

11 Central Government Funding of Irish Water

- 11.1** The Government decided in December 2011 to establish a public water utility to take over the delivery and operation of water services from local authorities.¹ An independent assessment of the planned transfer concluded that a public utility could achieve greater efficiencies and economies of scale than alternative delivery models and would reduce, and ultimately eliminate, the burden on the Exchequer of continuing to fund water services.² The assessment stated that a key factor in evaluating the merits of the utility was the possibility that its borrowings would be outside the general government debt.
- 11.2** In 2013, Irish Water was established as a commercial semi-state company and as a subsidiary of Ervia (formerly Bord Gáis Éireann). Under Irish Water's shareholding structure, Ervia holds one 'A' share with full voting rights but no economic rights, while the Minister for the Environment, Community and Local Government and the Minister for Finance each hold one 'B' share with full economic rights but no voting rights.
- 11.3** With effect from 1 January 2014, responsibility for the provision of water services transferred from 34 local authorities to Irish Water. Following the transfer, each local authority provides services to Irish Water under an individual service level agreement.³
- 11.4** The primary governance arrangements for Irish Water are set out in the Water Services Acts 2007-2014, and the company's memorandum and articles of association. The Code of Practice for the Governance of State Bodies also applies to Irish Water. In September 2013, the Department of the Environment, Community and Local Government agreed a memorandum of understanding with Irish Water dealing with its establishment and development. A separate memorandum of understanding was agreed in July 2013 in relation to the metering programme.⁴
- 11.5** The Water Services (No. 2) Act 2013 provides that the Commission for Energy Regulation (CER) will be the economic regulator of the public water and wastewater sector. CER's role includes protecting the interests of water customers, ensuring water services are delivered in a safe, secure and sustainable manner and that Irish Water operates in an economic and efficient manner. CER's responsibilities include reviewing plans submitted by Irish Water for water charges, by reference to the costs likely to be incurred by Irish Water and its investment plans. CER can then either approve the water charges plan (with or without modification) or reject it.
- 11.6** Funding was provided to Irish Water from a number of central government sources during 2014, and some payments are expected to continue for a number of years. Because of the significant changes in funding and accounting involved, this report was compiled to provide an overview of that funding, and of the controls being applied.

¹ In this report, the term 'water services' refers to water treatment and supply, and removal of sewage/waste water.

² Irish Water: Phase 1 Report, PwC, November 2011

³ The terms of the service level agreement (SLA) require Irish Water to remunerate each local authority for staff costs arising under the SLA, while local authorities provide water functions (operational and maintenance) on behalf of Irish Water.

⁴ The Department has indicated that these will be replaced by a new performance framework following the finalisation of a revised Code of Practice for the Governance of State Bodies, which is currently in draft.

Transfer of Assets and Liabilities

- 11.7** The Water Services (No. 2) Act 2013 provided for the transfer of assets and liabilities of local authorities to Irish Water on date(s) specified by the Minister for the Environment, Community and Local Government. The Minister has made a number of orders in relation to the transfers. From 2014, the capital commitments previously funded by the Department of the Environment, Community and Local Government under the Water Services Investment Programme became the responsibility of Irish Water.

Value of Infrastructure

- 11.8** To date, Ministerial Orders have transferred all underground assets and 634 treatment plants. The process of identification and transfer of assets is continuing.
- 11.9** The physical water-related assets in local authority accounts at the end of 2013 had a net book value of €11.4 billion. This included some surface water drainage assets (road drains) which are not transferring to Irish Water. Local authorities are required to submit annual financial statements to the Department of the Environment, Community and Local Government by 31 March of the year following the year of account. The Department was asked to provide information in relation to the net book value of each local authority's water services assets at the end of 2014 from these financial statements or, from audited financial statements, if available. The Department was not in a position to provide this information. Annex A sets out details of the net book value of each local authority's water services assets at the end of 2013. The residual amounts at the end of 2014 are shown for those local authorities where audits of financial statements have been completed.
- 11.10** Irish Water's financial statements value the property, plant and equipment transferred from local authorities at €128 million. These assets have been recognised by Irish Water at 'fair value' in accordance with international financial reporting standards. Irish Water's financial statements set out the basis for the valuation as follows.
- Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date determined using discounted cash flows, market values, or replacement values.
 - CER decisions prescribe the elements on which Irish Water's regulated revenues are based. Those revenues determine the profitability of the Irish Water business. As the value of Irish Water's assets is derived from expected economic returns in the future, this regulatory regime is critical to valuing the transferred assets.
 - The value attributed to opening property, plant and equipment is based on the future return provided for in the regulatory regime - which consists mostly of liabilities linked to the opening assets assumed by Irish Water, for which the regulator has allowed a future return.

