



Speech

Given by Aileen Armstrong, Senior Director, Company Performance and Price Reviews
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Delivering into the future – challenges for PR24

I'm going to focus on how we – together – can meet the challenges facing the sector.

I think we're all familiar with the key challenges:

- The threat from climate change to our water supply and infrastructure is growing.
- Growing customer expectations around the service companies deliver and how they look after our environment.
- As the challenges facing the sector grow, we will also need to address the affordability challenge.

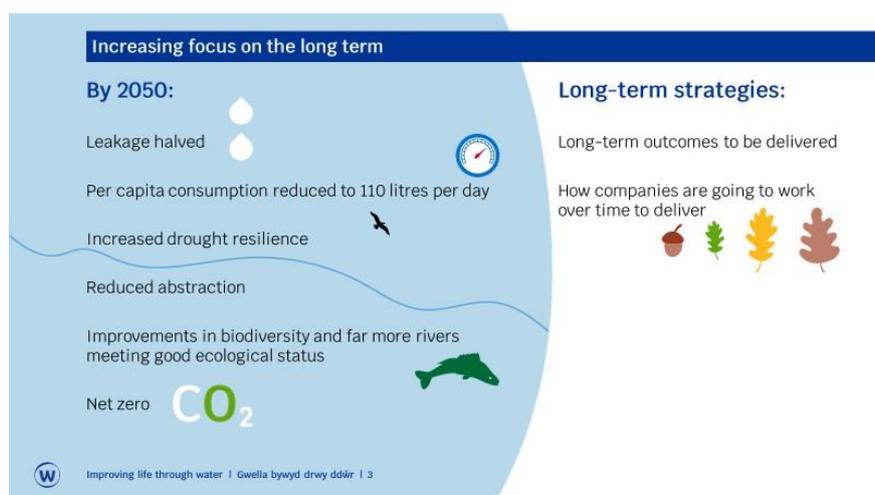


These challenges require us to think differently about how we plan, develop and maintain water and wastewater infrastructure:

- We need to think about what's needed into the long term.
- It will also need improvements in resilience to make the sector more robust to shocks and changes from climate change.
- And it will require companies to work in new ways to drive improved performance.

To facilitate this, we are thinking differently about how we regulate the sector. I'm going to cover three areas where we're looking for real changes through PR24 and beyond. I'm going to touch on proposals on how our framework can create a greater long-term focus and I'll mention some work we are doing to encourage the sector to improve its resilience. Finally, I'll cover how we plan to encourage new and innovative ways of working across the sector, and I want to pause a little on the importance of using data well.

Long term



None of us can be in doubt that the scale of transformation needed is great. By 2050:

- We should see leakage at least halved, and per capita consumption reduced to a hundred and ten litres per day.
- We expect significantly increased drought resilience and reduced abstraction from rivers and chalk streams.
- We expect significantly reduced environmental impact with far more rivers meeting good ecological status and improvements in biodiversity.
- And the sector will also have to meet the net zero target for carbon impacts. This will cover not only operational emissions from carbon but also the embedded emissions from construction.

Meeting these long-term challenges will require a long-term focus. We think that a large part of the solution is for companies to develop long term strategies, and to set their five-year business plans in the context of these strategies. Of course, companies already develop long term plans as part of strategic planning frameworks such as water resource management plans and drainage water management plans. However, these only cover part of a water company's business and look at each issue separately. So building on the good work covered

by strategic planning frameworks, we want to see long term strategies covering the whole of a company's business.

A long-term strategy will provide three key benefits to planning and delivering assets:

- It will provide greater confidence that the five-year plan will deliver against the companies' long-term ambitions. We'll be able to stand back and see whether companies are sequencing their investments to deliver the best-value outcomes over the long term. It will also provide assurance that the investments put forward by companies are the right ones to do now, taking into account future uncertainty.
- At future price reviews, there will be greater clarity about the outcomes that companies have already committed to and been funded for. This will create a better platform to hold companies to account and enable companies to develop better business cases for further improvements.
- It will give customers and stakeholders greater confidence that the challenges of the next few decades will be met and how those costs are likely to be spread between current and future customers.

