to existing consumers and deliver the enhancements needed to improve services to consumers, cater for growth and secure compliance with environmental and drinking water quality standards.)

- The Determination sets out the resource and capital budget cover (RDEL and CDEL) necessary to achieve the spending that the UR assess is necessary. In setting the capital requirement, the UR recommended a figure 5.5 per cent lower than NI Water had proposed while delivering the same outcomes, with 45 per cent to be spent on existing assets and 55 per cent on new capacity. The UR recognised that the recommended investment over the originally six-year PC period would not allow NI Water to clear all its backlog in asset management and development work and that there were limits to the ability of NI Water (and the wider supply chain) to scale-up works to the required level during PC21. So future investment would be required over multiple price controls.

- The UR published a **Mid-Term Review** of PC21 in September 2024. The UR made limited changes to the output targets placed on NI Water but allowed it to increase average tariffs (charges) by 4.5 per cent in each of the last two years to cover a big increase in its power costs – having already approved the tariff increase referred to above in 2023-24. The UR also agreed that NI Water should be allowed to spend more on capital investment (budget cover permitting) to reflect higher inflation, but not additional cost pressures it said it was facing. However, an official follow-up review[8] found that there probably had been underfunding of the capital programme as a result and the UR has told us they will take account of this when setting the next Price Control.

At each PC Determination, the UR sets out the amount by which a range of actual charges to non-domestic customers and notional charges to domestic customers (to be covered by DfI subsidy) are permitted to vary in real terms relative to the rate of inflation measured by the Retail Prices Index or RPI. It then translates these price limits into an estimated average notional household charge and typical charges for small and large businesses.

[8] Relates to an unpublished review document

Table 4.1 shows the average annual change in the average notional household charge and typical business charges set out in the Final Determination for each PC, adjusted for RPI inflation. It shows that average charges were set to fall over each PC period in real terms, although only very marginally for the household charge in PC21. This broadly reflects the need for increased investment to address development constraints, making further cost-saving efficiency improvements that could be passed on to customers and DfI in lower charges harder to achieve than in the earlier PC periods.

Table 4.1 – Average annual change in water charges in constant prices

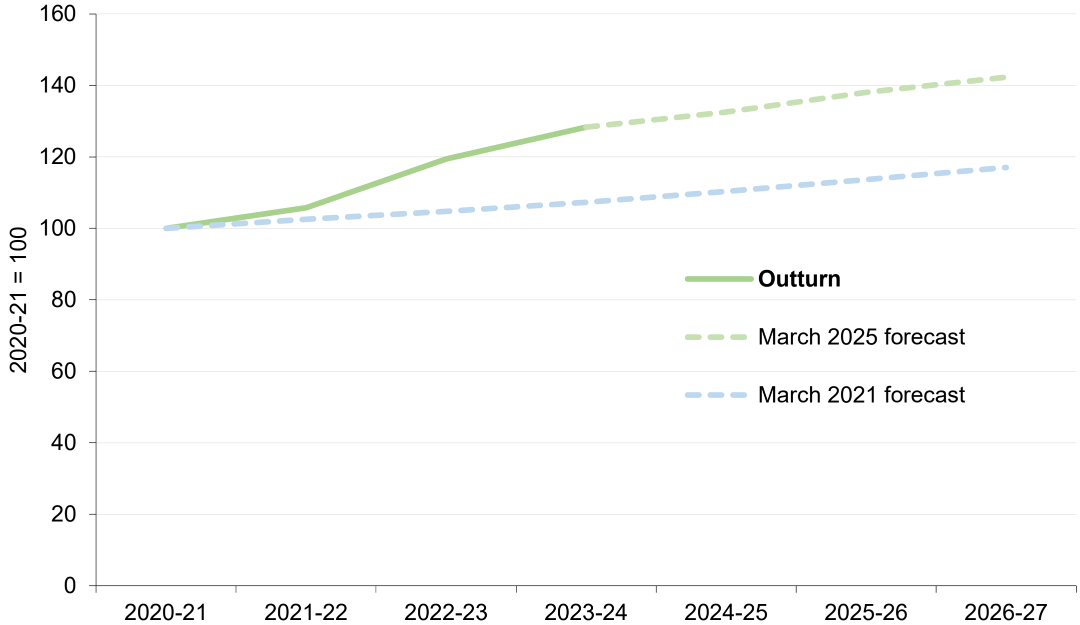
Per cent	PC13	PC15	PC21	2025-26 charge (£)
Average notional household charge	-5.7	-1.9	-0.2	£592
Typical small metered business bill	-6.6	-0.6	-1.3	£530
Typical large metered business bill	-6.7	-0.6	-1.3	£4,879
Typical unmetered business bill	-7.4	2.2	-0.3	£418

Source: Utility Regulator

As Chart 4.1 shows, the RPI has risen far more rapidly over the PC21 period to date than the Office for Budget Responsibility anticipated in its March 2021 forecast (on which the Final Determination was based), because of higher energy costs and economic overheating. Taking financial year averages, the RPI had risen by 28 per cent between 2020-21 and 2023-24 compared to the March 2021 forecast of 7 per cent. From 2020-21 to 2026-27 the OBR now forecasts an increase of 42 per cent rather than the 17 per cent it forecast in March 2021. So the modest declines in charges in real terms would translate into significant increases in cash or nominal terms. UR's Final Determination for PC21 gave an average notional household charge of £416 (in 2020-21 prices).[9] Reflecting further increases in the RPI and other adjustments at the Mid-Term Review, NI Water says the average notional domestic bill will rise to £592 in 2025-26. This is the best estimate of what households would pay if domestic charging were introduced today.

[9] https://www.uregni.gov.uk/files/uregni/media-files/PC21%20FD%20-%20Main%20Report%2002.00.pdf#page=28 Table 2.7

Chart 4.1 – Outturn and forecasts for the Retail Prices Index



Note: OBR March 2021 forecast to 2025-26. Assumption for 2026-27 taken from UR PC21 Final Determination.
Source: Office for Budget Responsibility, Utility Regulator

It should be noted that the RPI is a poor measure of household inflation that lost its designation as an accredited National Statistic in 2013. The UR has moved to using accredited Consumer Price Indices for its Determinations on regulated gas and electricity companies and plans to do so for water in the next PC.

The way this regulatory process operates suggests that the adequacy and sustainability of NI Water's financing needs to be addressed in two ways:

- Does NI Water in fact receive the funding that the UR concludes is necessary to deliver on its Price Control obligations?
- Are these obligations sufficiently ambitious to serve the public good, for example by permitting enough investment to address economically harmful development constraints?

The answer to the first question might suggest that the existing process and its link to funding decisions needs reform. The answer to the second might suggest that the existing corporate structure and ownership of NI Water should be revisited. We address these questions below.

There are of course broader questions around the sustainability of water and sewerage services in NI and elsewhere, for when viewed primarily through an environmental and/or public health rather than a financial lens. But given our remit, we focus here primarily on the financial dimension.

5 Is NI Water sufficiently well-funded to fulfil its regulatory obligations?

Under its licence to operate, NI Water must deliver all the outputs required of it under the prevailing Price Control contract to discharge its statutory and regulatory duties. Meanwhile, DfI and the UR are obliged under the 2006 Order to ensure that NI Water "[is] able (in particular, by securing reasonable returns on [its] capital), to finance the proper carrying out of [its] functions".

