



Comhshaol, Pobal agus Rialtas Áitiúil  
Environment, Community and Local Government



12 May 2015

Mr John Tierney,  
Managing Director,  
Irish Water,  
Colville House,  
Dublin 2

Dear John,

I refer to this Department's letter of 29 July 2014 outlining proposals in relation to the financing of Irish Water and related conditions of funding. As you are aware, that letter and the decision of the Commission for Energy Regulation ("CER") in relation to water services charges on 30 September 2014, was set in the context of the Ministerial Direction of 2 July 2014 in relation to Water Charges. Subsequently, the Government reviewed the general policy principles set out in the 2 July Ministerial Direction and the manner in which the Government operational subvention to Irish Water should be used to ensure affordability, certainty and clarity of charges. Following on from the announcement of the Government policy, the Water Services Act 2014 was enacted on 28 December 2014 and domestic water services charges to end 2018 will be subject to these statutory provisions. In light of these developments, this letter reflects the current funding position and updates the letter of 29 July 2014. Terms defined in the letter of 29 July 2014 shall have the same meaning in this letter, unless otherwise expressly provided in this letter.

### **Operating Funding**

The Government decision in November 2014 in relation to Operating Funding has been framed to ensure that all expenditure and third party debt of Irish Water can be classified as being outside Government accounts. A significant component of the strategy to establish Irish Water is that Irish Water will be classified, from inception, as a market corporation under Eurostat rules (ESA 95/ESA 2010).

The market corporation test ("MCT") for the purposes of the classification of Irish Water is a requirement that amounts billed (ex VAT where applicable) to domestic and non-domestic customers and amounts billed to Government for purchases by Government must regularly and clearly exceed 50% of Irish Water's production costs (including consumption of fixed capital and including interest).

In addition, there is a requirement that amounts billed to domestic and non-domestic customers (excluding purchases by Government as set out in paragraph 1 of Appendix 1 and ex-VAT where applicable) must regularly and clearly exceed the total of the payments derived from Government for water produced, as listed in 1(a), (b) and (c).

An initial classification proposal on Irish Water along with supporting documentation, as required, has been submitted by the CSO to Eurostat. It is understood that in the CSO submission to Eurostat, Irish Water is forecast to function as a market, publicly-controlled institutional unit, to be classified outside the General Government Sector in the non-financial corporations sector based on the current business plan and financial forecasts. The final classification decision will be made by Eurostat. The classification decision will be reviewed in later periods as actual results become available.

### **Conditions attached to the provision of Operating Funding by Government**

The Government has approved the provision of annual Operating Funding of up to €399m in 2015 and €479m in 2016 to Irish Water. The Government will also provide repayable interest bearing loans of up to €96 million in 2015 and up to €58 million in 2016 for working capital support, which for the avoidance of doubt cannot be used for the purchase of water services by Government. The provision of this Operating Funding is conditional on the matters at Appendix 1 being observed by Irish Water.

### **Commencement of Domestic Water Charges**

The Water Services Act 2014 provides for the commencement of domestic water charges on 1 January 2015 and not 1 October 2014 as envisaged when the CER made its decision on Irish Water's Water Charges Plan in September 2014. As the deferral of the commencement of water charges from 1 October 2014 to 1 January 2015 is a cost attributable to Government, the level of 2014 subvention which falls within the regulatory period (which remains unchanged) needs to be adjusted in respect of the shortfall in accrued revenue<sup>1</sup> from domestic customers in 2014.

In this regard, it should be noted that Operating Funding from 2015 onwards will reflect the Government support for child allowances, capping of charges and a product subsidy on the basis set out in Appendix 1. Prior to the commencement of charges on 1 January 2015 the budgetary decisions on funding for Irish Water were based on a combination of the cash flow requirements of the utility and resources from the Local Government Fund which would have been allocated to public water services under previous funding arrangements. Taking these factors into account, of the overall subvention provided to Irish Water in 2014, €179m will now be assigned to Quarter 4, 2014 (an increase on the amount of €111m included in the Department's letter of 29 July 2014).