Financial Assets

- 11.11** Financial assets to be transferred to Irish Water mainly comprise unallocated development levies collected by local authorities. The Water Services (No. 2) Act 2013 provides for development levies received by local authorities for the purpose of investment in water services to be transferred to Irish Water. A Ministerial Order provided for the transfer from the local authorities to Irish Water of development levies received or due to be received.¹ Due diligence work is underway to determine the amounts to be transferred. Amounts have been agreed with some local authorities and Irish Water is engaging with the remaining local authorities.

Water Services Related Loans

- 11.12** Most local authorities had borrowed funds to invest in water services. Such loans were not transferred to Irish Water. The Local Government Fund provided local authorities with €47 million in respect of the service cost of those loans in 2014.
- 11.13** The Water Services Act 2014 provided that payments of up to €460 million may be made to local authorities from the Central Fund of the Exchequer for the purpose of repaying water related loans outstanding with the Housing Finance Agency.
- 11.14** At July 2015, Housing Finance Agency water related loans held by local authorities were in the process of being repaid (€427 million including interest). The redemption of these loans will be reflected by local authorities in their 2015 accounts.
- 11.15** A further €140 million in water related loans from commercial lenders are held by local authorities. The servicing of these loans is being funded by the Department of the Environment, Community and Local Government.

Central Government Funding of Irish Water

- 11.16** Irish Water is funded by a combination of
- central government grants (in the form of an operating subvention), capital contributions and loans
 - receipts from domestic and non-domestic customers
 - commercial borrowings.
- 11.17** The Water Services (No.2) Act 2013 provides that the Minister for the Environment, Community and Local Government may make grants to Irish Water from moneys provided by the Oireachtas and that the Minister for Finance may make advances to Irish Water from the Central Fund, subject to such conditions as may be determined. The Act also provides that Irish Water may borrow up to €2 billion subject to the approval of relevant Ministers.²
- 11.18** In 2013 and 2014, Irish Water received a total of €1.2 billion in grants, loans and capital contributions from central government. Further funding of €1.4 billion is anticipated in 2015 and 2016 (see Figure 11.1).

¹ SI No. 112 of 2015

² The Minister for the Environment, Community and Local Government, the Minister for Communications, Energy and Natural Resources, the Minister for Finance and the Minister for Public Expenditure and Reform.

Figure 11.1 Central Government Funding of Irish Water, 2013 to 2016

	Actual		Estimated	
	2013	2014	2015	2016
	€m	€m	€m	€m
Grants and capital contributions				
Local Government Fund subventions	–	439	399	479
Vote for Environment, Community and Local Government	1	–	–	–
Central Fund capital contributions	–	407 ^a	–	184
	1	846	399	663
Loans				
Convertible loan	–	54	–	–
Central Fund loans	–	–	96	58
National Pensions Reserve Fund/Ireland Strategic Investment Fund ^b	250 ^c	50 ^c	150 ^d	–
	250	104	246	58
Total	251	950	645	721

Source: Department of the Environment, Community and Local Government

- Notes:
- a €222 million of this amount relates to capital spending to be incurred in 2015.
 - b National Pensions Reserve Fund loans were transferred to the Ireland Strategic Investment Fund with effect from 22 December 2014 pursuant to the National Treasury Management Agency (Amendment) Act 2014.
 - c The aggregate €300 million facility provided in 2013 and 2014 was refinanced and replaced by a new €300 million facility in September 2015.
 - d Anticipated additional loan facility.

