

## **Multi-sector water supply Assets: Possible Commercial and Legal Models**

### **Paper for Discussion at RAPID Pricing and Incentives Working Group Meeting**

22<sup>nd</sup> April 2021

The group has identified three priority areas for focus. This paper is focussed on the development of a working commercial model for multi-sector, multi beneficiary water supply assets (hereafter referred to as MSWSAs) which is likely to be the model for proposed SROs in the East of England.

This paper first summarises previous work commissioned and undertaken by Anglian Water and WRE, before outlining a draft problem statement, a case study to provide some broader context before summarising a set of next steps and recommendations for the work of the group to take forward.

#### **Work to date**

Three key pieces of work have been completed to date that provide a basis for the work the Pricing and Incentives Working Group will take forward.

#### ***Sink or Swim: A multi-sector collaboration on water asset investment. The Cambridge Natural Capital Leaders Platform, 2014***

- Explores four potential financing, ownership and governance models in the context of the Wissey Catchment in Norfolk.

Finance Model 1	Water company provides 100% of the up-front finance but splits financing between regulated and unregulated channels.
Finance Model 2	Splits the upfront investment between water companies and major water users in the catchment – farmers.
Finance Model 3	Engages a non-direct water user further down the supply chain – retailers.
Finance Model 4	Proposes a Water Service Company (WASCO) model which involves a third-party entity at the middle of the finance chain and serves as the key interface between the MSWSA, the investors and the water users.

- No single model is recommended as the preferred but the report identifies advantages and disadvantages of each but concludes that innovative financing models are crucial for the success of a multi-sector investment approach.
- Highlights that contractual arrangements that define the allocation of water resources amongst stakeholders is also crucial, along with regulatory guidance and support.

#### ***Financing Multi-Sector Water Supply Assets, FTI Consulting, 2015***

Identifies seven different financing models and undertakes comprehensive analysis including the allocation of risks and prevailing cost of financing under the respective options.

Single Water Company	A single statutory water company finances, builds and operates the MSWSA as part of its normal activities, using a standard corporate finance approach
Multi-Sector Joint Ventures	A group of water users e.g. farmers, supermarkets, power companies invest alongside the statutory water company

	through a Joint Venture arrangement to finance, build and operate the MSWSA
Special Purpose Vehicle	An independent SPV is established to finance, build and operate the MSWSA project using Project Finance. Ownership of the SPV could be opened up to a range of different investors.
Regulated / Unregulated Split	The MSWSA is split into two separate projects, one financed by a statutory water company for PWS purposes, and the other financed by other parties for both non-PWS and PWS purposes. Financing would be through a mixture of corporate and JV finance.
Pre/Post Construction Split	The project could be split temporarily. For example, a statutory water company could undertake the preparatory work, before other parties undertake the construction. Financing would be through a mixture of corporate and project finance.
Statutory Water Company Joint Venture	Two or more statutory water companies could form a JV to finance the MSWSA.
Water Company Shareholder Joint Venture	The parent companies or two or more statutory water companies could form a JV to finance the MSWSA separately from the regulated statutory water companies.

- The paper concludes that there is no definitive preferred financing options, but highlights that the benefits of opting for a multi-sector JV or SPV model would need to be carefully considered against the likely higher financing costs of these options compared to options which solely utilise corporate finance.
- Highlights that the proportion of the water from the MSWSA that would supply statutory water company customers is likely to influence the model adopted.
- Summarises key legal and regulatory issues relevant to the financing of MSWSAs and states that all of the options would require some amendment to existing legislation in order to be feasible.

***Consideration of Legal Forms. Paper produced by the AMP6 Water Resources East Financing Group, 2017***

Analysis considers some of the issues associated with the legal form of a MSWSA and sets out considerations for financing, governance and operation. A range of stakeholder interests are considered, and in this context the analysis considers the options for forming a “social enterprise.”

Four legal forms are considered:

- Company Limited by Guarantee
- Company Limited by Shares
- Community Benefit Society
- Community Interest Company (CIC)

With respect to funding, the analysis considered in some detail the model adopted by Housing Associations and the ability to access equity investment and grant funding.