NI Water's ability to deliver the outputs required of it depends in part on the cash it has available. This principally reflects the subsidy and other income it receives from DfI, plus the charges paid by non-domestic customers. As we have seen, it can also draw down up to £3.63 billion from the loan notes it has agreed with DfI. As of March 2024, it had drawn down £1.81 billion.

But, more importantly, NI Water's ability to spend depends on the resource and capital budget cover it receives from DfI, which in turn depends on what the Department receives from the Executive in the broader budget process. As NI Water points out: "The availability of Resource and Capital DEL to enable delivery of PC21 is the overriding constraint, irrespective of access to cash. A shortfall in Resource DEL limits what cash NI Water can spend to run and operate its business. A shortfall in Capital DEL creates a limit on what cash NI Water can invest in water and drainage infrastructure." NI Water's income from charges scores as resource income – in effect negative spending that allows it to carry out more gross spending within a given envelope.

Treasury rules mean that NI Water cannot carry forward unspent DEL from one year to the next without permission, even if this might enhance value for money. Under the Budget Exchange scheme, any aggregate underspend at the Executive level can be carried forward within limits set by the Treasury.

Under this regime, one might expect DfI to tell NI Water as a matter of course to prepare its Operating Budgets and investment plan on the basis of the RDEL and CDEL budget cover implied by the most recent PC Determination, adjusted for any deviation in RPI inflation from that anticipated when it was set (plus any other adjustments permitted under the PC). For example, DfI had placed a firm limit on capital spend in the previous PC period (PC15) and the business plan and PC Determination were both tailored to lie within it.

But this is not the case for PC21. PC21 was set without formal budget guidance from DfI regarding the RDEL and CDEL allocations. As shown in Table 3.2, DfI's capital investment in water and sewerage services is at historically high levels, but annual budgets remain less than the level recommended by the UR. This in part reflects the fact that DfI cannot be certain about its own RDEL and CDEL allocations other than over the very short term. The Executive and NIO have only been able to set single- rather than multi-year budgets over the past decade, and changes in the overall budget envelope from year to year are driven more by UK Government spending decisions than by Executive or (when Stormont is not functioning) NIO actions. DfI may also be cautious in its near-term guidance to NI Water because the Executive's overall budget is often topped up in-year when UK Government spending is increased with the proceeds allocated through In-Year Monitoring Rounds.

That said, there is nothing to stop the Executive prioritising the funding of NI Water in line with the PC Determination over other demands on its budget.

So how have NI Water's DEL allocations evolved through PC21 to date?

- Based on the OBR's RPI forecasts in March 2021, the UR's May 2021 **Final Determination** implied an RDEL requirement of £732 million over the six years from 2021-22 to 2026-27 and a CDEL requirement of £2,050 million (Table 5.1). Adjusting for inflation, the CDEL ambition was 85 per cent higher than the PC15 envelope. Despite this jump, as noted above the UR judged that this increase would need to be sustained for more than one PC to address investment needs.

- Higher-than-expected energy costs and inflation more broadly meant that NI Water needed more nominal RDEL in **2021-22 and 2022-23** than UR and DfI had initially anticipated. This was met through in-year bids. The budget for CDEL was higher than the requirement set out by the UR in both years.

- The position was more challenging in **2023-24**. NI Water needed £172 million of RDEL in that year, but in the absence of In-Year Monitoring Rounds (because Stormont was suspended) this was only agreed through a £27 million top-up in the last month of the financial year. NI Water said it needed £370 million of CDEL – well above the UR's determination of £327 million that was set prior to the inflation shock – to satisfy its PC21 requirements and £353 million merely "to mitigate risk of prosecution". DfI allocated £337 million which was above the UR's initial requirement, but below what NI Water said it needed in its operational plan. So "management took steps to slow down the PC21 capital programme".

- NI Water's Operating Budget for **2024-25** set an RDEL requirement of £175.9m and a CDEL requirement of £470 million. But in May 2024 DfI indicatively allocated only £137.7m in RDEL and £324.5 million in CDEL, shortfalls of more than 20 and 30 per cent respectively.

- In its September 2024 **Mid-Term Review** of PC21, the UR set revised requirements for 2024-25 to 2026-27. It believes that NI Water will require £491.9 million in **RDEL** over these three years, 33 per cent more than in the 2021 Final Determination, because of unexpectedly high inflation and additional revenue.

- As regards capital, the **Mid-Term Review** concluded that NI Water would need £1,465 million over these three years (compared to the £1,792 million the company asked for). If **CDEL** funding were in line with DfI's £992 million "reasonable worst-case scenario" for capital, this would imply a shortfall of 32 per cent. What is more, the UR warned that NI Water's material and tender costs appeared to be higher than could be explained by RPI and real price effects. Further analysis has been undertaken for the UR which indicates that NI Water would have been unable to deliver the outputs in the Review for the Government expenditure figures quoted without significantly higher levels of capital efficiency.[10]

- In light of the prospective shortfalls, **NI Water said in its 2023-24 Accounts**: "The Board of NI Water finds itself in a difficult position… The current and anticipated shortfalls in Resource and Capital DEL allocations give rise to material uncertainty regarding going concern in the context of delivering a six-year PC21 programme of work as well as having the potential to lead to conflicting requirements in relation to: obligations to deliver services under the regulatory Licence; the Board's statutory duties; Accounting Officer responsibility not to overspend against budget; and regularity of spend". It said that it had convened a forum including the UR and other stakeholders "to engage in the development of a reasoned submission which will consider an agreed adjusted programme of outputs and outcomes for PC21". This group (chaired by DfI) met and concluded without specific agreement other than acknowledging each organisation's statutory obligations.

- The final approved position for **2024-25** saw allocations of £154.7 million and £348.8 million to Resource and Capital DEL respectively. The RDEL figure is 9 per cent lower than the amount set out by the UR in the Mid-Term Review (£170.5 million) while the capital allocation is 27 per cent lower than the UR recommendation (£479.6 million). However, for RDEL at least, this presumably partly reflects the fact that energy prices are now more favourable than anticipated by the UR at the Mid-Term Review.

- Following the publication of the **Executive's 2025-26 Draft Budget**, DfI said in its February 2025 Equality Impact Assessment that it was provisionally planning to allocate £149.2 million of RDEL and £350 million of CDEL to NI Water in that 2025-26.[11] It conceded that for CDEL this would mean a £188 million shortfall compared to the Mid-Term Review recommendation. DfI said: "NI Water has advised previously that it will prioritise safe drinking water, resulting in less investment in wastewater works, including for new homes. It would also mean less capital maintenance spend on the road network and street lighting column replacement…. The draft budget allocation for NI Water will allow investment in water and wastewater treatment works including assisting with housing supply. However, it would not fund all of the PC21 requirements, and it will be for NI Water as a Non-Departmental Public Body and Company to prioritise projects."

[10] Relates to an unpublished review document
[11] https://www.infrastructure-ni.gov.uk/sites/default/files/2025-03/eqia-consultation-draft-budget-2025-26.pdf

Table 5.1 – Resource and Capital DEL allocations

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Resource DEL						
UR Final Determination (May 2021)	122.0	120.8	119.7	119.9	122.9	126.8
Received / *Allocation*	148.6	171.6	171.9	154.7	*149.2*	-
UR Mid-Term Review (Sep 2024)	-	-	-	170.5	162.9	158.5
Capital DEL						
UR Final Determination (May 2021)	178.6	251.2	327.3	438.2	449.4	405.7
Received / *Allocation*	222.1	290.1	337.3	348.8	*350.0*	-
UR Mid-Term Review (Sep 2024)	-	-	-	479.6	537.6	447.5

Source: Utility Regulator, Department for Infrastructure

The evolution of NI Water's DEL funding described here prompts several observations, mirroring those of the NI Audit Office's (NIAO's) March 2024 report on *Funding water infrastructure in Northern Ireland*:

- **Current arrangements do not give public bodies clarity** over the funding they will have available over the medium or long term.

