

July 2022

Creating tomorrow, together:
consulting on our methodology for PR24

Appendix 1 - Affordability

About this document

This appendix sets out our approach to affordability at PR24.

First, it explains why affordability is important and the different dimensions of affordability we consider. It then explains the main policy tools we propose to use at PR24 to address affordability, and how we use our wider toolkit too. It finishes by explaining how we intend to assess affordability at PR24.

1. Dimensions of affordability

Affordability in the water sector is the ability of a customer to pay their water bill. It can be measured in a variety of ways, and we note that other regulators define affordability differently.¹ CCW's independent water affordability review used the metric of customers spending no more than 5% of their income (after housing costs) on their water bill.²

For PR24, we are proposing that companies develop business plans that deliver:

- overall affordability, including providing value for money;
- affordability for current and future customers; and
- affordability for residential customers struggling, or at risk of struggling, to pay.

PR24 is our primary tool for regulating companies to deliver overall affordability, value for money, and affordability for current and future customers.

1.1 The importance of affordability in water regulation

Affordability is an acute issue. It is estimated that around 1.5 million households are spending more than 5% of their income (after housing costs) on water and 4.1 million spend more than 3%.³ Our recent cost of living report revealed that just over half of water bill payers believe they will struggle to pay a utility bill over the coming year, rising to 7 in 10 if there are children in the household.⁴ CCW conducted qualitative research with customers ahead of publishing its report on objectives for PR24: it reported customers' top priorities related to affordable bills in exchange for clean, reliable water.⁵

¹ For example, Ofgem often focuses on definitions of fuel poverty, and Ofcom often refers to a good or service being affordable if consumers can purchase it without hardship.

² CCW, '[Independent review of water affordability](#)', May 2021.

³ CEPA, '[Quantitative analysis of water poverty in England and Wales](#)', March 2021.

⁴ Ofwat, '[Cost of living – water customers experiences](#)', May 2022.

⁵ CCW, '[Delivering for customers at PR24: CCW's objectives for the 2024 Price Review](#)', May 2022. See also CCW, '[PR24 Objectives: Yonder debrief](#)', May 2022.

Affordability is an important issue for both the UK and Welsh Governments, as reflected in their respective strategic priorities and objectives for Ofwat.^{6 7} And our statutory duties include a need to further the consumer objective, including the need to have regard to the interests of low-income consumers.⁸ We see affordability as a key challenge for PR24. And the importance of delivering affordable business plans underpins each of the ambitions we have identified for PR24: focusing on the long term, delivering greater environmental and social value, reflecting a clearer understanding of customers and communities, and driving improvements through efficiency and innovation.

⁶ Defra, '[The government's strategic priorities for Ofwat](#)', 28 March 2022. For example, the UK government's SPS states that "...it will be vital that support is in place for those who may struggle to afford water bills", and that "Ofwat must consider the affordability of bills for the generality of customers, as well as requiring that water companies have protections in place to support households who struggle with their water bills."

⁷ For example, the Welsh Government's strategic priorities for Ofwat include challenging companies to deliver value for money for customers, communities and the environment, seeking to ensure that the timing of investment results in intergenerational equity, and challenging companies to provide effective support to customers who are struggling to pay.

⁸ UK Government, '[Water Industry Act 1991](#)', Sections 2(2A) and 2(2C)(c).

2. Our approach to affordability at PR24

In line with our ambitions for the price review, we expect companies to support affordability at PR24 through:

- taking a long-term focus to reduce lifetime costs and phase investments over time;
- finding new ways of working, and working in partnerships to deliver more for customers;
- clearly understanding customers' views, including their expectations about bills today compared to the future;
- clearly understanding and supporting customers' diverse needs on a day-to-day basis, not just for a price review; and
- innovating and delivering a step change in efficiency.

2.1 Our toolkit

PR24 is our primary tool for regulating companies to deliver overall affordability, value for money, and affordability for current and future customers. We also use our wider toolkit outside of PR24, particularly to support customers struggling to pay their bills. This includes our charging rules and guidelines on debt management, and our wider work on affordability with CCW and others. We set out our key policies in Tables 3.1 and 3.2 below.

Table 3.1 PR24 policies to support affordability overall, for current and future customers

Area	Detail
Long-term focus	Increasing our focus on the long-term in price controls, we propose that companies set out their five-year business plan in the context of a 25-year delivery strategy. We expect business plans and long-term delivery strategies to demonstrate how they deliver fairness between current and future generations. This includes considering how to best phase investments over time, with trigger and decision points clearly described. We will be looking for a core pathway based on investment that is required across a range of scenarios and keeps future options open.
	A transparent and predictable regulatory regime encourages long-term investment, supporting affordability.
	Transparency in our regulatory approach, supported by evidence-led changes that are consulted on as they evolve over time, minimising the size of any regulatory risk premium in required returns, facilitates companies making efficient investment decisions over the long term.
New ways of working	To encourage new ways of working, we are encouraging partnerships between companies and other stakeholders, for example to implement nature-based solutions, to reduce costs to companies and support affordability.
	We will take into account third-party funding when we undertake our cost benchmarking, to encourage partnerships.