The four models are assessed in respect to the ability to:

- Create a collaborate stakeholder forum
- Secure equity investment
- Raise external debt
- Gain access to government funding

- Delivery flexibility
- Be scaled up or down depending on the size of the MSWSA

The analysis demonstrates that no single model satisfies all the requirements above but that the use of a hybrid model (using a combination of Community Benefit Society, Company Limited by Guarantee and Company Limited by Shares), which would enable the organisation to realise both its social and commercial ambitions. In addition, focussing on a “right to water” rather than a right to dividends it may be possible to devise a structure which does not require investment by conventional equity investors

### Case Study – Future Fens: Integrated Adaptation

This case study is included to provide some broader context to the proposals and illustrate the scale of ambition that exists in relation to promoting solutions that deliver multiple economic and wider societal benefits, along with addressing the pressing water resources challenges we face in the Anglian region. The South Lincolnshire Reservoir Strategic regional option (SRO) and Fens Reservoir (proposed to join the RAPID programme at Gate 1) are being explicitly considered in the context of the Future Fens: Integrated Adaptation strategy.

The Fens is the area of the UK most exposed to climate change, on the frontline of rising sea levels, and is the driest part of the country, with water resources a presenting a key challenge. Centuries-old drainage infrastructure treats water as a threat to remove, rather than a resource to conserve. This damages biodiversity and stops farmers making best use of their land. Meanwhile, increasing flood risk exacerbated by climate change holds back development – trapping residents in a low-value, low-wage economy.

A ground-breaking partnership is coming together in the Fens between key partners with a responsibility for water managing in the area, drawing on lessons from the Netherlands, utilities Dutch water engineering expertise, and applying it to the challenges faced in the Fens,

The ambition of the partnership of to create a new water management system that will address many of the challenges faced by the Fens and deliver economic, environmental and social benefits.

The ability for the partners to promote a MSWSA in the Fens as part of the wider ambitions of the partnership is critical to the success of the overall strategy and the work on commercial models being proposed in this paper is a key to unlocking the potential benefits a MSWSA could deliver in the Fens.



## Draft Problem Statement

The complexity of the challenges we are currently facing for meeting our collective future water resources needs mean that, for certain regions, a single sector approach to developing new water supply assets **no longer represents best value** for customers or the environment.

The ambition is to move to developing multi-sector, multi-beneficiary water supply assets that could deliver more sustainable, longer term benefits to public water supply, agriculture, flood risk management, energy and the environment and at lower overall costs compared to these issues being addressed individually.

This approach is widely supported by regulators and stakeholders and can help to reduce the costs ultimately faced by customers, supported by the assets in question being subject to competitive procurement by the Direct Procurement for Customers.

However, more work is required to establish a workable commercial and regulatory model. Three comprehensive studies have already been undertaken since 2014, in addition to work understand with the sector previously relating to water resource trading and bi-lateral market development but further work is required to agree on a preferred commercial model that can be taken forward as a working model for the delivery of Strategic Regional Options in AMP8 and beyond. This should probably take the form of a consultancy project is probably needed to help progress this at pace, with input from members of the RAPID group.

## Key Principles and Next Steps

Based on the work completed to date, the following may be key principles to be borne in mind when considering a commercial model suitable for the delivery and operation of MSWSAs:

- Governance arrangements need to be flexible, such that the key stakeholders have an appropriate level of input at key stages of the project;
- Needs to have access to a range of financing options;
- Needs to be able to effectively work within a regulatory framework, which that water companies and other, non-regulated stakeholders, can jointly invest in a single asset; and
- Needs to specifically consider design, build and operate phases of the project and the range of stakeholders who may wish to be involved during each phase.

The work to date has been comprehensive, but all three of the studies conclude that there is no one model that fulfils all the criteria. The studies were also undertaken prior to the recent work by Ofwat and water companies during PR19 in relation to the Direct Procurement for Customers model and also prior to the publication of the National Policy Statement for Water Resources Infrastructure (which is pertinent to the issues around legislation raised in the FTI report).

It is therefore recommended that a new study now be commissioned, with the aim of coming forward with a commercial model that could be implemented in the delivery of one or more of the SROs in the RAPID gateway process (for example the South Lincolnshire Reservoir).

The study should take account of the work completed to date and take account of the more recent work completed on the DPC model and conclude with a working recommendation that can be taken forward by RAPID, water companies and other stakeholders for implementation in AMP8.