Future of Utilities: Water

Transforming the sector – the challenges for companies at PR24

Aileen Armstrong, Senior Director, Company Performance and Price Controls

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I'm delighted to be here this morning to start proceedings. There's an impressive array of speakers and I'm sure we will enjoy some rich and informative discussions. Let me get the ball rolling.

The challenges for companies at PR24

You'll hear a lot today about the pressures the sector is facing. Water resources. River and bathing water quality. Climate change. Cost of living pressures. The issues themselves aren't new. But in the face of continued public concern the sector's every action is given greater scrutiny.

Recently, there's been close attention on how companies are dealing with the pressures on water resources. And there's strong, continuing concern about sewage discharges.

We've seen from our own research that all of this has led to a steady decline in trust in water companies. The scale of the challenge is already evident.
The UK Government has set a range of targets for the water sector as part of the Environmental Improvement Plan. By twenty-fifty, the sector needs to have eliminated ecological harm from sewage discharges, and leakage must have been halved.

And the Welsh Government wants to see companies acting with ambition and pace to address the climate and nature emergencies. It has clear expectations to protect the interests of customers and to drive cross sector action to address nutrient pollution in rivers.
We know that solutions to these challenges will take time and money. The sector needs to be seen to be responding with vigour and urgency. Companies need to drive a transformation of the sector. And what they deliver through PR24 should be a big part of that transformation.

Companies' business plans are due in just under 200 days. This morning I want to talk about two things:

- First, the importance of thinking creatively and planning effectively to identify best value solutions to the challenges the sector is facing
- And second, the need to think practically about how plans can be implemented – to ensure that plans are deliverable on the ground, have the right financial foundations for that delivery, and that they are affordable for customers

The importance of long-term planning

So I want to look first at the planning approach that companies are taking in the run up to PR24.

Over the past couple of years, companies have been working with stakeholders to put together their long-term strategic planning frameworks. We have assessed draft versions of these plans, and provided feedback ahead of the final versions.

These include the water resource management plans, or WRMPs, and the drainage and wastewater management plans, or DWMPs, which set out how the company will deliver key outcomes in these areas over the next 25 years. Companies are also developing their programmes to protect and improve the environment – the WINEP in England, and the N-E-P in Wales.

What unites all these frameworks is that –

- o they should identify best value solutions;
- o they should focus delivery on outcomes as far as possible; and – crucially
- o they need to take a genuinely long-term view of what's needed over the coming decades.

I've already touched on the wide range of targets and ambitions the sector needs to meet. So - there's clarity about what needs to be achieved, and by when. Companies need to step back and consider their actions carefully.

Like anything else, the task seems more manageable once you break down everything that needs to be done into bite-sized chunks. And we have 5 five-year chunks – our price control periods – until 2050, when many of these targets should be achieved.

At PR24, we expect companies to bring all the planning frameworks together, into a holistic, 25-year ,long-term delivery strategy. The idea is for companies to demonstrate that the first five-year chunk, the PR24 business plan, is the right one to kick off the trajectory towards ambitious long-term outcomes.

As I mentioned, we've now had the chance to assess some of the main ingredients that will be feeding into these strategies. Let me pick out some of our main observations.

We expect the investment that's driven by these frameworks – the WRMPs, DWMPs and environmental programmes – to rise significantly at PR24 compared to previous price reviews. The draft WRMPs, for example, are the most ambitious we have ever seen. By 2050, companies aim to provide water supplies that are resilient to a 1 in 500-year drought event, while reducing per capita consumption to 110 litres per person per day, as well as halving leakage levels.

So companies are going to be asking their customers to fund a significant step-up in investment, and it's essential that the companies are able to justify their planned investments properly – they need to demonstrate that their plans are going to deliver the best value for customers and the environment.

And companies also have a responsibility to be ambitious about the improvements they can make from existing and ongoing allowances, without additional customer funding.

Looking at the draft WRMPs, we've seen that the step up in water needs hasn't been matched by an attendant increase in the range of options identified to meet those needs. And, while the ambition is there on reducing the demand for water, the plans for achieving this efficiently often lack detail.