Local Government Fund Subvention

11.19 The Local Government Fund provides local authorities with general purpose grants for funding day-to-day activities. Up to 2013, the funded activities included water services but the water-related element of the grants was not specified. The total general purpose grants paid to local authorities in 2014 decreased by €360 million compared to 2013, mainly due to the transfer of responsibility for water services to Irish Water.¹

11.20 In 2014, Irish Water received a subvention of €439 million from the Local Government Fund.² The amount was determined by reference to resources which would have been allocated from the Local Government Fund to public water services under previous funding arrangements. The conditions attached to the funding required that Irish Water would provide the Department with

- copies of the budgets agreed between Irish Water and local authorities for 2014
- bi-monthly expenditure reports and estimated expenditure to year end
- bi-monthly cash flow reports with projections to year end
- confirmation (at the time of each report) that
 - all expenditure had been properly accounted for and was in line with budget
 - all procurement was in accordance with public procurement rules and that the (Department of Public Expenditure and Reform's) Public Spending Code had been followed.

¹ General purpose grants were replaced by local property tax allocations in 2015.

² Section 6 (2CA) of the Local Government Reform Act 2014 provides for payments from the Local Government Fund to Irish Water.

- 11.21** From 2015, the Local Government Fund subvention, which is to be paid quarterly in arrears, funds the following in relation to domestic customers
- **product subsidy** – a volume-based payment such that the amounts charged to domestic customers per 1,000 litres do not exceed those set out in the Water Services Act 2014
 - **capping cost** – the cost of purchasing water in order for the maximum annual charges per household set out in the Water Services Act 2014 to apply
 - **child allowances** – the cost of purchasing an allowance of 21,000 litres for each child under eighteen years of age.
- 11.22** Requests from Irish Water to the Department for drawdown of funding are required to identify the amounts attributable to each category. The actual amount of funding provided will be dependent on the actual volume of water, the number of households and the number of children. However, the funding to be provided is not to be greater than the approved amounts for each year (i.e. €399 million for 2015 and €479 million for 2016).
- 11.23** In 2015, just over half (€211 million) of the maximum €399 million subvention is expected to be in respect of the product subsidy, around a third (€128 million) in respect of the capping cost and the remaining 15% (€60 million) in respect of a child allowance.
- 11.24** The estimated 2015 subvention was calculated on a customer database of 1.5 million households. An analysis of Irish Water's domestic customers as at 31 August 2015 is shown in Figure 11.2.

Figure 11.2 Irish Water – household registrations at 31 August 2015

	Number of households
Customers of Irish Water	
Registered with Irish Water	1,099,545
Unregistered	422,455
Total Irish Water customer base	1,522,000
Households with own/group water supply and own wastewater treatment	
Registered with Irish Water	284,327
Unregistered (estimated)	101,857
Total	1,908,184

Source: Department of the Environment, Community and Local Government

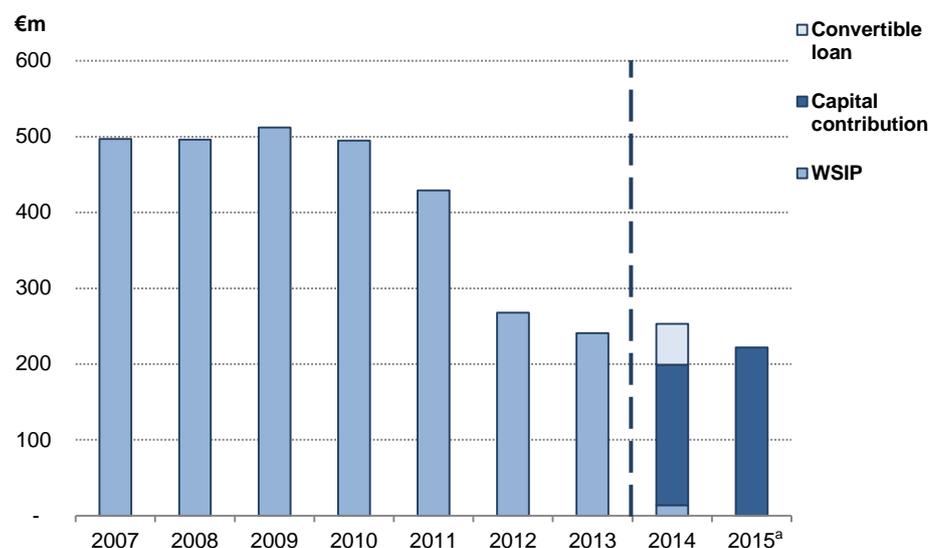
Loans from National Pensions Reserve Fund

