

31 January 2022

Ofwat PR24 consultation: Financial resilience in the water sector

Introduction

Owned by pension funds, IFM Investors is one of the largest infrastructure investors globally, with more than £45bn of infrastructure equity assets managed worldwide. Drawing upon our 25+ years investing in the sector, we focus on buying high quality, essential infrastructure businesses which form the backbone of economies and societies. 98% of our nearly 600 investors are pension funds, including more than 60 here in the UK, which means the returns that we generate go towards supporting pension members. Those returns rely on receiving stable, predictable cash-flows over long periods of time. Any major changes to these cash-flows are ultimately to the detriment of the millions of pensioners that we represent.

Financial resilience in the water sector

Ofwat's discussion paper 'Financial resilience in the water sector' is built on a premise with which we disagree fundamentally: namely, that the current capital structure of the sector reduces its capacity to respond to the big challenges of the present and future, and as such is not in the interests of customers. We disagree so strongly because of Anglian Water's demonstrable success in meeting customers' everyday needs and tackling long-term environmental challenges in the East of England – the country's driest region and one facing substantial population growth pressures. Since we became a co-owner of Anglian Water in 2006, the company has built a reputation as one of the leading companies in the sector, delivering for its customers, the communities it serves every day, and for the pension fund beneficiaries who ultimately own it. Anglian Water has invested over £10bn into new infrastructure across this period.

Some of the recent evidence demonstrating this consistently strong track record:

- 2017: Business in the Community Responsible Business of the Year
- 2017: First utility company in Europe to launch a sterling Green Bond
- 2017: Committed the business to Carbon Neutrality by 2025 then in 2019 accelerated that commitment to 2030
- 2018: International Water Association Gold Award for Innovation
- 2018 Glassdoor (UK) Best Place to Work
- 2019: First company in sector to embed public interest objective into the company's articles of association
- 2019/20: Shareholders reinvest £165m in the business
- 2020: Queen's Award for enterprise: Sustainable Development for a second time
- 2020/21: Sector leading in Ofwat's service delivery reports
- 2021: Unveiled route map to achieve net zero by 2030

- 2021: First water company globally to issue a sustainability-linked bond connected directly to achieving emission reduction goals
- Today: No dividends paid since 2018

As the above demonstrates, our experience as a responsible long-term investor negates the proposition put forward by Ofwat that additional regulatory arrangements and licence requirements are required to deliver stable successful water and wastewater companies. The case study on Southern Water which underpins the paper is misleading. Southern Water contributes less than 10% of the total RCV of the sector and the case study is not relevant in understanding Anglian Water's performance; the extrapolation of Southern Water's case to others in the market is unjustified. Furthermore, even on its own terms the case study does not prove the financial structure at Southern Water to be culpable in explaining its operational issues. We invite Ofwat to take a broader look at the evidence and examples across the entire sector as part of this consultation phase. Compromising the freedom of shareholders and management to determine the financing structure most efficient in meeting the needs of customers and the environment is a course of action which demands a much more convincing and comprehensive evidence base than generalising from the Southern Water example.

Short-term versus Long-term

The overwhelming challenge the industry faces is the need to invest for the long-term. For the sake of future generations, short-termism will not do. The future of a liveable planet depends on investment decisions made now for the benefit of our future generations.

Anglian Water's extensive customer engagement programme during PR19 - acknowledged by Ofwat as industry leading – resulted in an unequivocal message from customers and stakeholders: investment for the long-term to address growing and urgent climate change impacts. That is why the Board of Anglian Water approved the ambitious business plan featuring a refreshed Strategic Direction Statement and 25-year Water Resource Management Plan.

The UK Government's National Infrastructure Commission ("NIC"), with its mandate to offer the long-term view, is calling for such transformational investment within the sector. The nation's National Infrastructure Strategy 2020 reflected this NIC perspective: the government committed to the investment needed over the coming decades to meet the UK's commitments to net zero – commitments contained in the UK's National Determined Contribution presented to the world at COP 26. Equally, both the House of Commons Public Accounts Committee¹ in 2020 and the House of Commons Environment and Audit Committee in 2022² call for more long-term water sector infrastructure investment to improve resilience and operations to ensure the assets are fit for the challenges of the 21st century.

We would also note that, were Ofwat to implement the proposed changes set out in the financial resilience and risk and return papers, this would reinforce a short-term regulatory approach which is squarely at odds with its stated objectives elsewhere in its suite of PR24

¹ House of Commons, Public Accounts Committee, Water Supply and Demand Management (2020), [URL](#)

² House of Commons Environmental Audit Committee, Water Quality in Rivers (2022), [URL](#)

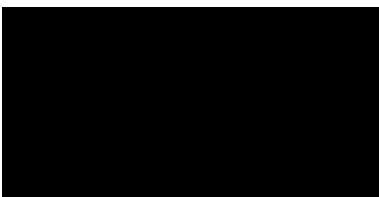
documents to encourage long-term approaches and enable a significant increase in investment to address critical customer priorities and environmental needs.

Ofwat should be encouraging the use of longer-term financing to underpin the increased investment in water and wastewater infrastructure necessary for it to meet its duties to customers and to wider society, not least in the context of the UK's commitment to net zero by 2050.

Approach going forward

We see with interest that the Water Industry Commission for Scotland – the economic regulator of Scottish Water – is recognising the challenges the water sector is facing, specifically the need for “doing regulation differently” to support a longer term approach.³ The change in Scotland's approach reflects the desire to avoid a trap which the English regulator is in danger of falling into – an overwhelming focus on regulatory periods which are too short to incentivise tackling environmental challenges that cannot be solved overnight but which must be addressed urgently. Scotland's approach is to begin with its 2045 net zero target and work backwards, aligning the water sector's future approach to outcomes that are recognised are needed to achieve this target. At the heart of its strategy is a candid shift away from the short-term thinking inherent in traditional regulatory models. We would, on this basis, encourage Ofwat to consider the Scottish model.

We would welcome further discussion with Ofwat on the issues outlined in this letter. As we have conveyed, these latest consultation papers raise major concerns around the direction of travel. Following the outcome of the extensive water CMA redetermination process, there was a modest improvement in sentiment towards the UK water industry. We are concerned that in attempting to re-open debates which were considered closed, and in some cases inappropriately relying on the outcomes of the CMA energy appeals, these papers represent a step backwards rather than forwards. It is difficult to make long-term investment decisions against a backdrop of such high uncertainty. The predictability of the UK's regulatory model has long seen it viewed as the gold standard globally - maintaining stability will support the inbound investment necessary to deliver the government's 'Plan for Growth'.



Head of Infrastructure – UK & Europe
IFM Investors

³ WICS A longer term approach [URL](#)