Looking at the draft DWMPs, the quality of information around the costs and benefits of solutions varied significantly across companies, particularly for schemes with multiple benefits.

And we've seen similar issues in companies' WINEP submissions. Although companies have demonstrated some optioneering, different options often haven't been costed and wider environmental benefits haven't been detailed. Without this information, it's uncertain whether a best value programme is being presented.

Companies need to give their customers confidence that they will meet their targets in a best value way. And to really ask themselves: are there better options out there that haven't been considered?

Another key observation is that, given the scale of the task, there has to be a real change in how companies deliver outcomes. That means new ways of working and innovative new solutions.

We've seen some evidence of companies rising to the challenge. We've been encouraged, for example, to see companies working together to produce the first regional water resource plans.

And the Advanced WINEP submissions have also shown some fresh thinking. The Advanced WINEP is about delivering more and better value through the WINEP, and identifying what the barriers might be to doing this. We've seen some exciting nature-based and catchment-partnership proposals, covering both urban and rural challenges associated with nutrient control, rainwater management, groundwater improvement, carbon reduction and biodiversity enhancement.

But we need to see more of this fresh thinking. And it is stark that, in the draft DWMPs, many companies failed to show they were prioritising nature-based solutions or surface water separation options. And we don't think companies are maximising the potential of partnership solutions to deliver better drainage and wastewater outcomes.

So while there are some great examples of companies taking forward innovative, non-traditional solutions, we need to be seeing companies turning to these ideas by default.

And a further observation is that meeting long-term targets in the most intelligent way will require a sustained shift towards adaptive planning.

So, adaptive planning means that investment decisions are taken in the context of future scenarios. It allows for informed consideration of how to phase the investment programme given long-term uncertainty.

We know that there are opportunities and uncertainties ahead – whether its new technologies that can bring rapid, transformational changes, or the fact that forecasting changes in climate or population is far from an exact science. We mustn't assume we know how the future will turn out – that's likely to be a recipe for inefficiency and wasted effort.

We expect the WRMPs and DWMPs to be adaptive, but our review of draft plans suggests there's more work to do.

Talking to companies over the past couple of months about their approaches, some companies are thinking hard about how they can invest intelligently. The leading companies are prioritising investment in 2025 to 2030 that they are unlikely to regret down the line – either because it's the right option regardless of how the future turns out, or because it sets the company up to take advantage of future opportunities. But some in the sector need to catch up here.

The industry now has an important opportunity to improve their plans, ahead of final submission. With such pressing challenges, customers and the environment need them to grab this opportunity – they need to provide the right evidence, show fresh, innovative thinking, and plan intelligently. We've already seen enough good practice to be confident that this is achievable.

Key issues for business plans

So now, I want to turn to three key issues that companies need to be considering as they finalise their plans. Companies need to produce plans that are deliverable on the ground, have the right financial foundations for that delivery, and they need to be affordable for customers

So, on deliverability

The sector needs to ramp up its capacity to deliver works to meet the considerably increased investment demands of PR24. And it needs to do this against a background where some companies are under-delivering against their investment allowances in this current price review period.

It's critical that companies can evidence that they have robust plans in place for the challenge ahead. We want to ensure that companies' plans are deliverable, and we want companies to demonstrate this clearly to help to build confidence in the sector's ability to deliver the long-term goals.

These plans cannot be developed in isolation from the supply chain who will be relied upon to deliver much of the work. So we expect companies to be taking active steps now to engage with the supply chain to understand key risks and mitigations, and ensure that preparation for a substantial increase in expenditure is underway. To ensure that companies do this we have set out additional requirements for board assurance on deliverability and supply chain availability within our final methodology.

Companies also need to ensure they have the right financial foundations.

Companies need to consider how they will finance the increased investment. And alongside this, they will need to refinance the substantial amount of debt maturing between twenty-twenty-five and twenty-thirty.

Companies should already be progressing with planning how they will fund the necessary investment over the next period.

Based on current projections about the size of the capital programme for the next period we expect there will be a need for fresh equity to support RCV growth. And we expect the sector to continue to be attractive given the relatively predictable index-linked revenue allowances and the opportunities for this RCV growth.

