

THE WATER REPORT EXPERT FORUM

Please help us get fast feedback on key industry issues and policies by joining our The Water Report Expert Forum. The process is simple, easy and completely anonymous. You will be emailed a survey once every few months by our research partner Accent, to complete online. Accent send us aggregate, anonymised data which we report in the following issue.

We are actively seeking new members, so if you are working at a reasonably senior level in the sector, within a company or at another stakeholder organisation, please email karma@thewaterreport.co.uk to join. Thank you very much to our existing members.



A LOT ON THEIR PLATES

Can water companies feasibly balance all delivery demands by 2030?

Judging by the results of our most recent The Water Report Expert Forum poll, it is going to be an incredibly close call whether water companies can feasibly deliver everything being asked of them by 2030.

Expectations are running high. As Ofwat put it in the

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final methodology for PR24, companies “need to transform their performance to help rebuild trust and confidence in the sector”. As well as day-to-day operational service, this will include delivering new environmental outcomes, increasing resilience in more adverse circumstances, offering more for customers, increasing efficiency and potentially adopting different corporate behaviours.

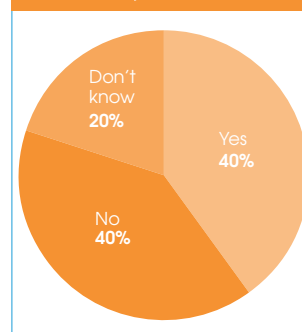
We asked The Water Report Expert Forum for views on the outlook for these greater expectations.

Theory of everything

Opinions were polarised on the question of whether water companies can feasibly deliver everything being expected of them by 2030, as chart 1 shows.

A number of those who felt it will be possible noted that

CHART 1: CAN WATER COMPANIES FEASIBLY DELIVER EVERYTHING BEING EXPECTED OF THEM BY 2030)?



this will hinge on the appropriate level of resourcing and investment being allowed. Others who were positive offered the caveat that expectations must be realistic. One for instance said: “I believe that the water companies can deliver what is expected of them by their customers by 2030 providing there is thorough engagement and explanation of the compromises that will be needed between wishes/ambitions and realism/expectations.” Another noted: “Progress on too many fronts is not realistic. Our engagement with stakeholders is going to be critical to set expectation, but we will have to show progress and a willingness to strive for better performance.”

One participant remarked there is little choice for the industry: “The issue is not whether it’s feasible to deliver what’s needed – it will be difficult but not impossible – but whether the companies can afford to not deliver. Politicians and customers are becoming frustrated and impatient!”

Among those who felt water companies would not be able to deliver everything expected of them, one contributor summed up the situation as follows: “The scale of achieving all of these expectations simultaneously across the whole sector, within the deliverability, affordability and financeability constraints which the sector faces, makes for an infeasible scenario.”

Others highlighted specific limitations. Affordability came up frequently. One Forum member said: “The total cost of doing everything will be very difficult for Ofwat to accept, as they cannot be seen to be putting bills up by 20-30%.” The contributor went on to offer an interesting suggestion that might go some way to addressing this problem: “If there were some messaging on this around a special tariff for environmental improvements (CSOs) as a temporary additional charge on bills, that could help, but the political landscape and household hardship may prevent bills being increased, so the work will not get done. There is a further risk that this is compounded by lack of public understanding of the asset challenges, so the water companies could be unfairly criticised here too.”

Other factors raised as constraints included capacity, skills and supply chain limitations (see p8). One participant commented: “We appear have got ourselves in a position in which ambition is not always tested against evidence or deliverability. Too much appears to be driven by media and politics. We need our leaders and regulators to work more collaboratively together.”

A couple of Forum members challenged the premise of the question. One pointed out that the realisation of many outcomes will need to extend beyond 2030, and – regarding

resilience – this may not have been tested by extreme conditions by 2030 either. Another highlighted that delivery is not entirely within water companies’ gift: “Water companies’ ability to deliver to their potential against these broad agendas is dependent on critical factors such as willingness of customers to act (currently CCW report trust is at an all time low), patient investment and government policy taking a firm stand to deliver on enabling systems. Wide change needed e.g. on water efficiency labelling.”

Trade offs

We asked a supplementary question of those who felt water companies could not feasibly deliver everything expected of them by 2030: what trade offs should be made? Suggestions fell principally into two camps.

Some advocated the compromise must be higher bills, with adequate support (some mentioned a single social tariff) to protect those who can’t afford to pay them. While challenging as a prospect, one participant pointed out that, unlike with the recent energy price rises, customers would see the benefit of their higher spend: “Customer bills: unfortunately they do need to go up, but proportionately this is still very good value for households (e.g. an extra c.£100 p/a on water bills will give significantly more value to custom-

ers than the extra c.£1000p/a increase on energy which only covers the energy commodity cost, not any asset or service enhancement.”