- Price Controls currently set spending requirements over a six-year horizon (reviewed after three), while NI budgets have been single-year for a decade and will at best extend over three years (with one year's overlap) in future. **Funding to deliver the PC is not ear-marked or ring-fenced** across the years covered by the plan, despite DfI's statutory duty to ensure that NI Water can finance its obligations.

- NI Water has often depended on in-year allocations to narrow or close shortfalls between allocated funding and regulatory requirements. The **in-year allocation process is inevitably a competitive one** and this can contribute to tensions between the Department and its sponsored bodies as it arbitrates between competing claims.

- **Unused DEL allocations cannot be automatically carried forward** to the next year, even when this would safeguard value for money. This is true even when additional funding is awarded relatively late in the year. This encourages a cautious approach to investment early in the year, with spending ramping later when there is more clarity on the total available resources and which projects can be funded.

Given Treasury budgeting rules and the UK Government's choice of Spending Review horizon, there is a limited amount that could be done about some of these constraints. But the Treasury might consider permitting NI Water greater end-year flexibility to avoid wasteful "use-it-or-lose it" spending. For example, National Highways (formerly Highways England) was set up in 2015 and given ring-fenced multi-year budgets to improve the road network. In 2020-21, it was provided with a year-end financial flexibility arrangement, allowing early use or deferral of 10 per cent of its annual budget in respect of particular projects. To establish a similar arrangement for NI Water would need the Executive to ring-fence funding as well as Treasury agreement.

Greater transparency around DfI's indicative and ultimate DEL allocations would be welcome, as it is hard to keep track of how NI Water's RDEL and CDEL allocations, provisional allocations and worst-case scenarios evolve over time, and how they compare to the latest recommendations from the UR. If and when DfI decides not to allocate the resources necessary to meet the UR's recommendations it should explain clearly to the public and to its Assembly Committee why it has done so. NI Water should also be transparent in the same way about its Operating Budgets and explain how and why these evolve as they diverge from the UR's PC Determinations.

6 Are the PC recommendations for NI Water spending sufficiently ambitious?

Assessing whether NI Water's spending requirement as set out by the UR has been or is now sufficient is not straightforward and ultimately a matter of judgement. It depends partly on whether one focuses on spending and performance comparisons with companies elsewhere in the UK or on NI-specific issues, such as the need to address identified development constraints or making an appropriate contribution to climate change mitigation measures.

Relative performance compared to England and Wales

Back in 2007 the Independent Water Review Panel looked at relative performance and found that the NI Water Service had done quite well against drinking water standards but less so on wastewater. As noted, its operational efficiency was also much lower than top performing comparable companies in England and Wales – suggesting that there was significant potential to improve outcomes simply by using resources more effectively. The Panel concluded that "comparative evidence on performance pointed to the continuing need for substantial infrastructure investment, but [did] not of itself prove that we suffered serious underinvestment relative to Britain".

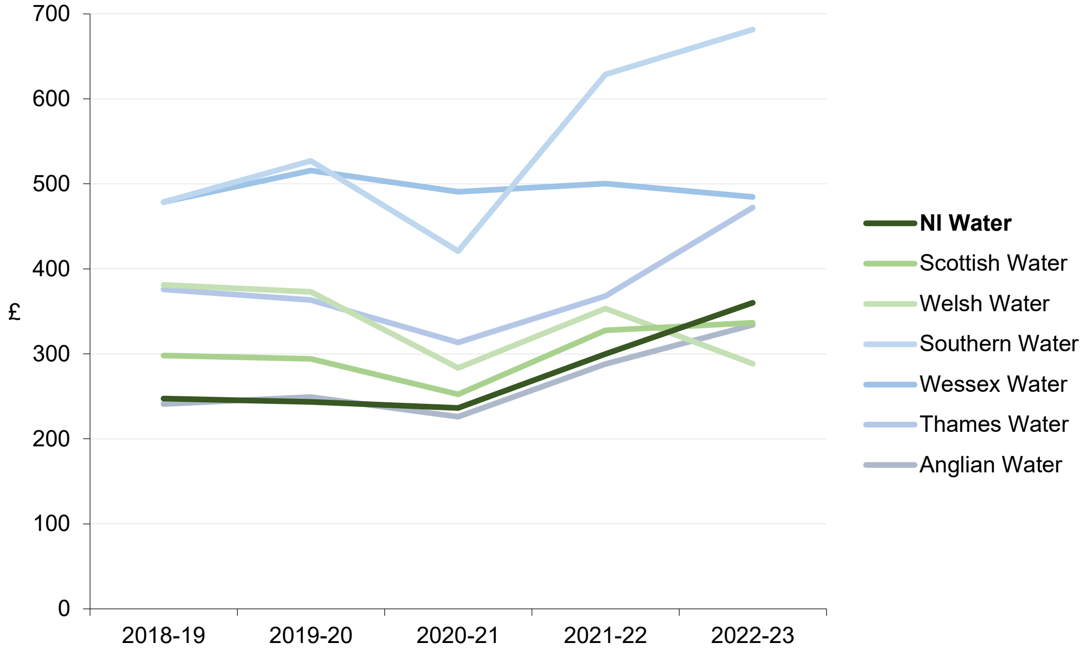
Real[12] capital investment spending per connected property was lower in NI than in Scotland and England and Wales in all but two years between 1989-90 and 2000-01. But it then surged, notably during a period of Direct Rule, rising above England and Wales in 2001-02 and above Scotland from 2003-04 through to 2006-07.[13] Data discontinuities prevent a straightforward updating of these figures, but we have carried out our own simplified calculations of capital investment per connected property for NI Water and six other water companies between 2018-19 and 2022-23[14] (Chart 6.1a). They show NI Water consistently ranking towards the bottom of the pack, close to Anglian Water, although in 2022-23 it overtook Welsh and Scottish Water with the PC21 boost to CDEL.

[12] Adjusted for the construction output price index

[13] https://www.infrastructure-ni.gov.uk/sites/default/files/consultations/infrastructure/independent-water-review-strand-one-report-costs-and-funding.PDF pg 44

[14] For England, we selected water companies considered by Ofwat as top (Wessex Water), middle (Anglian Water) and bottom (Southern and Thames Water) performing in terms of customer satisfaction[14] and where recent data were available. It should be noted that customer Satisfaction is one measure of performance but does not necessarily correlate to the level of spending. https://www.ofwat.gov.uk/regulated-companies/company-obligations/customer-experience/c-mex-and-d-mex-2021-22-results/