- 11.25** When proposals to establish a water utility were initially developed, the National Pensions Reserve Fund (NPRF) agreed (in 2010) to provide a loan facility to the proposed utility to fund metering installation, subject to certain pre-conditions including the establishment of a regulatory regime.
- 11.26** As the Irish Water programme developed, a need emerged for funding for establishment costs prior to the introduction of domestic charges. Discussions were progressed with the NPRF on the basis of funding both the metering programme and establishment costs.
- 11.27** In July 2013, Irish Water entered into a €250 million bridging loan facility with the NPRF. In November 2014, the facility was increased to €300 million. The €300 million facility was fully drawn down and was repayable on 2 September 2015. Under the terms of the NPRF facility, interest and commitment fees were capitalised. The rate of interest payable on each tranche was 2% over the Euribor rate at the drawdown date. The Minister for Finance provided a guarantee to the NPRF in respect of the loan. This is recognised in the Finance Accounts. Irish Water agreed to pay the Exchequer a guarantee fee of 2% per annum of the drawn facility. The total guarantee fee to be paid is €10.3 million, and the final instalment is payable in October 2015.
- 11.28** The €300 million guaranteed facility was repaid on maturity date and refinanced with a €300 million unguaranteed Ireland Strategic Investment Fund (ISIF) facility at 1.9%.
- 11.29** It is anticipated that an additional loan facility for €150 million at 2.4% will be provided by ISIF in 2015.

Central Fund Capital Contributions and Loans

- 11.30** The Exchequer is also providing capital contributions and loans to Irish Water.¹
- 11.31** Prior to the establishment of Irish Water, local authorities were responsible for the delivery of water services capital infrastructure for which the Department provided funding under the Water Services Investment Programme (WSIP). The total cost of the programme from 2007 to 2013 was €2.9 billion including expenditure of €241 million in 2013 (see Figure 11.3). The WSIP included some funding for projects and infrastructure on activities not transferred to Irish Water such as river basin management plans and water sector reform programme projects. The Rural Water Programme provided some funding for smaller water and sewerage schemes.

¹ A capital contribution is an irrevocable, non-refundable and unconditional payment from a shareholder to the company in which it holds shares.

Figure 11.3 Water services investment, 2007 to 2015

Source: Department of the Environment, Community and Local Government

Note: a A capital contribution of €222 million was paid in 2014 in relation to 2015 capital investment.

Capital Contributions

11.32 The total Exchequer capital contribution in 2014 was €407 million. Of this, €185 million was based on the level of capital funding provided to the water sector in 2013 (when taken together with a convertible loan of €54 million – see below). The remaining €222 million, which was provided in December 2014, was calculated as the gap between Irish Water's projected available funding for 2015 capital investment (from operating cash flow and projected debt drawdowns) and its total funding requirement, based on financial assumptions on costs and revenues. A further capital contribution of €184 million is reflected in the Irish Water funding model for 2016.

Loans

11.33 In 2014, Irish Water was provided with a €54 million convertible loan note at a rate of return of 2.5% per annum. The loan is convertible into equity at the discretion of the Minister for Finance and is an unsecured obligation of Irish Water.

11.34 In addition, exchequer loans have been approved to provide working capital in the light of the timing difference between costs arising and revenue being received from water charges in the early years of operation. The amounts notified to Irish Water for this purpose are €96 million for 2015 and €58 million for 2016.