The size of the investment requirement will vary between companies. And the impact on companies will be different depending on their levels of financial resilience.

All companies need to be ensuring that they maintain adequate levels of financial resilience for PR24 and into the future. It is vital that companies sort out any issues in advance of 2025. We highlighted concerns about a number of companies in our monitoring financial resilience report last year. Those companies need to take whatever steps are necessary now to be in a robust position to deliver the investment required at PR24.

This morning, we have set out changes to company licences to improve financial resilience. We have made it a formal licence requirement for companies to take account of key issues when setting dividend payments. They must take account of their performance for customers and the environment, as well as future investment needs and long term financial resilience when deciding what dividends to pay. And the licence condition also formalises the existing expectations about companies needing to explain clearly their dividends in the context of their performance. It also provides us with more formal powers to take actions where companies pay dividends which do not clearly reflect their performance.

And, from April 2025, the licence will also prevent companies from paying dividends if their credit rating is at risk of the falling to the bottom of investment grade.

Companies also need to ensure that their approach to performance related pay for their executives inspires trust that they are operating their business in line with the expectations of a monopoly provider of an essential public service. We have been clear that remuneration committees should exercise judgement to take account of overall performance when making their decisions on performance related pay.

And finally, I want to talk about the need for companies to ensure that their business plans are affordable.

The first step is to think long term and to consider carefully the phasing of investment. I've already spoken about the value of having a long-term delivery strategy, and effective long-term planning. Companies should phase investments over time to meet their commitments in a way that's sensitive to the challenges that customers are facing right now.

And of course, good adaptive planning relieves affordability issues over the long term as well as the short term. That's because it aims both to avoid unnecessary investment, and to ensure companies can ride the wave of future innovations as much as possible – therefore reducing the long-term costs of meeting outcomes.

Companies can also ensure fairness between customers today and in the future through the rate at which they recover their efficient costs of running the business and investing in new projects. There's an important balance to be struck between pay as you go and RCV run-off rates.

We expect companies to propose RCV run-off rates that have regard to balancing the recovery of costs between different generations of customers and affordability for customers. The cost of previous investment held within the RCV should be allocated fairly to customers in a way that represents the period over which that investment provides services to customers.

Effective planning of investments and the right choices about RCV run-off rates will go some way to addressing the affordability challenges.

But of course, companies need to do more than that. We will continue to push companies to provide prompt, accessible support to those customers that need it most.

And we have been clear that companies should not be waiting until PR24 to take action on the affordability challenges. Last year, jointly with CCW, we wrote to all companies asking them to do more to support customers given the current cost-of-living pressures. Many companies responded positively and we particularly welcomed the cases where companies were contributing their own money to fund financial support measures.

But there is scope for more companies to increase funding of social tariffs through shareholder contributions. And to improve customers' access to support, and awareness of what is available. And we will look at what companies are doing to support affordability when we come to assess business plans for PR24.

We have also been calling on water companies to think more creatively about charges and to establish trials directed at supporting customers struggling to pay. This could include seasonal charging to help lower water bills in the winter. Similarly, customers who use a lot of water, for example those with swimming pools or large scale sprinkler systems, could be charged a premium for very high use, particularly at times when water is scarce.

And I'm pleased to announce that Affinity Water has answered this call, and it plans to begin a trial this year. The company will be testing a new charging system with a small group of customers using a rising block tariff. That means different levels of water consumption will be charged at different rates. The aim here would be for water to become more affordable for more of its customers, while also providing incentives to reduce water consumption. Along with the company, we'll be sharing more information on this in the coming days. We welcome this innovation and we want more companies to follow this lead and develop charging trials for next year.

Rising to the challenge

We're due to get business plans on the 2nd of October. Of course plans need to get the basics right for their customers. But the plans also need to be underpinned by effective planning. And plans need to have tackled the challenges of deliverability, strong financial foundations and affordability.

Ultimately we want to see plans which will significantly push forward the sector's performance for the benefit of customers, communities and the environment. That's our ambition for PR24 and one which I look forward to seeing the sector realise.

Thank you.