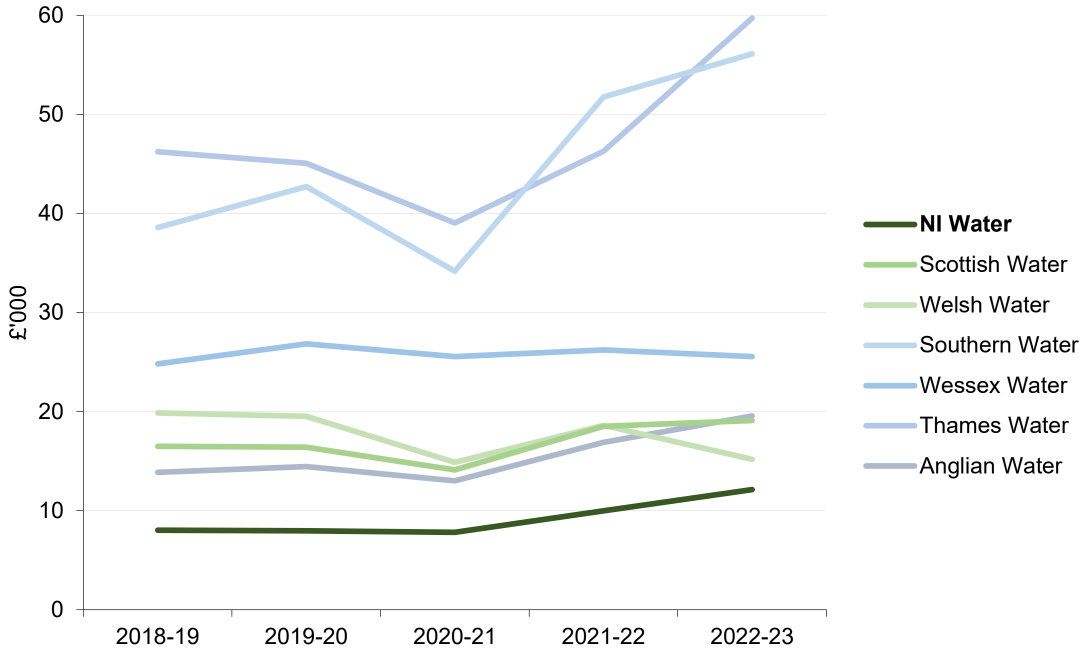
Chart 6.1a – Capital investment per connected property in 2023-24 prices



Source: Annual Reports and Accounts, Utility Regulator, WICS, Ofwat, HMT GDP deflators (March 2025)

The Independent Water Review Panel caveated its original analysis by noting that NI's dispersed population required a relatively longer network of water mains than Scotland and especially England and Wales. NI Water and the UR therefore favour a comparison by the length of total water mains instead of the number of connected properties. On this measure, NI Water consistently invested less than the other water companies over the same 2018-19 to 2022-23 period (Chart 6.1b).

Chart 6.1b – Capital investment per kilometre of water main in 2023-24 prices



Source: Annual Reports and Accounts, Utility Regulator, WICS, Ofwat, HMT GDP deflators (March 2025)

As we have seen, NI Water's operational efficiency has improved significantly since 2007, with the gap compared to the top quarter of companies in England and Wales narrowing from almost 50 per cent in 2007 to less than 6 per cent in 2021. But what of outcomes? As part of the PC process, the UR judges NI Water's performance against a range of operational targets. The NIAO concluded that this had showed a "trend of long-term improvement in NI Water's performance". In its most recent Cost and Performance Report for 2021-22, the UR found that NI Water had met 37 out of 45 output targets. But the UR notes itself that these are of differing ambition. The drinking water and wastewater quality measures are the lowest that NI Water should be expected to achieve, while the leakage target is challenging given the sustainable economic level of leakage[15] and the legacy of past underspends.

For this report, the UR told us that notwithstanding the improvements in NI Water's efficiency relative to its English and Welsh peers: "It is difficult to robustly benchmark capital enhancement investment and performance given the 'sawtooth' profile of spend, but from the data we do hold - which needs very careful interpretation - we believe there is potentially a relative service performance gap that currently exists between NI and GB and that we need more investment in NI to fill this gap".

Pollution is an increasingly high-profile dimension of water company performance, not just in NI but elsewhere in the UK. Many pollution incidents in NI are attributed to the agriculture industry, but according to the UR[16] the number of high and medium incidents attributed to NI Water is higher than for comparable companies in England and Wales. The UR has set a target of no more than seven such incidents by 2026-27, compared to a target forecast of nine in 2024-25. This would bring NI Water broadly into line with the average in 2018-19 for companies in England and Wales that report a comparable measure.[17]

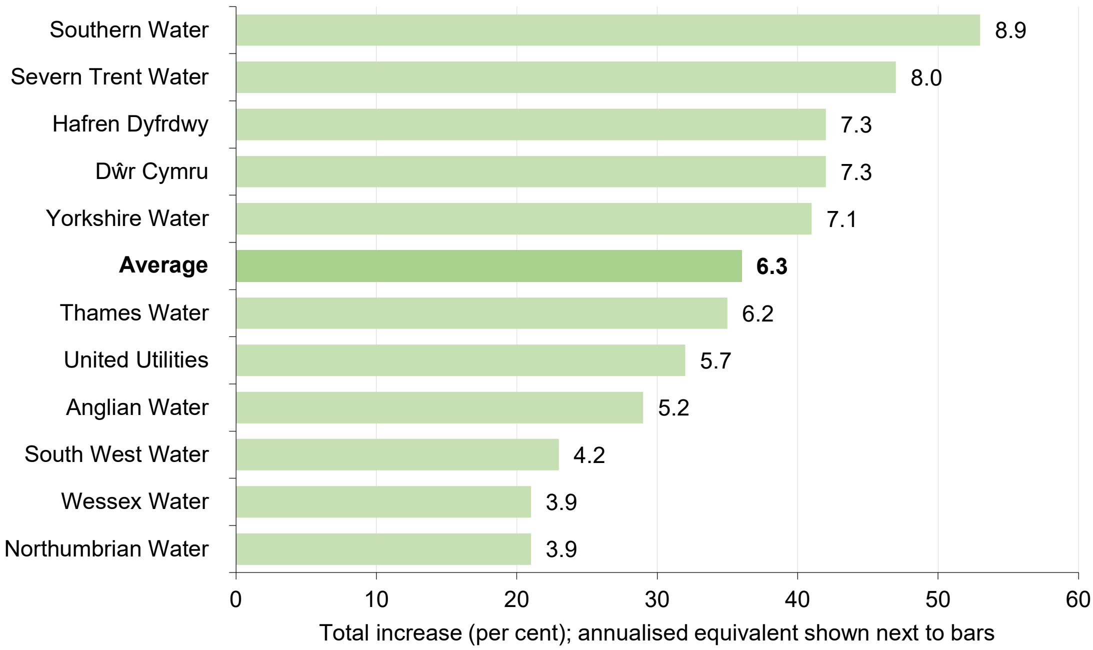
But many stakeholders question whether matching performance in England and Wales is a sufficiently stretching goal given the fierce criticisms of the companies there that have prompted the establishment of the independent Cunliffe Commission into the water sector and its regulation[18] – especially given the increased rainfall and flooding experienced in NI in recent years.