Allowed Revenue

- 11.35** When approving the level of water charges, CER determines the 'efficient level' of costs (including depreciation and return on capital employed) that Irish Water incurs in carrying out its activities. The total amount to be recovered is known as the allowed revenue. This is recovered through a mixture of charges to customers (which are approved by the CER) and subvention from Government.
- 11.36** In September 2014, CER approved allowed revenue of €2.1 billion (in present value terms) for Irish Water for the period 1 October 2014 to 31 December 2016, an 8.2% reduction on Irish Water's proposed cost recovery of €2.3 billion for the period.
- 11.37** As a result of the Water Services Act 2014, Irish Water made certain changes to the approved water charges plan. A revised water charges plan was approved by CER in March 2015. The Water Services Act 2014 exempted Irish Water from commercial rates on water infrastructure.¹ This had the effect of reducing its annual costs by some €59 million. This resulted in a revised total allowed revenue of €2 billion for the period October 2014 to December 2016, representing a reduction of 8.5% on Irish Water's proposed cost recovery.

Water Conservation Grant

- 11.38** Measures in relation to water services announced by the Government in November 2014 include an annual €100 water conservation grant which is payable in respect of all primary residences to households who registered with Irish Water by 30 June 2015. The grant is being administered by the Department of Social Protection, on behalf of the Department of the Environment, Community and Local Government. The water conservation grant is expected to be operational by September 2015. The Environment, Community and Local Government vote estimate for 2015 includes a provision of €130 million for the water conservation grant. The funding provision is based on an estimate of up to 1.3 million households potentially applying for the grant.

Market Classification of Irish Water

- 11.39** A significant component in the strategy to establish Irish Water is that it would be classified as a market corporation under Eurostat rules, with operating funding (other than any government subvention) and third party debt excluded from the general government balance calculation.² Such classification would allow Irish Water to borrow for investment from commercial lenders, in a manner similar to other commercial state bodies, without impacting on the general government balance or debt.
- 11.40** A Eurostat ruling on the market classification of Irish Water was received in July 2015. This stated that, on the basis of available information, Eurostat considers that Irish Water should be classified within the government sector. The CSO is engaging with Eurostat to clarify interpretation issues relating to the ruling. The classification ruling will be reviewed again in 2016 as part of the European Union's excessive deficit procedure process, using the most up-to-date data.

¹ Local authorities will be compensated through the Local Government Fund for this loss of revenue.

² Eurostat is the statistical office of the European Union. Its task is to provide statistics that enable reliable comparisons between countries and regions.

Conclusion

- 11.41** The most significant element of central government funding of Irish Water is a subvention from the Local Government Fund. The 2014 subvention of €439 million was based on the amount previously provided to local authorities for the provision of water services which have transferred to Irish Water. The audit of the 2014 Local Government Fund is examining whether the conditions attached to that funding were met.
- 11.42** The total subvention from the Local Government Fund in 2015 and 2016 is expected not to exceed €878 million. The calculation of the actual amount of the subvention in each year will be complex as it will depend on the actual volume of water used by Irish Water's domestic customers, the number of customer households and the number of children in respect of whom a water allowance is due. The payment of the subvention will be examined as part of the audit of the Local Government Fund from 2015.

Annex A Net book value of local authority water services assets, 2013 to 2014

Local Authority	Net book value at 31 December 2013	Net book value at 31 December 2014
County Councils	€m	€m
Carlow	123.1	n/a
Cavan	144.8	–
Clare	407.5	n/a
Cork	829.5	n/a
Donegal	342.6	–
Fingal	778.8	109.9
Dun Laoghaire Rathdown	282.3	85.7
Galway	222.8	n/a
Kerry	471.2	–
Kildare	420.0	n/a
Kilkenny	128.0	n/a
Laois	77.3	n/a
Leitrim	107.5	n/a
Limerick	277.6	n/a
Longford	126.6	n/a
Louth	161.5	n/a
Mayo	566.0	n/a
Meath	318.0	n/a
Monaghan	122.6	n/a
North Tipperary	163.7	n/a
Offaly	219.7	–
Roscommon	203.9	n/a
Sligo	269.8	n/a
South Dublin	635.4	n/a
South Tipperary	247.3	n/a
Waterford	170.1	n/a
Westmeath	248.9	n/a
Wexford	232.0	n/a
Wicklow	191.4	n/a
City Councils		
Cork	360.0	n/a
Dublin	2,000.0	456.6
Galway	150.4	–
Limerick	263.7	n/a
Waterford	139.2	n/a
Total	11,403.2	n/a

Source: Department of the Environment, Community and Local Government

Note: n/a The Department was not in a position to provide this information.