	In Wales, the PR24 forum will provide an opportunity to consider affordability in a Welsh context, which will help to ensure that companies reflect this context in their long-term delivery strategies and business plans.
Customers' views	We propose several new approaches that will strengthen stakeholders' roles in the process, especially customers.
	There will be better clarity of customers' priorities through more robust customer research.
	We propose open sessions for stakeholders, including customers and community groups, to challenge companies.
Customers' diverse needs	We expect companies to engage meaningfully with customers to understand their diverse needs and perspectives, including on affordability concerns. We expect companies to demonstrate that they have adopted the common approach to testing of customers' views. ⁹
	We expect the companies' approaches to include explicit consideration of their customers' financial constraints. For PR24, we are working with CCW and companies to deliver a more consistent approach to testing customers' views of the affordability and acceptability of plans. ¹⁰ We aim to publish the agreed approach by October 2022.
	We expect companies to explain how their long-term delivery strategy protects customers' ability to pay their water bill over the long term, and how the strategy delivers fairness between what existing customers will pay for and what is paid for by future customers.
	We will be testing companies' business plans to the extent they have met our expectations of quality in taking account of affordability concerns. We will also reward companies that demonstrate ambition in this area, depending on whether the plan overall represents value for money.
Innovation and efficiency	In setting expenditure allowances, we expect to make greater use of benchmarking, incentivising all companies to deliver expenditure efficiently. We expect companies to deliver a step change in efficiency so that they can deliver the improvements required by government and regulators in an affordable way. Our expectations in this area will be stretching but achievable.
	We propose to retain cost sharing, so that companies are incentivised to spend efficiently, as they keep a share of any underspend, but also have to fund a share of any overspend.
	We set stretching but achievable performance commitment levels from efficient base costs. Companies will only be rewarded for going beyond these performance commitment levels where the benefits of doing so outweigh the costs to customers, or represent value for money to them.
	Price Control Deliverables (PCDs) facilitate money being returned to customers if companies do not deliver schemes which customers have funded.
	We expect companies to innovate, such as by making better use of markets. For example, we propose to focus competition on the delivery of large infrastructure projects through Direct Procurement for Customers (DPC). This is where companies put major projects out to competitive tender for delivery by third parties, which reduces the costs paid by customers through competitive pressures.
	We propose to continue with the Innovation Fund to encourage companies to find new ways to deliver and share learning.

⁹ We will propose the data requirements related to affordability that we expect companies to include in the PR24 data tables once the common approach to testing affordability and acceptability of business plans is developed.

¹⁰ Ofwat, '[PR24 and beyond position paper: Collaborative customer research for PR24](#)', October 2021.

Table 3.2 Other regulatory tools to support affordability, particularly for customers struggling to pay their bills

Area	Tools
Insight	<p>Customer insight: We conduct our own customer research to better understand the challenges customers are facing, as well as to inform our policy on affordability, and to challenge companies to improve. Examples include research on the cost of living (May 2022) and Listen, Care, Share campaign (July 2021) about water customers' experiences during the Covid-19 pandemic, including the different types of support required and offered.¹¹</p> <p>Our research has identified low awareness of the support that is available to customers struggling to pay their water bill.</p> <p>We also work with CCW on joint research projects.</p>
	<p>Company insight: We monitor performance through Annual Performance Reports (APRs) and ad hoc requests. This includes affordability metrics.</p>
	<p>CCW's independent review of water affordability recommended introducing a single social tariff with consistent eligibility criteria across England and Wales. The UK and Welsh governments are working with the sector on the potential to implement this recommendation from April 2025 onwards. Prior to such an implementation, we expect companies to retain and develop their social tariff offering, having regard to existing government guidance.</p>
Social tariffs and charging rules	<p>CCW's role includes providing advice on the support available to customers struggling to pay their bills, and handling customers' complaints about companies.</p>
	<p>Companies' charges, and hence water bills, must comply with our charging rules. We require companies to consult with CCW before finalising their charges each year, and to undertake additional reporting if their charges increase significantly. Being high level, our rules give companies the flexibility to take responsibility for setting their charges, including introducing charging innovations. We have the flexibility, with governments' support, to change our charging rules and are planning to consult in the autumn, following a recommendation of CCW's affordability review, on whether the rules should more explicitly support customer affordability.</p>
Licensing and guidelines	<p>Guidelines: We issue guidelines to companies on how to support customers to pay their bill, access help and repay debts,¹² consistent with the recommendations of CCW's affordability review.</p> <p>We are taking forward work to consider additional protections for customers, including customers in vulnerable circumstances, through development of a new customer-focused licence condition for water companies.</p>

¹¹ Ofwat, '[Cost of living – water customers experiences](#)', May 2022. See also Ofwat, '[Listen, Care, Share: Water customers' experiences during Covid-19](#)', July 2021.

¹² Ofwat, '[Paying fair – guidelines for water companies in supporting residential customers pay their bill, access help and repay debts](#)', May 2022.

**Ofwat (The Water Services Regulation Authority)
is a non-ministerial government department.
We regulate the water sector in England and Wales.**

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