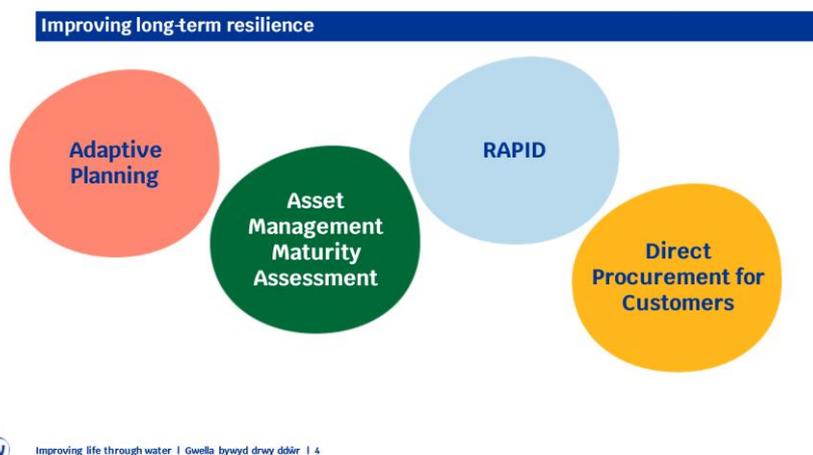
While a clear long-term strategy is a positive step forward, it won't, on its own, necessarily deliver the long-term focus that's needed to plan and deliver assets. Let's highlight two factors we are considering to help support long term delivery.

First, we're considering how we can provide greater clarity around how we'll reward good performance in future periods. This could include setting out indicative performance commitment levels for the next price review or fixing key parameters such as outcome delivery incentive rates over several control periods.

Second, we also need to ensure that customers get the benefits that they paid for:

- We propose to be clearer what improvements we expect companies to make over time from on-going base expenditure.
- A longer term focus will also allow us to be clearer on the impact of enhancement expenditure on future performance levels.
- Underspending on resilience expenditure may only appear over time. And so we are also considering what measures we should take if performance improvements are not sustained – perhaps extending the period in which outperformance payments are made, or making adjustments to the RCV if companies have not maintained their assets or met statutory requirements.

Improving long-term resilience



There are four ways we are helping the sector to improve its long-term resilience.

First let's talk about **adaptive planning**. None of us can predict the future. The shock of a global pandemic illustrates this to us all.

It is important that company business plans are robust to potential changes in the future. As the future is unpredictable, long-term strategies need to adapt. Embracing the world of adaptive pathways will allow companies' long term delivery strategies to respond over time, adjusting to reflect new information and experience.

We need adaptive plans that allow investment to be sequenced over time, combining options as needed. They will help us identify investments and investigations are needed now, for example to avoid ruling out future options or rendering these options more expensive. And they will allow options to be kept open into the future until it is the best time to make the right decision for the long term. Planning in this way can also help identify future thresholds or tipping points, beyond which a particular action is no longer adequate for meeting long-term objectives and a different option or strategy is required.

Some companies started to develop adaptive plans for their last round of WRMPs, but this was the exception. The next round of regional and company plans promises a much bigger step into an adaptive future.

For PR24, we want adaptive planning to be at the core of all parts of every company's business plan. Over the last month we have been co-creating some core future scenarios with water companies and other stakeholders. We expect each area of a company's business plan to be tested against these scenarios, and adaptive long-term plans developed to make sure we are

doing the right thing at the right time. Any investment requirements must be well evidenced, clear on the risks they are addressing, tested against a range of possible futures and supported by customers.

I am going to touch on some recent work we have been doing to explore how asset management decisions are being made, and the role of asset management in delivering operational resilience. But let's pause on the critical importance of asset health for the sector and its ability to deliver for customers and the environment. There seems to be a lot of discussion around the age of assets in the water sector. But I'm sure many of you will agree that the condition and performance into the future of the assets are key and age is not a reliable indicator of these factors.