This issue is thrown into sharp relief by the five-year Price Review Final Determination announced by Ofwat for the English and Welsh water companies on 18 December 2024 – the equivalent of the UR's Price Control for NI Water.[19] As shown in Chart 6.2, Ofwat has said that it will allow the combined water and sewerage companies to increase average bills by 36 per cent over the next five years on top of CPIH[20] inflation (equivalent to 6 per cent each year in real terms), with the increases ranging from 21 per cent for Northumbrian Water to 53 per cent for

[15] The "sustainable economic level of leakage" is the point at which repairing further leaks would cost more than the value of the water saved. This is currently estimated at around 150 million litres per day for NI Water, which it aims to achieve by 2027.
[16] https://www.uregni.gov.uk/files/uregni/media-files/Annex%20E%20-%20Outputs%2002.00.pdf
[17] The supporting data showed that Welsh Water had zero Category 1 and 2 (High and medium) pollution incidents in 2018. The English company data showed a range of 0.1 to 2.3 for the number of Category 1 and 2 (sewerage) pollution incidents per 10,000km of sewer. The equivalent figure for NI Water in 2018 was 9.4 (15 high and medium sewerage pollution incidents and c15,900km of sewers), which was four times higher than the maximum in England and Wales.
[18] https://www.gov.uk/government/news/governments-launch-largest-review-of-sector-since-privatisation
[19] https://www.ofwat.gov.uk/regulated-companies/price-review/2024-price-review/
[20] Consumer Prices Index including owner occupiers' housing costs

Southern Water. While large, the increases are in general less than the companies had been asking for.

Chart 6.2 – Five-year real increase in average bills proposed by Ofwat



Source: Ofwat Price Review 2024

Ofwat said that the bill increases would permit a quadrupling of investment over the next five years. It said that "90 per cent of this funding will go towards meeting new requirements set by the Environment Agency, Natural Resources Wales and the Drinking Water Inspectorate. These relate to a range of programmes, such as reducing spills from storm overflows, improving wastewater treatment standards and raising further the quality of drinking water." To the extent that this additional spending improves the performance of the English and Welsh companies, this would make NI Water's performance look relatively less impressive other things being equal.

As we have seen, PC21 is based on holding actual and notional average bills constant in real terms in NI from 2021-22 to 2026-27. Under current Executive funding arrangements, it would seem almost impossible for NI Water to be given scope for an equivalent increase in investment to that proposed by Ofwat to pursue similar improvements. Even if the company, UR and the Executive were willing to allow for a big increase in non-domestic charges for this purpose, there would be no additional DEL allocation available in DfI's budget to allow the increased expenditure by NI Water equivalent to that being funded by domestic customers in England and Wales. Like any other increase in the generosity of 'super-parity' policy decisions, this would have to be found elsewhere in DfI's or other departments' budgets.

Development constraints

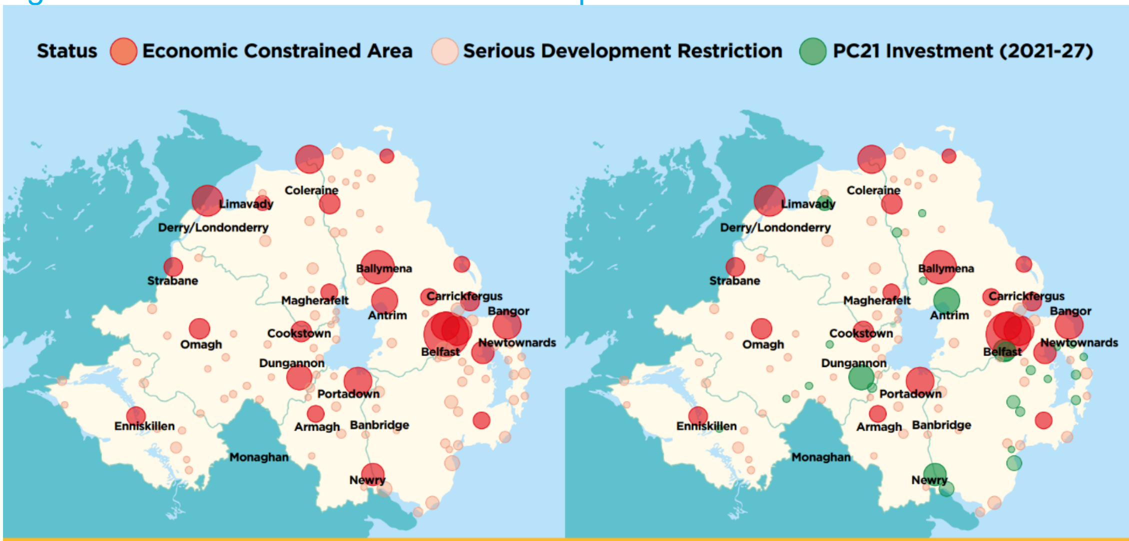
Notwithstanding the importance of the general performance of NI Water, in our discussions with stakeholders in the business community, local councils, political parties, and the NI Civil Service and public bodies, by far the greatest concern regarding NI Water's spending plans and constraints is the impact of inadequate wastewater infrastructure on future residential and commercial development and thus long-term economic growth and wellbeing (although everyone recognises that this is not the only barrier to those goals).

The NIAO points out that this is a longstanding issue that predated the creation of NI Water and is not unique to NI. DfI recognised the need for significantly higher investment when providing guidance for PC15 but did not push for it because it could not be confident that the money would be available. "Whilst the overall level of investment planned in the PC was substantially delivered, the gap between what was needed to alleviate capacity issues and what was available meant the scale of these problems worsened over the PC15 period and became more expensive to remedy."

When the time came for DfI, the UR and NI Water to prepare PC21, they recognised that spending had to increase but that it would be impossible to address the whole problem in one six-year period. NI Water's Business Plan identified 25 "economically constrained areas" (namely hub towns that local councils believed should drive the NI economy in future) that have "severely compromised sewerage infrastructure" that would prevent it from supporting major new planning applications. If fully funded, the investment proposed over PC21 was expected to address 12 of these. It also identified another 91 large towns where sewerage infrastructure was a "serious development restriction". The Business Plan would address 37 of these, although it warned that up to another 30 towns could be added to this category over the period.

The PC21 Final Determination offered slightly less CDEL cover than NI Water had hoped for, but enough to deliver these targets. Figure 6.1, taken from NI Water's latest Accounts, shows the number and distribution of development constraints and the areas where investment is being delivered during PC21. During 2023-24 NI Water worked with local councils and their planning teams and they continue to develop decision support tools to help prioritise and target investment. They have also been looking at more innovative wastewater technologies (such as the use of oxygen from hydrogen production) that may increase plant efficiency and allow for some growth in areas across NI which are currently operating at or near their capacity.

Figure 6.1 – Location of water-related development constraints



Development constraints across Northern Ireland at the start of PC21 (2021/22).

Development constraints across Northern Ireland at the end of year three of PC21 (2023/24).

Source: NI Water Annual Report 2023-24

When discussing NI Water's assessment of development constraints, it should be noted that some stakeholders suspect that it exaggerates the inadequacy of infrastructure in some planning responses. As the NIAO notes: "Some have questioned the extent to which the restrictions being applied are entirely merited, and do not feel they are presented with appropriate evidence by NI Water to justify the restrictions currently applied. For example, on 2 March 2022 the Drains for Development group highlighted… their concerns that the capacity issues frequently cited were not always correct and may instead be a tactic used to influence the Executive's budget setting process."

That said, NI Water estimated in its latest Accounts that it "will take a sustained increase in investment over the next 18 years plus to solve the problem of development constraints". According to the NIAO, NI Water estimates that investment of around £350 million a year in 2021-22 prices would be required beyond PC21 to "fully address the consequences of historic underinvestment", not including additional investment to address climate change and the costs of moving towards net zero (or, presumably, the costs of the sort of investment being envisaged by Ofwat in England and Wales). The projections were being reviewed by the UR "with early indications showing that there will be a significantly higher financial requirement". The NIAO warned: "In our view, it is not clear that the investment required will be delivered on such a significant scale, in the context of a highly uncertain economic outlook and competing priorities elsewhere within the public sector."

