



South Staffs Water

Green Lane, Walsall WS2 7PD
www.south-staffs-water.co.uk

7 September 2022

By email: [REDACTED]

Dear David

Thank you for giving us the opportunity to respond to Ofwat's consultation on the PR24 methodology. We welcome the opportunities it presents to enable us to carry on driving our business forward in terms of the services we deliver to our customers and the vital role we play in protecting and enhancing the environment for future generations.

We recognise the challenges we face in the next AMP and beyond are considerable – not just as a water only company delivering clean, high-quality water supplies at an affordable price, but also as part of the wider water sector. Being resilient to a changing climate and a growing population, playing our part to help the sector deliver net zero operational emissions by 2030, and continuing to meet customers' rising expectations are all key objectives for our business going forward.

So, we are supportive of the focus in the draft methodology of setting our PR24 business plan in the context of a more long-term, adaptive framework. We believe this approach to business planning will give us the flexibility to adapt to changing circumstances while at the same time continue to deliver those things that are important to our customers – excellent service, affordable bills, support for the most vulnerable in society, and an environment that is protected and enhanced for future generations.

However, we do have some concerns, which we set out in more detail below.

Financial resilience, cost of capital and retail indexation

We understand the importance for the sector on maintaining credit quality, but this is a responsibility for both Company and Regulator. For its part Ofwat has a key role in making sure efficient water companies are funded at a level that allows them to maintain a target credit rating. Key to this is an appropriate cost of capital and a notional capital structure that reflects rating agency guidance.

There are additional credit challenges for the smaller water only companies. As you know the company issued a long dated index linked bond in 2005 through the, then, innovative and cost effective Artisian programme. Unlike WaSCs and the larger WOCs we have subsequently not benefited from either a large WBS programme or a portfolio of debt instruments. It is fact that this instrument is expensive by today's standards and leaves the company exposed to (1) the decision to end RPI indexation of the RCV and (2) a mismatch between RPI and CPIH. Together these factors



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expose the company to additional credit risk which can best be mitigated by a company specific cost of debt allowance and deferring the decision to switch to full CPIH indexation of the RCV until such time as the [REDACTED] RPI and CPIH.

With regards to the retail price control, by 2025 we will have had ten years with no indexation allowance on costs. As a large proportion of costs in retail are in man power or bad debt, we do not think it is realistic to assume this continues for a further five years and would support a sector-wide indexation allowance. This is a higher risk to smaller water companies as retail revenue is a higher percentage of total appointed revenue when compared with the water and sewerage companies.

Accounting for past delivery

We appreciate the detailed criteria provided for the quality assessment to ensure our plan is sufficient quality and meets the minimum expectations set out in the round. However, we are disappointed to see that past delivery will not be seen as a key driver for ambition at PR24. We think that reflecting on past performance is key to giving customers confidence that we can deliver the things they have said are important to them. Therefore, we ask Ofwat to consider maintaining "Accounting for Past Delivery" as a criteria for quality assessment as it indicates the credibility of the delivery of future plans.

Cost of living crisis

While it is not part of the PR24 consultation, we also feel it is important to raise the potential impacts of the current cost of living and energy bill crisis on PR24 and the water sector in general. The potential impact of this is deep and wide ranging.

First, there is the impact on customers of cost of living increases – particularly energy, fuel and food. The inflationary pressures associated with these will also have a knock-on effect on to many other areas of people's everyday costs. In comparison with energy, the water bills our customers currently pay are relatively low and stable. However, if they can no longer afford to pay their energy bills, or they have to prioritise energy, fuel or food over other costs, then there is a real risk of this impacting their ability or willingness to pay their water bills. In addition, the current crisis creates a risk of wider recession in the economy, as signalled by the Bank of England recently. This could impact customer's incomes and increase the demand for social tariffs or other financial support, with rises for the water companies beyond what these schemes are able to cover.

Second, it is also important to consider the impact on customer perceptions and in research studies. We are already seeing evidence in the customer acceptability and affordability testing study of our draft WRMP24s that is currently in fieldwork that events currently playing out, and particularly the increases in the cost of living, are having a notable impacts on customers' views that the sector tries to evaluate during price reviews. If no further significant central Government support is provided to households and businesses is announced in the coming weeks, this increases the risk that levels of investment that customers have previously considered acceptable and affordable are no longer considered to be so because of these external pressures.



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Third, we think it is important to also take into account the impact on water companies' direct and supply chain [REDACTED] inflation falls back to lower levels, it is very possible that high energy costs will persist for a number of years – as a sector, we are dependent on energy for abstracting, treating and supplying water. Different part of our supply chain are also energy dependent – for example, to manufacture the chemical we use in our treatment processes. The expiry of energy contracts within the sector and its supply chain over the next few years could see a substantial rise in these costs, depending on the operating conditions at the time. There are also risks for us and our supply chain around labour costs, given the obligation we have to support our people during the current cost of living crisis.

On the whole, we believe there is a high potential for events currently escalating in the wider economy to seriously impact the water sector. In addition, we believe that while there remains considerable uncertainty in this, it would be prudent for Ofwat and the sector to build contingency in the PR24 business planning process to allow for this.

I would be happy to discuss any of these points in more detail if that would be helpful.

Yours sincerely

Andy Willicott
Managing Director, South Staffordshire Water PLC