Another reasoned: “Trade offs over time are happening all the time putting the interests of future customers in danger. The WRSE plan is clear: there is a significant water deficit into the future and to plug this needs action now. Immediate affordability for all should not dominate the agenda and nuanced approaches across sectors are required to help those who really need help. Our children won’t forgive us.”

Others said the compromise should take the form of modified delivery expectations, such as targeted rather than blanket CSO eradication. One argued: “There needs to be a recognition by policy makers that some emissions targets (such as spill frequency-based ones for overflows) are in conflict with others (such as GHG reduction). Trade offs, priorities and phasing would need to be informed by a proper understanding of the degree of harm being addressed and accounting for the net value being delivered.”

A couple of commentators pointed out that trade offs should be made by customers. One commented: “We should not be afraid to engage customers in this debate, but then expect to be held to account to deliver the outcomes they sign up to pay for.”

Affordability and investment

Next we asked The Water Report Expert Forum for views on how things are likely to turn out, rather than what should be done. First, we addressed how the balance between bill affordability and investment levels is likely to play out at PR24.

There was a widespread belief that bills will have to rise, with many pointing out that support for those who need it will be the key ingredient. For example: “Affordable bills do not necessarily mean low bills. Appropriate bills to support efficient investment are essential – with support available to ensure affordability for customers that are struggling.” There was clear recognition too, that companies will need to play their part in keeping the rises as low as possible, for instance: “The balance is likely to shift to seeing a period of lower profits and greater efficiencies in order for companies to deliver what’s needed within moderate bill increases.”

Moreover, the Forum suggested the loud voices calling for investment will need to be balanced against wider views, by “making sure equal voices are given to everybody, not only those who are prepared to shout. Silence should not necessarily be interpreted as agreement.”

Some participants were concerned that bill increases to fund greater investment

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may not be used optimally. One participant offered: “I think CSOs will dominate the agenda for investment. Water availability remains a more invisible topic in the media and with the public. Without the requisite foresight, there is a chance that short term bill impact will be prominent and the LTDS approach a way to kick investment needed today – e.g. on smart meter rollout – into the long grass.”

For others, the more likely outcome was that affordability concerns will take precedence. One shared: “I worry that because of cost of living pressures, investment will be squeezed, even though it helps reduce bills in the future.” Another said that flat

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bills would not actually facilitate much improvement. “If bills do not increase, then the term ‘investment’ is perhaps misplaced – in reality the allowances will only cover base costs, and a modest amount of enhancements/pollution reduction. There is also a risk of investment plans being squeezed and made impractical, because of the uncertainty and ambiguity on how WRMP, WINEP and PR24 come together – regulatory slicing, dicing and iteration make it difficult for companies to create stable delivery/execution plans.”

On a similar theme, another Forum member warned: “The risk is that business plans are developed to deliver government/regulatory policy/expectations (compliant core pathway in LTDS). Late in the process it’s decided these are unaffordable and plans are adjusted in a hurry which leads to disjointed investment programmes and poor value for

money. We should be making these judgments now, not in 2024.”

A final participant lamented on this investment v bills theme: “In a high inflationary economy and cost of living crisis, the timing is not ideal for a big price hike. It’s a pity that in the last decade prices were overly constrained.”

Short v long term

Second, we asked the Forum for views on how the balance between focus on the short-term and focus on the long-term might play out at PR24.

Some were confident a good outcome could be found here. One said: “For PR24 this should be fairly easy to achieve. The programme needed of no-regrets works should be sufficiently large to deliver demonstrable improvements. The long term focus can then be developed during AMP8 and form the basis of AMP9.” Another observed: “This will be critical. One cannot come at the expense of another. If we do not achieve short term improvements then trust in achieving long term goals will be eroded. If we only focus on short term then problems will keep coming.”

Some, however, felt the promise of a good balance is slipping away. “PR24 and other regulatory aspects are starting to look longer term, which is great. But it looks like reality at PR24 may undermine much

of this work and we revert to short term thinking/investment.”

Others noted companies’ shortcomings in not fully seizing the opportunity. For instance:

“My hope is that Ofwat’s goals for PR24, including a long term view on value, will allow a better focus on long term than has previously been the case. That said, with some exceptions, few companies have put good long term cases together in previous price reviews, so Ofwat can only deal with what it is given.”

“I’m sceptical that the long-term approach will meaningfully inform PR24. I’ve not seen enough evidence of strategic planning, scenarios thinking (beyond black box models) and meaningful partnership working across the water companies. Do the assumptions and evidence going into an LTDS tally with the assumptions of the neighbouring companies? Hard to know.”