In 2022 NI Water commissioned the Ulster University Economic Policy Centre (UUEPC) to revisit its December 2020 analysis of the economic impacts of water and wastewater infrastructure constraints. It concluded that even if PC21 is fully funded and implemented, the remaining infrastructure inadequacies will still be a significant economic constraint in 2027 and beyond. The economy will be smaller than if development were unconstrained and perhaps 5,900 fewer new jobs will be created. And if PC21 is not implemented in full, even a relatively small shortfall in funding could magnify the economic impacts arising from constraints in wastewater infrastructure.

So what are we to conclude about the level of ambition for NI Water's spending cover that emerges through the Price Control process?

Overall performance does appear to have improved significantly since NI Water's creation and through successive PCs. The company is meeting most of the targets that the UR sets for it, but still lags behind comparator companies in some respects, including pollution. It will be harder for NI Water to improve performance further simply by increasing operational efficiency, as it has largely caught up with its peers. But Ofwat has clearly concluded that absolute performance in England and Wales is not good enough and has sanctioned large real increases in tariffs and average bills over the next five years to improve it. If this does indeed improve absolute performance in England and Wales, NI Water would need significantly more resources to keep up. Otherwise its relative performance will decline again.

The case for greater ambition on spending (and capital spending in particular) does appear strong to ease economically costly development constraints. NI Water's own claims about the deleterious impact of historic underinvestment on wastewater infrastructure – and the studies it commissions – should not be accepted uncritically given the potential for self-interest. But the weight of stakeholder opinion clearly accepts the basic diagnosis and is in favour of bolder action. Although this should be rigorously assessed to understand its scale, impact and necessary action.

But it is important to remember that funding is not the only constraint on the scale and speed of infrastructure spending. Proceeding too rapidly could undermine value for money by pushing up labour and other construction costs, especially in the current economic climate (although proceeding at pace could help encourage development of local supply chains).

7 Are domestic charging and changing NI Water's corporate form the answer?

If we start from the premise that the people of NI would benefit if NI Water had more reliable and greater funding, in particular for capital investment, what reforms and changes might that lead one to consider? The ideas most often discussed are the long-deferred introduction of domestic water charges, making it easier for NI Water to borrow, and changing its corporate form.

Domestic water charges

NI is unique among the UK nations/regions in not imposing some direct household charge for water and sewerage services. Elsewhere these are typically based on metered water use or the rateable value of customers' homes, with some fixed charges (Table 7.1). The Republic of Ireland legislated in 2017 for Uisce Éireann (Irish Water) to impose 'Excess Use Charges' on the small number of households consuming more than 1.7 times the national average, but these were never implemented.[21] In March 2025 the Taoiseach ruled out their introduction by the new Irish Government.[22]

Table 7.1 – Water company models across the UK and Ireland

Jurisdiction	Model	Financing capital investment	Charging approach
Northern Ireland	Government-owned Company (NDPB)	Non-domestic charges, subsidy and borrowing from NI Executive (DfI) within CDEL controls	Charges to non-domestic customers, government subsidy for domestic customers.
England	Privatised companies	Customer charges and borrowing from capital markets	Charges to customers based on usage (metered) or rateable value of property (unmetered).
Wales	Mutual (not for profit)	Customer charges and borrowing from capital markets via low-cost bonds	Fixed charge + unmeasured (based on rateable value of property). Or fixed service charge + measured (metered).
Scotland	Government-owned Company (Public Corporation)	Customer charges and borrowing from Scottish Government within CDEL controls	Unmetered charges form part of Council Tax bill (customers can opt to have a meter installed and if so will be charged directly via Scottish Water).
Republic of Ireland	Government-owned commercial company	Non-domestic charges, subsidy and borrowing (including from Irish Government within public finance controls)	Abandoned previous plans for 'Excess Use Charges': Metered or non-metered bills to households above a specified threshold. It was estimated around 7 per cent of metered households (many were unmetered) would exceed the threshold.

Source: Department of Finance and various sources

[21] https://www.water.ie/sites/default/files/2024-09/Uisce-E%CC%81ireann-Water-Charges-Plan-2024_final-draft_Clean-Version-20-Sept.pdf page 8
[22] https://www.rte.ie/news/ireland/2025/0311/1501396-water-conservation-charges/

As noted in Chapter 2, the UK Government was planning to introduce domestic water charges when it created NI Water in 2007. But it left the decision to the incoming Executive, which then deferred their introduction after initially preparing to proceed. It was widely felt at the time (including by the Executive) that households were already paying for water through the Regional Rates. This sentiment persists despite the average sum of Council Tax on a per dwelling basis and water charges in England and Wales being nearly twice the average domestic rates bill in NI. The Independent Water Review Panel set up by the Executive considered this argument and found that "after 1998 the linkage between the Regional Rate and payments to the NI Water Service was broken, but as the rate was not reduced, ratepayers understandably believed that they were continuing to contribute directly to the cost of water and sewerage services".[23] The latest decision to defer domestic charging was taken in 2021, when it was agreed and legislated to extend it at least until 31 March 2027.[24]

DfI estimated the potential implications for its DEL budgets of introducing domestic charges when it was required to publish a consultation paper on the subject in December 2023 by the Secretary of State.[25] It concluded that if a charge was set to match the cost of providing water and sewerage services to households, with no remaining need for government subsidy, in 2022-23 this would have freed up £172 million of Departmental Resource DEL that was being used to cover NI Water's day-to-day operating costs. The charge would also have freed up around £135 million of Capital DEL. NI Water estimates that over the last three years of PC21 – 2024-25 to 2026-27 – full domestic charging would save even more: an average of around £280m a year in RDEL and £190 million a year in CDEL.

DfI noted that some of the newly available RDEL might need to be spent on concessions or subsidies for low income or vulnerable households. It also highlighted potential set-up costs, estimating in 2022 from the experience of Scottish Water that introducing domestic metering for 829,000 households in NI would cost around £300 million[26] and take considerable time to roll out. Whether metering were used or not, billing and bad debt collection arrangements would have to be put in place and paid for.

After taking these into account, DfI's potential savings are still significant. On the face of it, there is no guarantee that the RDEL and CDEL liberated by adopting domestic charges would be spent improving the performance of NI Water or addressing development constraints rather than on some more immediately crowd-pleasing priority. Given other pressures within the DfI budget – and the possibility that RDEL and CDEL cover could be reallocated to other departments – this would be a political decision at the Executive level.

However, if charges are compulsory for domestic water but the revenues generated are not used to deliver the service in exchange for the payment (i.e. are 'requited') then the Office for National Statistics might classify them as a tax. And Treasury agreement is required to create new taxes. Assuming therefore that domestic water

[23] https://www.infrastructure-ni.gov.uk/sites/default/files/consultations/infrastructure/independent-water-review-strand-one-report-costs-and-funding.PDF page 10
[24] https://www.legislation.gov.uk/nisr/2022/23/made
[25] https://www.infrastructure-ni.gov.uk/sites/default/files/consultations/infrastructure/consultation-water-and-sewerage-charges-dec2023.pdf
[26] Ibid, page 14

charge revenues are retained by NI Water to deliver services (so it could be classed as a charge), it would only be the current DfI subsidy that could be spent on other Executive priorities. The domestic water charge revenues would still ensure that there is dedicated funding for NI Water, and a funding source that could be increased over time if the charge is increased.