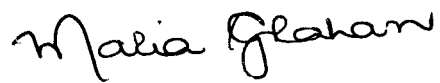
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<sup>1</sup> *Irish Water did not expect to receive any cash income in 2014 from domestic charges for Q4 2014 as bills are issued quarterly in arrears.*

**Review Mechanism**

As the funding position has been developed on an ex ante basis based on currently available data, it will be necessary for both Irish Water and the Department to keep under review all inputs and assumptions and to assess the impact of additional data on Irish Water's finances and the MCT as it becomes available.

Yours sincerely,

A handwritten signature in black ink that reads "Maria Graham". The signature is written in a cursive, flowing style.

Maria Graham  
Assistant Secretary  
Water & Planning Division

cc. Paul McGowan, Commission for Energy Regulation

## **Appendix 1 – Purpose, Quantum and Conditions of Funding in 2015 and 2016.**

### **1. Purpose of Operating Funding**

Operating Funding provided shall be used to fund the purchase of the following amounts of water provision and treatment for domestic customers (for validated metered domestic customers amounts based on recorded consumption and for all other domestic customers equivalent amounts will apply based on consumption assumptions used to derive charges in the approved Water Charges Plan): :

- a) The cost to Government of purchasing 21,000 litres of water services in relation to the normal consumption per child in primary residences in the State on an annual basis, (child defined as any person up to the age of 18);
- b) The cost to Government of paying for a product subsidy (in the form of a volume-based monetary sum) such that the net charges per 1,000 litres are as set out in the approved water charges plan (as amended pursuant to in Section 3 of the Water Services Act 2014);
- c) The cost to Government of purchasing water for certain households in order for the maximum charges set out in the approved water charges plan (as amended pursuant to Section 3 of the Water Services Act 2014) to apply (which now includes any households which would have above normal usage due to medical need); and

### **2. Quantum of Operating Funding and working capital loans**

The Government set out in November 2014<sup>2</sup> the updated level of Operating Funding relating to the purchase of water services (components 1 (a), 1(b) and 1(c) above) that it envisages providing to Irish Water for 2015 and 2016 being up to €399 million and €479 million respectively.

The Government shall also provide for an interest bearing repayable loan facility to cover working capital requirements of Irish Water, in light of the lag between costs arising and revenue being received from billing in the early years of the utility. The amount of the working capital loans, which are additional to the Operating Funding, set out in the letter

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<sup>2</sup> <http://www.environ.ie/en/Publications/Environment/Water/FileDownload.39557.en.pdf>

of 29 July 2014 of up to €96 million in 2015 and up to €58 million in 2016 remain unchanged.

### **3. Drawdown of Funding and Conditionality**

The drawdown request for Operating Funding from Irish Water should clearly identify the amount of funding attributable to each of the categories set out in paragraph 1 in line with a payment schedule and set of supporting reports agreed with the Department. Drawdown requests should also identify the amount of working capital required in line with paragraph 2 above.

As there may be variance between the forecast amount of Operating Funding (“**Forecast Operating Funding**”) attributable to categories 1(a), 1(b) and 1(c) and the billing to Government reflecting the actual volume of water, number of households and number of children, the amount billed to Government (“**Actual Operating Funding**”) may be less than the amounts set out in 2 above but the Actual Operating Funding for a given year cannot be greater than the maximum level of Forecast Operating Funding for that year set out in paragraph 2 above.

The level of Forecast Operating Funding expected to be provided to Irish Water when considered relative to the forecast billed revenue to be realised from the Water Charges Plan approved by the CER (relating to both domestic and non-domestic customers) (“**Forecast Customer Revenue**”) taking account of the provisions of the Water Services Act, 2014, is expected to meet the Eurostat rules (ESA 95/ESA 2010) in relation to the classification by Eurostat of Irish Water as a market corporation for each of 2015 and 2016. If over the period 2015 and 2016, the actual billed customer revenue differs materially from Forecast Customer Revenue, such that there is a risk of Irish Water not meeting the Market Corporation Test, Irish Water will engage with the Department in the first instance to determine the appropriate mitigating strategy.