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**Sustaining success:
water company business plans 2010 to 2015**

Pamela Taylor, Chief Executive

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Good morning and thank you for coming in.

Could I introduce you to my colleagues, Janet Wright is our Economic Regulation Adviser, Rob Wesley is our Policy Adviser and Barrie Clarke is our Director of Communication.

Introduction

I'd like to talk for a few minutes about the business plans the water companies in England and Wales have just delivered to Ofwat. Then we'll be happy to take questions.

The business plans are very diverse, reflecting the different environments that companies operate in, the different priorities their customers have and the nature of their assets. Companies will be able to tell you about the details of their own plans – so I will focus on key national topics.

Over the last year, companies have been working with stakeholders to develop their plans – which will eventually result in new price levels for 2010 to 2015 being announced in November 2009.

Companies' plans have taken into account longer term themes – such as climate change – and are shaped in the context of the Government's vision laid out in "Future Water". Indeed last year, companies set out 25-year visions in their Strategic Direction Statements. Today's business plans are a first step to turning these visions into reality.

But it's not too soon to talk about investment or customer service or bills. The plans contain companies' assessment of potential work programmes and effects on customer bills.

The plans are a starting point. As part of the regulatory process, they have already been independently audited, and will now be scrutinised by Ofwat. Their relationship to the bills after 2010 depends on decisions yet to be taken, as some of the key drivers for investment have yet to be fully determined.

What we're really doing today is making a big step towards finding the answers to some of the big questions:

How will we secure the environmental and service improvements of the last twenty years – including of course the excellent quality of tap water?

At the same time, how will we meet the challenges of climate change – both in mitigating our carbon emissions, and adapting to more extreme weather?

How will we ensure that customers continue to receive reliable, high quality services when floods and droughts are becoming more common?

How will customers be affected? What is affordable? How will the overall financeability of our essential service be affected?

Summary

Let's start with a topline summary.

The first thing to note is that there is no single industry picture – there is a diverse series of pictures for different companies, reflecting their specific local situation and needs. I will talk about the *range* of values in the industry to give you a flavour of this diversity; as well as this I will also give you an industry average.

The job for companies in price reviews is to respond to the demands of customers, government, and the ravages of time on an ageing infrastructure. They're required by Ofwat to identify work projects and prepare realistic costings as part of the review process.

These costings take into account many factors, but the key ones are what level of capital investment is needed, both to maintain reliable services and to improve them and the environment, what it is going to cost companies to operate services – in particular energy costs – and how companies finance all this activity.

Of course these factors affect every company differently.

No company is expecting average household bills to fall in real terms (excluding inflation) over the 5 year period, but some are forecasting that bills will stay flat or only go up a little, with increase of less than £2 each year. Other companies are forecasting larger increases, of up to £15 each year.

Looking at average figure, household bill are forecast to increase by about £6 each year, a total of about £30 by 2015, taking the average bill to about £350.

To put these changes into context, it's worth comparing them with bill changes caused by the last two price reviews. In April 2000, there were sizeable reductions in bills for almost all companies, averaging 12%. Then in April 2005, for most companies bills rose, on average by nearly 10%.

This time, the picture is much more diverse, with a significant range in projected bill increases. One of the things the industry has long called for is to move on from a "one-size fits all" approach to one that reflects regional needs – companies and customers will be hoping that the regulator will reflect this regional diversity in the final determinations in 2009.

This diversity is apparent when we look at investment. Investments are always driven by local need. The customers, the environment, the climate, the age and condition of existing water and sewerage assets are different in different places, so naturally individual company programmes show a range – from a fall of 13 % compared to current period, 2005 to 2010, to increases of over 50 % and in the case of some of the smaller water only companies, of over 100%.

Looking at averages again, the overall industry proposal for capital investment in new plant and pipes in the period 2010 to 2015 is around £27 billion. This is up by over a third on the £19.8 billion investment in the current period, 2005 to 2010.

Commentary

There are several things to say about these possible investments and bills.

First, the investment plans are *draft* plans. They're proposals for meeting the requirements of environmental and quality regulators; the maintenance of pipes and works; the expectations of customers (for example, reducing the risk of flooding from sewers); and the need to improve security of supply.

In the next few months there will be much scrutiny on these requirements and expectations. How necessary are they? Must they all be carried out in the 5 year period? Is all the information needed to make decisions available? There will be much for companies to take into account when they produce their final plans and costings in the spring, and for Ofwat to consider when they make final price decisions in November next year.

Second point. Over the last couple of years, companies have worked hard to understand customers' priorities up to 2015. There aren't many industries where customers pay so high a proportion of their bill for costly projects they can't see or experience directly. This makes ensuring that plans have the support of customers and affordability critical subjects.

Complementing the extensive customer research already carried out by companies, eight of the key stakeholders in the sector (CCWater, the Environment Agency, Water UK, Defra, Natural England, the Welsh Assembly Government, the DWI and Ofwat) will be working together on joint customer research to investigate how customers view the plans companies are publishing today.

Thirdly a point about value. We could go into the relative cost of cups of tea or downloads from iTunes, or even bottles of mineral water. But let me just say that, at the level of the *average* bill change, the annual household increase would work out at less than 12p more each week. At the level of the *lowest*, there would be no change to bills, and at the level of the *highest*, it would be 29p a week more each week. You won't be surprised if I say that this represents good value to customers.

The draft plans in more detail

I would now like to explore the changes a bit, so you can see what's driving the increases.