As discussed above, the UR publishes notional average household charges and believes that these would be around £590 a year in 2025-26. Table 7.2 suggests that the combined bill for water charges and the domestic rates or Council Tax would probably still be lower in NI than in the rest of the UK if charges were introduced, on the basis of an average per dwelling calculation. While average disposable household income is also comparatively low in NI, the current level of household charges relative to disposable income is at least 1 percentage point lower in NI than in the other jurisdictions.

Table 7.2 – NI domestic rates and GB Council Tax bills 2025-26

£	Average Council Tax or Rates	Average water and sewage	Total average household bill	Average disposable household income[1]
England	1,770	603[2]	**2,373**	51,834
Wales	1,970		**2,573**	46,942
Scotland	1,426	490	**1,916**	43,462
Northern Ireland	**1,239**	**-**	**1,239**	**43,912**

Note[1]: 2022-23 (latest subnational data). Income after direct taxes and direct benefits in cash.

Note[2]: Combined average for England and Wales

Source: MHCLG, StatsWales, Scottish Government, LPS, DiscoverWater, WICS, ONS

Notwithstanding this comparison, with household budgets still under pressure there remains little appetite at Stormont for lifting the deferral of domestic charging after 17 years. The then Minister for Infrastructure and now Minister for Finance John O'Dowd said in April 2024 that "the challenges … with water infrastructure [are] a consequence of underfunding for basic public services over many years…" and "the solution therefore does not lie in charging hard-pressed workers and families for an essential public service".[27] The DUP has also in the past ruled out the need for water charges. The Alliance Party has for a long time been calling for a change in the funding model favouring mutualisation. In its recent policy paper 'In Deep Water'[28] it said that "this does not mean new water charges". However it is difficult to see how NI Water would recover 50 per cent of its production costs through commercial revenue – required to leave the public sector – without domestic water charges. NI Water estimate that sales would need to increase by £80-90 million to meet the market test, which would involve a charge of at least £100 per household – although this could be considerably more depending on what ONS scored as commercial income. Domestic water charging was also conspicuous by its absence in the list of potential revenue raising measures when the Executive published its Budget Sustainability Plan in October 2024.

27 https://www.infrastructure-ni.gov.uk/news/no-household-water-charges-odowd
28 https://assets.nationbuilder.com/allianceparty/pages/15526/attachments/original/1729600319/In_deep_water.pdf?

Corporate form and borrowing

As we have seen, NI Water finances its infrastructure and other capital investment partly by borrowing from DfI. But as noted, this looks more like an additional source of ongoing subsidy as the company has shown no sign yet of repaying any principal even though it makes regular interest payments (albeit they have until March 2027 before the first loan comes due).

NI Water currently borrows only from DfI but it could in principle borrow from private sector lenders (with the consent of DfI and the Department of Finance) if the transaction delivers better value for money for the public sector as a whole. However, unless it has unused budget cover there is little point in doing so as its spending is constrained by DfI's spending limits not by the availability of cash for as long as it remains within the public sector.

Introducing a significant level of domestic water charging, while retaining some government control and accountability, would likely result in NI Water being reclassified as a Public Corporation (like Translink and Scottish Water). The public expenditure budgeting rules mean that if NI Water were then (as now) to finance investment from a combination of borrowing, charging income and subsidy, it would make a smaller claim on DfI's capital budget as a Public Corporation than as an NDPB, freeing some additional budget cover for investment. Conversely, it might have less room for manoeuvre on resource spending as any subsidy it receives from DfI would count towards the Department's resource budget, which is not the case while NI Water is an NDPB. Becoming a Public Corporation would also allow NI Water to run a reserve, which would give it greater flexibility in financial planning.

Ultimately, as long as NI Water remains in the public sector, its spending is constrained not by the availability of cash but by DfI's Resource and Capital Departmental Expenditure Limits (RDEL and CDEL), towards which NI Water's spending scores and towards which its borrowing would score as a Public Corporation. It is no coincidence that Scottish Water, which does raise more than 50 per cent of its revenue from charging, is classified as a Public Corporation and can borrow from the private sector with agreement from Ministers, still borrows exclusively from the Scottish Government.

For external borrowing to create significantly greater capacity for additional investment, NI Water would have to leave the public sector through privatisation or mutualisation (see Annex A for a summary of this and other differences of corporate models). Its spending would then no longer count towards DfI's Capital or Resource DELs. The privatised water companies in England and the mutual Welsh Water both finance investment by issuing bonds on the capital market. Moving into the private sector would also allow NI Water to access the Executive's modest pot of Financial Transactions Capital (FTC) DEL, which can only be used to make capital injections into or make loans to private sector entities. This has been used to support universities but is almost always underspent.

English water companies have taken on £60 billion in private sector debt, which has exposed them to a financial double whammy as high inflation and rising interest rates have increased their operating and finance costs. Investors have written down their investments in Thames Water to zero and Ofwat said in its October 2024

Monitoring financial resilience report that: "We have 10 companies categorised as requiring an increased level of monitoring and/or engagement. This is based on our assessment of their financial position, challenges, and in some cases the actions they need to take to address and strengthen their financial resilience, including to ensure they are appropriately financed to deliver their investment plans."

Given public and political concern about indebtedness, dividend payments, executive pay, levels of investment, price hikes and pollution incidents among the English water companies, it is hardly surprising that there is little political appetite for this model of privatisation in NI. But more willingness has been expressed for considering mutualisation. As a mutual, Welsh Water is a not-for-profit company, run for the users, where profits are reinvested back into the company or passed on to the consumer through reduction in bills.

But Welsh Water does not appear to be outperforming its privatised peers. As Ofwat noted in its December 2024 Price Review Final Determination: "At present, Dŵr Cymru's [Welsh Water's] performance in 2023-24 lags behind most other companies in the sector, only meeting five of the twelve key performance indicators. In 2023-24, Dŵr Cymru was a top performer on reducing internal sewer flooding but performed worse than the target we set for performance in areas such as water supply interruptions and leakage. Additionally, Dŵr Cymru achieved a two-star overall company rating in Natural Resources Wales' Environmental Performance Assessment 2023 which means the 'company requires improvement'." In November 2024 Ofwat stopped the company paying executive bonuses because of poor performance.

In any event, the Minister for Infrastructure has voiced her opposition to privatisation or mutualisation referring to these as "essentially water charges by the back door".[29] The former Minister for Infrastructure and current Minister of Finance has also expressed his firm opposition to mutualisation as well as privatisation. As he told the Assembly on 8 April 2024: "While the principle of a mutual company reinvesting all profits back to customers would at first appear to have merits, it would require a change in current funding policy. Fundamentally, a mutual company requires a guaranteed and predictable funding stream that is not subject to direct political control or competing public-sector priorities. Simply put, achieving mutualisation would require charges being paid by domestic water customers. It would also require the relinquishing of Executive control over the company… If you want to go down the mutualisation route you will end up charging hard-pressed workers and families directly for water."

The mutualisation process itself might also not be straightforward. Welsh Water did not move straight from the public sector into its current mutual form. It had been privatised first. A company, Glas Cymru, was created in 2000 for the sole purpose of acquiring and then managing Welsh Water. After a process that took around 18 months, it successfully acquired the company from Western Power Distribution (a US owned electricity network company) in May 2001, financed by a £1.9 billion bond issue (thought to be the largest ever non-government-backed sterling corporate bond issue). As one senior figure involved in the Welsh Water

[29] https://www.newsletter.co.uk/news/politics/infrastructure-minister-liz-kimmins-says-she-will-resist-concerted-effort-to-push-for-water-charges-in-northern-ireland-5017737

transformation told us: "I suspect it could be done, but not if the NI Executive wishes to keep control".