For Ofwat's part, we've certainly always been open to ensuring that companies have enough money to deliver the right outcomes – since privatisation, expenditure has roughly doubled on capital maintenance. And it's worth noting that over the last four price reviews, the sector underspent its cost allowances.

Our focus in price reviews has to be to make sure that the long-term resilience of the assets overall is being secured – the key thing is to make sure that money is spent wisely and the health of the assets is maintained. To this end, we built in a set of improving asset health performance commitments into the PR19 settlement to help make sure the sector continued to improve asset health. And we need to ensure that we are tracking the best measures for that into the future.

So back to our recent project. Over the course of the last year we have been collaborating with the sector to co-create the **asset management maturity assessment** or 'AMMA'. The aims of the AMMA are:

- To increase the sector's understanding of how companies monitor and manage the operational resilience of their assets.
- To share good practice and knowledge, as well as raise the profile of asset management across a range of stakeholders.
- To assess whether more needs to be done to improve the sector's approach to asset management.

We published our findings from the assessment yesterday. There were some real positives.

First and foremost, the levels of engagement shown by the sector and willingness to co-create something beneficial together is a great example of what collaboration can achieve.

In addition, our review of the company submissions showed that companies have come a long way, and are really moving forward on areas such as emergency response and

contingency planning. They are demonstrating clear processes and plans for maintaining vital supplies when things go wrong and they are learning from experiences to continuously improve. Outcomes and performance commitments appear well embedded and integrated in how companies make decisions.

But the assessment also highlighted where more focus from companies might make positive improvements to the sector's operational resilience. Let me give you three examples:

- There's a need for company boards to take a greater interest in assets and asset health so that decisions are continuously viewed through the lens of assets and asset health.
- We also think companies need to have a more comprehensive suite of leading and lagging asset health measures. This will improve their understanding of the asset health risks and help to monitor the effectiveness of their strategies and plans.
- And companies need to develop better understanding and insight about whether their investments are actually delivering the improvements in performance that were intended.

The third thing that I would like to highlight that Ofwat has been doing to improve resilience is working with our partner organisations in RAPID to progress the development of **new strategic water resource options**. We know that over the next few decades, with increasing water demand and climate change, we expect there to be less water available, particularly in the South East of England. And we need companies and regulators to work together to address these challenges. So as part of PR19, Ofwat provided nearly £500 million of funding for companies to work together to deliver new water resources.

We're seeing good progress – all fifteen schemes involved passed our recent Gate One assessment. Over the next three to four years schemes will continue to be refined and optimised, and of course some schemes may drop out. And we expect the first new water resulting from the schemes to be delivered from 2027, with most solutions coming on stream in the 2030s. The potential to significantly improve water availability and resilience across England and Wales is considerable – If all these schemes are delivered, the result would be an additional fifteen hundred megalitres per day – that's enough for more than 10.5 million people.

And the last area I'll highlight is **direct procurement for customers**. We know that meeting the future needs of customers and the environment is likely to continue to rely on the delivery of some large infrastructure projects. It is important for customers that these investments are efficiently procured and delivered. So at PR19 we introduced Direct Procurement for Customers (DPC), as a process for water companies to competitively tender for a third party to design, build, finance, operate and maintain infrastructure.

And while we are in the early stage of implementing the DPC process, we are continuing to develop how we can better support delivery.

We're looking to enhance the long-term view of major projects. As I've already said, we're asking companies to increase their focus on the long term. And this should provide a pipeline of upcoming investments to potential investors covering not just the next five-year review period, but over the next 25 years. This longer-term view of investment needs will provide more time to assess the needs, costs and options of individual investments, aiding efficient procurement.

We're also looking at the incentives for water companies to engage with DPCs. We know that DPCs can offer better value for customers, but we have seen relatively few projects brought forward so far. We are considering whether we can enhance incentives for water companies to engage with the process to help improve value for money.