Capital investment

Let's start with capital investment.

Many of you know about the success of the present and previous investment. There have been dramatic improvements in rivers, bathing waters, biodiversity, drinking water quality, and in managing leakage.

By 2010 we will have invested over £80 billion at a rate of around £4 billion a year since 1990. At over £10 million every day, this is high for an industry with a turnover of £9 billion. In fact about half of everyone's bill is reinvested for the future.

At the industry level, the company plans for 2010 to 2015 would produce different changes for different elements of the capital programme, including maintenance, quality, and growth to ensure reliable supplies of water. And recent extreme weather – droughts one year, floods the next – has raised questions of whether 19th century infrastructure is fit to meet the challenges of 21st century weather.

Let's start with maintenance.

Investment in capital maintenance would increase by over a third compared the current programme. Over the five years, this would take it from just under £10 billion to more than £13 billion. This increase is important, if we want to protect the existing level of service to customers, the economy and the environment. This investment is a bit like protecting a house by painting it regularly or repairing brickwork. Or servicing a car to stop it breaking down.

The total replacement value of the industry's mains and sewers and works is around £250 billion. In recent years spending on renewal has been around £2 billion a year. Not exactly gold-plating. Of course you can take a view on this, because a lot of the Victorian stuff was exceptionally well-built. But a replacement cycle of over 100 years must be pushing it.

At the 1999 price review the companies' capital maintenance proposals were reduced by the regulator. This highlights an important point that everyone should understand. If there look like being problems with affordability, it's an easier option to squeeze capital maintenance than statutory investment in quality. Our view is that realistic investment in renewing assets can't be put off indefinitely. At least it can't without risking a fall-off in service that customers would hate and could seriously damage the economy and the environment.

For this reason, we were pleased that at the 2004 price review, the regulator significantly increased the allowance for capital maintenance, and we will be watching closely how companies' proposals are treated this time.

- Next let's look at investment in higher quality.
- Investment in environmental improvement and improved drinking water quality over the next five years will vary significantly between companies. Some would have a much smaller programme than now; others a much larger programme. The work would deliver the statutory improvements in standards required by European Directives.
- At an average level, investment in higher quality would rise slightly from the current level of around £6.5 billion.

That's the quality investment picture.

Another other key investment driver, ensuring that customers continue to have adequate supplies of water – and that this water can be taken away safely when it has been used. As well as planning to take account of changes in demand from new houses and other factors, recent events such as droughts and floods have clearly emphasised the need to have resilient water and sewerage networks.

Investment for this driver is expected to about double. It would rise from £2.7 billion in the current period to over £5 billion in 2010 to 2015. And again there would be wide variation between companies.

Operating costs

Efficiency gains will continue – but input prices are increasing

Another key factor in companies' plans is operating costs. Ever since privatisation in 1989 the industry has been able to hold down the effect of higher costs on customer bills by making large efficiency gains year after year. Ofwat has calculated the benefit and shown that, without efficiencies made by companies, the average bill would have been £100 higher in 2008 than would otherwise have been the case.

The industry will carry on making efficiency gains, but the input prices faced by water companies have been rising sharply – most notably the cost of materials and of energy. The headline increases in energy bills

that we are all aware of as domestic energy users also have a big impact on company costs, as energy already makes up 10% of the industry's total operating costs, even before this year's price increases. Increases in energy costs and other input prices offset, and in some cases outweigh, efficiency gains over the next five years.

The costs of financing investment

In the end the customer pays for water investment programmes in England and Wales, but the full price can be paid slowly over the life of the assets. To get the work done means attracting more funding from shareholders and the debt markets, the main sources at present. Obviously this has to be paid for, so a part of the higher bill, and the industry's profits, will go to lenders and shareholders.

Compared to the last review, in general the cost of financing investment – in particular of debt – has reduced. But over the last year, the financial world has changed dramatically. The continuing credit crunch has had a major impact on the debt markets, and companies will need to raise large amounts of new debt over the period from 2010. In their plans, companies have had to ensure that they can continue to finance new investment going forwards.

Costs which could change

There are also other important costs that could affect the final determination of price limits that Ofwat will announce in November 2009 – but are not fully known at this point.

Energy prices are highly volatile, and while companies have included their best current assessment of energy costs from 2010 in their plans, they will be watching energy markets carefully over the next few months to see if they need to change their forecasts.

Some parts of the programme to improve the quality of the environment need to be clarified, which could result in changes to investment needs. The transfer of private sewers to the responsibility of sewerage companies is another area where the costs – and the timing – is uncertain.

And charges for traffic management is another area of uncertainty. This is not fully quantified yet, but charges for traffic management are likely and could have a big impact on the cost of essential roadworks. Especially

when the increased maintenance programme would mean more roadworks.

Conclusion

So to sum up.

We have some of the best water services in the world in this country. That's because we've invested a lot over a relatively short time and we've been successful.

For the sake of our customers, the economy and the environment we can't let things slip. So our priority is maintaining the assets we all depend on for reliable services and protecting the higher quality we've achieved – which are also customers' priorities.

There are major potential benefits for customers and the environment including:

more resilient services, to ensure that adequate supplies of high quality water are available – and can be taken away when used – despite the changing climate, better taste and appearance for drinking water, further reductions in sewer flooding; even better cleaner rivers and beaches; a reduction in sewers overflowing in storms; and more protection for wildlife habitats.

Now we'd be happy to take questions.

Ends

For more information about any aspect of this statement or water company draft business plans please contact:

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