The NIAO pointed out in its March 2024 report that several exercises have been undertaken, mainly led by DfI and NI Water, to see if there are any options to facilitate access to additional finance for water infrastructure beyond what can be granted through the Executive's budgetary processes. None has led to any substantive change to the funding and governance model, but the Office is right to argue the model should be kept under review, not least given the challenge that we have found trying to find a shared view of what exactly the impact of different forms of corporate form would be.

Neither domestic water charging nor moving NI Water to the private sector would be a silver bullet guaranteed to improve performance, release large sums of money or unlock NI's development constraints. And neither would currently enjoy the broad-based political support necessary to implement such a major reform legislatively in NI. But as the consequences for economic growth and household wellbeing of development constraints become more apparent who knows how political opinion might shift in the future?

Existing budgetary mechanisms

What of the prospects of funding greater investment through existing mechanisms, by increasing DfI's CDEL allocation and/or permitting NI Water to borrow more from the Department or the Executive (which would also increase its need to service/repay debt)?

One option would be in effect to increase DfI's RDEL envelope by increasing the Regional Rates, perhaps in the form of an earmarked Infrastructure Levy. But to the extent that this were done through the domestic rates this would squeeze household finances in the same way as water charging. Increasing non-domestic rates might be seen to inflict unacceptable short-term pain on businesses (who already pay higher rates poundages than in most other parts of the UK), with the gains from more development only accruing longer-term.

Another option would be to seek more financial help and flexibility from the Treasury. In the current budget climate, and given concerns about treating all the nations fairly, this looks a tough ask. Additional resources could be provided through a non-Barnett addition to the Block Grant or a change to the fiscal framework that would set the Executive's CDEL envelope (and not just additions to it) based on an estimate of investment need that explicitly took the damaging consequences of development constraints into account. Other possibilities would include increasing the limits on the Executive's RRI borrowing and allowing DfI and thence NI Water to make more use of this.

The Treasury would no doubt be very wary of this, given the recent history of budget management in NI, the longstanding cycle of political package funding 'dollops' and the Executive's relative lack of tax raising capacity, as well as concerns about cost and repercussive demands beyond NI. But it might be worth thinking more broadly about where additional support could come from. It is worth remembering that if the lifting of development constraints succeeds in raising economic growth, many private and public sector entities benefit. Developers would benefit to the extent that it allowed them to make bigger profits. The Executive and local councils would benefit to the extent that this increased the number and value of properties liable to the Regional and District Rates. And the UK Government would benefit to the extent that increases in jobs, wages and profits boosted income and corporation tax receipts. In principle it would be desirable for all potential beneficiaries to make a contribution to the upfront costs, but coordinating such a process would be far from straightforward.

From the public policy point of view the fundamental constraint on NI Water is a budgetary one. Under the current arrangements, especially in the absence of domestic water charging, NI Water is competing with all the other demands on the Executive's resource and capital budgets. With the Treasury unlikely to agree to provide significant additional Block Grant funding, additional revenue raising by the Executive – from domestic water charges and/or from other sources – appears inescapable if NI Water is to be given the resources necessary to deliver high quality and environmentally sustainable services and to be able to support residential and commercial development needs. Various other policy interventions have been suggested, such as allowing more capital borrowing from the Treasury, mutualisation or hypothecating a proportion of the domestic Regional Rates. But without raising more revenue in aggregate none of these is likely to ease the budget constraint sufficiently.

Annex A – Comparing corporate models

Model	Advantages	Disadvantages	Comments
Government-owned Company[1]: **NDPB[2]**	Can borrow from government at public loan rates	Spending financed by all sources including borrowing scores against Departmental Expenditure Limits (DEL) and so is constrained	This model does not appear to be delivering sufficient resources for NI Water, when compared to the Utility Regulator's Price Control, either in quantum or over a sufficiently long and secure investment planning horizon. However NI Water's performance is on a par with equivalent UK companies.
	Can in theory borrow through capital markets subject to value for money test and conditions	In practice borrowing from outside government is not beneficial in this model	
	Avoids domestic water charges	Absence of charging removes incentive for conservation	
	Government retains policy control/influence	Government retains policy control/influence	It is open to interpretation whether this is a pro or a con. It could be both or neither at different times.
	Public owns resources/assets	Investment planning horizon determined by government fiscal planning cycle	Significant disadvantage, particularly for a devolved administration which does not control the length of the cycle
		Cannot hold reserves	
Government-owned Company[1]: **Public Corporation[3]**	Can in theory borrow through capital markets subject to value for money test and conditions	In practice borrowing from outside government is not beneficial in this model because borrowing scores against Departmental Expenditure Limits	This model does not solve the borrowing constraints of an NDPB. For NI Water to become a Public Corporation would require an increase in commercial revenue to at least 50 per cent of its production costs – this would likely involve charging domestic customers.
	Government retains policy control/influence	Government retains policy control/influence	It is open to interpretation whether this is a pro or a con. It could be both or neither at different times.
	If customers pay per usage, there is an incentive for conservation	Introduces a water charge or levy to meet the 50 per cent market test	
	Can build reserves for future investment (subject to departmental approval)	Does not always pay a dividend, although NI Water would continue to pay while DfI remains sole shareholder, and this would score in budget	

Continued on the next page

Model	Advantages	Disadvantages	Comments
Mutual[4]	Can borrow through capital markets without scoring in government budget and therefore not affecting Executive DEL	Private sector financing costs likely to be higher than government borrowing	
	Does not pay a dividend. Profits reinvested and/or used to reduce customer bills	Reliance on effective regulation to prevent underinvestment and higher customer prices	
	Investment planning horizon not determined by government fiscal planning cycle	Requires domestic charges	
	Can build reserves for future investment		
	Government relinquishes policy control/influence and members have a vote	Government relinquishes policy control/influence and members have a vote	As well as meeting the market test, a mutual requires government to relinquish control over the company. It is open to interpretation whether this is a pro or a con. It could be both or neither at different times.
	Can access FTC DEL		
	If customers pay per usage, incentive for conservation		
Private company[5]	Can borrow through capital markets and raise share capital without scoring in government budget and therefore not affecting Executive DEL	Private sector financing costs likely to be higher than government borrowing	
	Infrastructure investment funded via revenue and debt, not public spending	Reliance on effective regulation to prevent profiteering, underinvestment and higher customer prices	
	Investment planning horizon not determined by government fiscal planning cycle	Requires domestic charges	
	Government relinquishes policy control/influence	Government relinquishes policy control/influence	It is open to interpretation whether this is a pro or a con. It could be both or neither at different times.
	Can access FTC DEL		
	Can build reserves for future investment	Expectation that dividends will be paid reducing reserves	
	If customers pay per usage, incentive for conservation		

Source: NIAO, Department of Finance and various sources

Note 1: A Government-owned Company ('GoCo') is a company owned by the government but operated by a non-government contractor.

Note 2: A Non-Departmental Public Body (NDPB) is a public body that operates separately from its government department.

Note 3: A Public Corporation is a public entity that is at least 50 per cent funded through commercial activities.

Note 4: A mutual is a company owned and run by its members for the benefit of its members, and which delivers public services and often aims to have a wider societal benefit.

Note 5: A private company is outside the ownership or control of the public sector.