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Dear Donald,

COMMISSIONING THE STRATEGIC REVIEW OF WATER CHARGES: 2027-2033

I am writing to commission work to start on the Strategic Review of Charges (“the Review”) for the period 2027-2033. This letter sets out Scottish Ministers’ preferred approach to the Review, building on the successes of previous Reviews, which have ensured a financial and regulatory environment within which Scottish Water has significantly improved levels of efficiency and service delivery. The circumstances within which this Review is taking place are unprecedented – in terms of climate change impacts, nature crisis, ageing assets and economic circumstances. These circumstances should be reflected in the approach that is taken.

Relevant to the Review are the three missions that the First Minister has set out in his [Policy Prospectus](#). I have set them out again here given the key relevance for the water sector vision and Scottish Water in particular:

- Equality: Tackling poverty and protecting people from harm
- Opportunity: A fair, green and growing economy
- Community: Prioritising our public services

Further to consideration of these three missions, the Review needs to respond to:

- The challenges of a changing climate on the industry both in terms of mitigation and adaptation,
- The risks associated with Scottish Water’s ageing asset base,
- The next cycle of River Basin Management Plans for Scotland,
- Our commitment to aligning with new EU legislation in the best interests of Scotland, including the recast Drinking Water Directive and the imminent Urban Wastewater Treatment Directive,
- The ongoing economic situation and cost of living crisis; and
- The need to move to nature-based solutions that deliver on responses to climate change, the nature crisis, environmental protection and green spaces for the enjoyment of Scotland’s population.

In conducting the Review, Ministers look to the Water Industry Commission for Scotland (the Commission) to build on the partnership arrangements with Scottish Water, Consumer Scotland, SEPA, DWQR. In particular, they expect the Commission to enhance and embed its commitment to working with Scottish Water according to the Ethical Business principles¹. We expect the Commission to work constructively with Scottish Water to collectively ensure the best outcome for Scotland. Those arrangements have developed and evolved over successive reviews to the benefit of customers.

1. Conducting the Strategic Review of Charges

Ministers request that the Commission undertakes a Strategic Review of Charges for the six-year period 2027 to 2033. The **Final Determination should be published by 31 October 2026** at the latest to ensure time for Scottish Water to prepare its charging schemes and submit them to the Commission for its approval, and then implement them in time for issuing via Council Tax bills in March 2027. Ministers would welcome sight of a **Draft Determination by June 2026**, but are open to discussion on this timing.

Ministers request that the Draft Determination sets out a range of possible charge paths for both the domestic and non-domestic sectors for the services provided by Scottish Water: drinking water, sewerage and drainage. Ministers want the Review to provide them with the necessary information to appreciate the progress towards objectives and the level of risk of service failure associated with different levels of investment in the short, medium and long terms. In calculating the range of charge paths, for planning purposes the Commission should assume that similar levels of lending to 2021-27 period will be made available (around £1.03 billion).

As the industry is aware, Scottish Ministers recently consulted on policy proposals (Nov-Feb 2024) to equip the Water Industry with the necessary powers to ensure that essential water, wastewater and drainage services can continue to be provide in a changing climate. **The Review must remain cognisant of ongoing policy development and any resulting legislative changes.** Ministers will confirm the extent of changes required in their final Ministerial Objectives.

Ministers request that the Commission ensures, together with water industry stakeholders, that consumers, communities and the environment are placed at the heart of this Review. They expect that the consumers are engaged throughout this process and that the Commission can demonstrate that Final Determination commands consumers' support.

2. Principles of Charging

Ministers recognise that their Principles of Charging for previous regulatory periods have provided a framework which has secured significant stability and clarity for

¹ Ethical Business Regulation and Ethical Business Practice – set out how regulators can deal with asymmetry of information, and evolve from an adversarial relationship to a collaborative one with the regulated entity.

Scottish Water, its customers and stakeholders. The Principles of Charging for the 2027-33 regulatory period will be an evolution of those that currently apply during the 2021-27 regulatory period, and request that the Commission takes these as their starting point with minor amendments (included in Annex B).

Ministers will consult on **Draft Principles of Charging for 2027-33 in early 2025**, and will confirm the final Principles of Charging following the next Scottish Parliament election (likely by September 2026). As in previous periods, the Principles of Charging will indicate the level of finance (lending) they are willing to make available in support of the investment programme.

To ensure continuity, Ministers request that the Commission considers measures that ensure a smooth transition of investment activity between and beyond regulatory periods (current 2021-2027 period to the 2027-33 period being considered in this Review). This is necessary to ensure that supply chains can respond to the investment challenges in the most effective and efficient ways.

3. Statement of Ministerial Objectives

The Ministerial Objectives will be an evolution of those that currently apply during the 2021-27 regulatory period, and Ministers request that the Commission takes these as their starting point with minor amendments (included in Annex C). **Ministers will consult on their draft Ministerial Objectives during 2025**, but due to the Scottish Parliament election will only be able to finalise their objectives by October 2026.

Scottish Ministers will consider their Objectives for the water industry for the regulatory period 2027-33 in light of the emerging challenges facing the industry and emerging policy priorities following the consultation (Nov-Feb 2024). Ministers welcome the Commission's ongoing commitment to, and engagement with, this policy development work.

Ministers will then set their Objectives in the context of the water industry vision describing the longer-term nature of the industry and what it can achieve. The Commission played an important part in the development of that vision and should continue to consider it as the set of outcomes towards which the industry must make clear and demonstrable progress.