Finally on DPCs – we expect bidders to become increasingly familiar with the DPC process over time, and to carry learnings from one tender to the next as the process matures. But we believe that we can do more to assist and will look for opportunities to standardise the procurement process.

All of these measures should help encourage more DPC schemes going forwards, helping to make sure that new water assets are delivered efficiently.

Working in new ways

Working in new ways

The scale of change demands new ways of working:

- Thinking differently
- Greater partnership working
- Harnessing data

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There is a lot going on that will help to improve resilience, but when you look at the scale of change required to meet the sector's long-term challenges and goals, the only way to achieve these is to work in new and different ways.

Real change will be needed in how companies do things and what investments they choose. We cannot keep just pouring concrete – the whole sector will need to think differently about how it will deliver improvements going forward, both to ensure it can deliver the scale of improvement needed at an affordable cost but also to meet the sector's net zero targets.

We clearly need:

- Far greater partnership working to leverage input from third parties to help deliver even more for water customers, as well as wider benefits to society.
- To fully embrace nature-based solutions which can offer multiple benefits for customers and the environment.
- And the sector needs to work with customers on issues like water consumption and reducing sewer blockages.

I also want to pause on the importance of **harnessing data to its full potential**. With the roll-out of smart meters and networks, companies will have more data than ever before. And we need to maximise the potential benefits of increasing amounts of data to help identify problems more quickly – reducing the need for later, more costly interventions to resolve issues.

Companies also need to improve their data collection and monitoring. As highlighted in the AMMA, it is important that companies have good data on the asset health of their network. It is great to see some companies taking a lead in this area, for example Severn Trent and United Utilities developing forward looking measures of asset health.

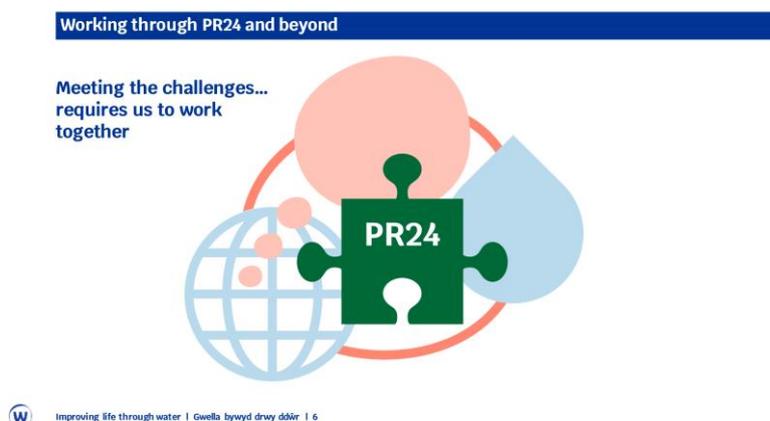
We are keen that water companies should explore the benefits of an **open data approach**. Open data can help to develop a better understanding of how companies can use data to increase resilience, to improve service efficiently; and to stimulate innovation. When data is more open, more people can access, use and share that data, and this will help address problems quickly and make us all make better decisions.

Individual companies often do not have all the data necessary to address these problems. Working together as an industry to collect, share and use data can help to stimulate innovation and improve performance, improve decision making and help companies adapt to changing environments.

We will shortly be publishing a document setting out our assessment of the sectors' approach to open data, highlighting good and developing practice across the sector.

All of this will contribute to making the sector more efficient – not simply through cutting costs, but by embracing innovative, win-win solutions.

Next steps



I'm really pleased with the engagement we've had around PR24 so far. We're still at an early stage in the process, and I want to continue the conversation on all of this – we have an opportunity now to translate our ambitions into practical action.

Improving the way we plan, deliver and maintain assets will be key to meeting the sector's long term challenges. It is important that we work together as a sector to meet these challenges, through PR24 and beyond. This will require changes across the sector, but if we work together, I am confident that the sector can meet these challenges and deliver a future that we can all look forward to.