Finally, other contributors indicated the short-term would clearly dominate:

“Key risk that it will be too heavily short term, given the public outcry on pollutions, unacceptability of leakage, and an ageing asset base being put under more pressure, with higher customer service expectations – maintaining serviceability and hitting Performance Commitments and regulatory undertakings

in AMP is going to be a huge challenge – very difficult to have head-space or funding for longer term options.”

“After so many successive price reviews which have kicked long-term investment into the long grass, almost everything is now urgent and short-term. The balance between short- and long-term has become so blurred that the sector is at risk of betraying its roots and becoming an intergenerational failure.”

PR24 methodology

As chart 2 shows, there was a huge amount of uncertainty as to whether the final methodology for PR24 is fit for purpose as a framework, giving the challenges in play. The majority said they didn’t know, while a third were confident it is fit for purpose and 10% confident it isn’t.

The uncertain majority indicated in one way or another that there remains a lot to play for. Some examples are:

“It all depends on what Ofwat meant when it wrote it, how the companies interpret it, and how Ofwat then views that interpretation in light of the pressures on it at the time of its final determination.”

“While the headline messages around value for the long term are encouraging, the details are less so – e.g. the principles for public value revert to least cost rather than best value.”

“Some really good thinking on adaptive pathways and LTDS, which is very welcome. But it may have gone too far with the level of detail being asked for in cost tables, and the dilemma on “what does base buy” – a very sound and reasonable question, but very difficult to answer and then deliver against (how to get to reasonable base allowances that give a realistic and fair chance for water companies to deliver their performance commitments).”

ability; and deliverability (“water companies wanting too much control over the programme and constantly changing their minds compressing a very ambitious investment programme into a timeframe that makes it difficult to deliver”).

Regulatory creep?

Finally, we pointed out to The Water Report Expert Forum that regulation is also under pressure to do more than ever before; from the original purpose of five-yearly price setting, Ofwat is now expected to oversee aspects of environmental and social delivery. We asked: how do you see the role of Ofwat evolving going forward?

The critics highlighted a number of particular shortcomings, including the diluted role to be played by customers via Independent Challenge Groups stripped of a mandate, and the fact that elements of the methodology are too vague.

We also asked for views on where the key PR24 battlegrounds are likely to be. The most popular answer was the base v enhancement boundary, with costs v outcomes/expectations also featuring highly. Among other elements mentioned were: agreeing the WINEP; shareholder returns and investor appetite; finance-

Another took the idea of closer collaboration further: “The sector would benefit from a single guiding mind that brings together economic regulation with quality and environment, and long term planning (e.g. a national solution to CSOs). RAPID has helped with Direct Procurement for Customers, so perhaps something similar could be done to bring together WINEP, WRMP and social value needs.”

Others indicated they expected to see Ofwat playing a more hands-on role in future. One Forum member cited for instance that it might mandate “things like EDI in boardrooms and banning dividends and bonuses,” while another pointed to areas currently lacking focus from the industry, such as supply chain resiliency, work programme stability and innovation.

Others still pointed to Ofwat playing a more active role in delivery oversight: “For Ofwat to move to a role where it oversees delivery, it would need to better inform itself on what has been delivered. This would be consistent with the messages from its AMMA review, particularly in the need for companies to improve their planning and delivery processes through benefits realisation – if companies don’t do it to themselves, Ofwat will step in. This might take the form of an evolution of the old annual returns and asset inventories, but with new developments such as tracking value delivered rather than activities undertaken. This might give Ofwat more confidence to adopt incentives relating to delivering value rather than just reducing costs.”

Roles and responsibilities review

Finally, some contributors felt Ofwat’s evolving role might ul-

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imately lead to the need for a substantive review of roles and responsibilities:

“As Ofwat’s role shifts further away from pure economic regulation, it will likely need to develop its skill and competence set. Its exposure will also grow along with tensions with other regulators. These may, ultimately, lead to review of regulatory roles and institutional arrangements.”

“The shift in expectations so that Ofwat is now viewed as responsible for the companies’ environmental performance brings into question what role the Environment Agency has any more in water company regulation. We are seeing regulatory creep by stealth, and there needs to be an open debate about the role of regulators and the interplay between them.”

“It is complicated! How to come up with something that points the best brains in the industry towards solving the industry issues and priorities for customers?”

“It’s probably time for a change – a first step will be an independent formal review of the sector by the SoS – not much will change until that point.”

“A more joined up strategic view of the industry in ten to 15 years time is needed. There are too many fragmented views and individual targets/aims that are not currently joined up to give a clear direction of travel.”

CHART 2: IS THE FINAL PR24 METHODOLOGY FIT FOR PURPOSE AS A FRAMEWORK GIVEN THE CHALLENGES IN PLAY?