Ministers also recognise that the coming regulatory period will present some important challenges to Scottish Water and accordingly invite the Commission to work with Scottish Water to ensure they are properly addressed. These are attached at Annex A.

Ministers expect that the outputs necessary to achieve their Objectives reflect the best possible value for money in terms of the improvement in outcome achieved for the investment made. Average annual expenditure on the investment programme should remain of a size that allows efficient delivery whilst facing up properly to the challenges the industry and its wider supply chain faces.

With the advice from the Investment Group, Ministers expect a suitable governance structure be developed which identifies, on a rolling basis, the outputs necessary to

deliver their Objectives. Scottish Ministers request that the Commission work with Scottish Water to establish a monitoring framework and process to review the delivery against these Objectives during the Regulatory Period.

Consistent with Ministers' policy of continuity of investment, as set out in the policy prospectus of 2023, and the development of the longer-term vision for the water industry, draft Objectives for the subsequent period 2033-2039 and beyond should also be developed. These must demonstrate how they will contribute to the Government's priorities as set out earlier and make clear and demonstrable progress towards delivering the longer-term vision.

Scottish Water will also be required to continue to meet their statutory obligations in responding to Net Zero and should ensure systematic monitoring and reduction of carbon emissions to ensure that reductions can be quantified. Ministers recognise that adapting services to the impact of climate change is an increasing challenge and wish an explanation to be included in the investment scenarios on the impact of delaying investment on the resilience of services.

4. Next Steps

In agreeing the timetable for the Review, Ministers ask that Scottish Water and its regulators ensure, in keeping with good practice, that there is appropriate consultation with the wider stakeholder group, communication with customers and for the Government's own public engagement. Ministers request that appropriate steering groups, led by the Scottish Government, are put in place to oversee the stakeholder engagement and to ensure that on-going policy development work is incorporated as required.

Ministers look forward to receiving regular updates on the progress of the Review.

I am copying this letter to the Chair of Scottish Water, the Chair of Scottish Environment Protection Agency, the Drinking Water Quality Regulator for Scotland, the Chair of Consumer Scotland and the Chair of the Competition Commission.

Yours sincerely,



MAIRI MCCALLAN

Investment Challenges

Capital Maintenance – Over this and future regulatory periods, Scottish Water should continue the transition to a risk-based approach to maintaining the overall condition and performance of its assets to ensure no deterioration of service levels to customers over the long term. Ministers accept that capital maintenance is key to achieving and maintaining service levels and compliance with statutory obligations in relation to drinking water quality and the environment and to reflect customer priorities. They wish the Commission to ensure that there is a stable and sustainable funding regime, recognising the economic conditions prevailing and forecast, for this important part of the investment programme.

Resilience – Ministers recognise the progress Scottish Water has made in developing a strategic approach to identifying the work required to ensure the resilience of the network, not least to adapt to the impacts of climate change. They request that the Commission provides assurance that Scottish Water's approach is proportionate, fit for purpose over the long term and represents value for money for customers.

Strategic Capacity – Ministers wish to ensure that Scottish Water is properly financed and incentivised to provide strategic and local water, sewerage and drainage assets in a manner that does not place a constraint or restriction on the achievement of their housing and economic development targets. To achieve this Ministers look to the Commission to ensure that finance is available to Scottish Water for this purpose over the regulatory period and that the funding arrangements for additional capacity (including the Reasonable Cost Contribution) remain fit for purpose and strike the correct balance of cost between existing customers, new customers and borrowing.

Private Finance Initiative funded Projects - Ministers recognise that 4 PFI contracts (Seafield, Tay, Moray and Ayrshire) mature in the period 2027-33. Highland and North East have already returned and Daldowie and Dalmuir return in 2026 with Levenmouth the final PFI due to complete in 2040. Scottish Water has been asked to consider the options and costs for the future operation and funding of these assets. Ministers request that the Commission undertake a full examination of Scottish Water's approach to establishing the options and costs with an overall assumption that these assets should return to public ownership.

Partnership Projects – Ministers recognise the progress that Scottish Water has made in delivering improvements in partnership with other stakeholders, and in particular Local Authorities. They consider that, increasingly, delivering outcomes particularly in relation to drainage, the reduction of flood risk and compliance with bathing water standards will require Scottish Water to work closely with Local Authorities, Developers, landowners and communities. Ministers therefore request that the Commission ensures that the funding arrangements are sufficiently flexible so that Scottish Water can deliver to agreed timetables within partnership frameworks.

Supporting innovation – Ministers look to Scottish Water to contribute to inclusive and sustainable economic growth to which end they are encouraged to be innovative in their operation and with regards to capital enhancement and maintenance. In addition, Scottish Water is expected to support the Hydro Nation programme through their renewable energy (including hydrogen), and energy efficiency programmes and by working with communities and customers in Scotland for example to manage water demand or create drainage assets. Ministers therefore request that the Commission ensures that the financing and funding arrangements for Scottish Water’s regulated elements create appropriate incentives towards efficient delivery of these objectives.

Security – Ministers recognise the importance of the security of Scottish Water’s physical, operational and IT assets, and the increasing nature of threats particularly in relation to cyber attacks. They require that relevant security standards in relation to physical, personnel and digital systems as advised by Scottish Government Resilient Essential Services and Drinking Water Quality Regulator, should be met.

Draft Principles of Charging

Attached as separate document.

Draft Ministerial Objectives

Attached as separate document.