

Water prices and investment in England and Wales February 2010

Water bills for 2010-11 take effect in April. The new bills are set according to price limits approved by Ofwat, following its review of water companies' operating costs and capital expenditure in business plans for the period 2010 to 2015.

The costs and need for capital arise from the companies' responsibilities to deliver four services to customers and society:

- supply of clean water
- sewerage
- surface water drainage, and
- highway drainage.

Company business plans propose activities, with costs, which show how they will meet standards and targets affecting these services, many of which are legal obligations. Ofwat assesses the revenue the companies need to do the work if they are efficient, and then sets price limits that will produce the revenue required and no more. If companies can carry out the work for less, they can keep the surplus for the remainder of the period but it is given back to customers in lower bills at the next price review.

This arrangement gives companies an incentive to be more efficient than Ofwat has assumed; if they are, both their shareholders and their customers benefit. Water bills would be £100 higher than they are today without the efficiencies the companies have made in recent years.

This briefing looks at: water bills in 2010-11; measured and unmeasured bills; operating costs; capital investment; differences between companies; value for money; low-income customers; industry finance and return to investors.

Related documents

Finance and Investment - Water UK's rough guide to water industry funding
A Decade of Delivery - Water services in England and Wales 2000-2009
www.water.org.uk

1) Water bills in 2010-11

The average household water and sewerage bill across England and Wales will be broadly flat in 2010/11. It will decrease by about 0.8 per cent or £3 meaning an average bill of £339. This takes into account a 0.3 per cent rise in inflation.

The average is, by definition, an average across all customers. Individual customers' bills may be more or less than the average because of their own characteristics (such as whether they have a water meter) and because they are served by different companies (see below).

In 2010-11 and the years to 2015, the average measured bill will remain flat before inflation (and provided the amount of water used stays broadly similar).

However the average unmeasured bill will rise before inflation (it is a fixed charge and unaffected by the amount used).

Why is there a difference?

2) Measured and unmeasured bills

In England and Wales customers pay for water services in one of three ways:

- 1) If they have a meter, they pay a measured tariff, based on the water they use.
- 2) If they do not have a meter, they pay an unmeasured or unlimited-use tariff, based on the rateable value (RV) of their property.
- 3) If they would like to have a meter but the location or architecture of their home makes this impossible, they pay an assessed charge based on the measured bills of equivalent households.

More and more people accept that the best way to pay for water is using a meter, because:

- a) It is fairer to pay for what you actually use than pay a fixed 'unlimited use' charge; and
- b) It is an incentive not to waste. 'Use less, pay less' makes sense, especially where water is scarce.

The government has for some time encouraged customers to switch to metered charges. All household customers can choose to have a meter installed at no direct cost.

Ofwat points out that the rate at which unmetered customers choose to switch to a metered bill has a big effect on typical metered and unmetered bills. This is because allowing customers to choose to switch if they believe they will pay less removes the subsidy some unmetered customers have been making to other unmetered customers.

The following shows the experience of two groups of unmetered households in recent years:

- Unmetered customers in properties with high rateable values, but who use relatively little water, pay more than it costs to provide their water and sewerage services;
- Unmetered customers with lower rateable values and higher water use pay less than the costs of the services they receive.

When low-use customers with high rateable values switch to a meter, their bills fall to reflect more closely the cost of the service they receive. But it would be unfair for these customers to go on subsidising the remaining unmetered customers, so unmetered charges have to increase.

The effect is that some unmetered bills are rising quite steeply, even though no more water is being used. This is most likely to happen in areas where a large proportion of customers now have a meter. Ofwat recommends that all customers with an unmetered supply should think hard about having a meter fitted.

Water companies will advise on the likely effect of switching and make no charge for installation. If the customer has second thoughts and wishes to return to an unmetered supply after a year, they may do so, again without charge.

3) Operating costs

The day-to-day costs of running the business include employment, water and wastewater treatment, business rates and licence fees.

Over time, the operating cost component of water bills has risen to reflect the impact of real world challenges facing the companies such as higher power, business rates and pension costs.

4) Capital investment

In England and Wales we have some of the best water services in the world. This is because we have invested heavily – £85 billion between 1990 and 2010 – in undoing the damage caused by neglect during much of the 20th century.

In the period April 2010 to March 2015, the industry will invest £22 billion. Ofwat sets price limits at a level it believes will enable companies to finance this significant requirement. The capital will be used in maintaining existing services and achievements of the past 20 years and further improvements in:

- balance between supply and demand;
- drinking water quality and the quality of effluent returned to the environment following wastewater treatment; and
- better service, including reductions in sewer flooding.

There will be major benefits for customers and the environment, including more secure supplies; better leakage control; better taste and appearance for drinking water; households freed from risk of sewer flooding; fewer problems with smells at sewage treatment works; a reduction in sewers overflowing in storms; higher river quality; more protection for wildlife habitats.

5) Companies are different

Attention is often drawn to the difference between the bills water customers pay in different parts of the country. This should not be surprising however. Water services are dependent on the water environment - the climate and rainfall, the flow and quality of rivers and streams, the existence of groundwater stocks.

All these factors differ from company to company, but so are the age and condition of pipes and plant, the development of the companies over generations, and the particular requirements of their customers. Individual companies must invest in different projects, take on different costs, and consequently, in partnership with Ofwat, set customer charges at different levels.

6) Value for money and efficiency

Water bills may be seen as good value because the actual cost is low relative to many other household expenses, and they are a fairly small part of most family budgets. (This is not true for everyone – see below).

But everyone has to pay their water bill, so the industry, together with its regulators and the government, must explain how water is valued and prices are set.

Valuing water is one thing, but no one wants to pay more than necessary for something they can't do without. That is why Ofwat and the industry aim to meet service and quality requirements at the lowest possible cost.

As mentioned, Ofwat calculates that in the past 20 years efficiencies made by companies mean that the average bills would be £100 higher than it is today. In this time there have been major improvements to the service and the environment.

7) Low-income customers

Affordability is a problem for some low-income customers who genuinely find it hard to make ends meet. Water companies provide a range of payment methods and advice, in many cases including access to support from charitable trusts.

The government's involvement is important, because supporting people on low incomes must always be a national public policy matter. Beyond a certain level the majority of paying customers should not be expected to subsidise a social security cost of this kind.

At the same time most people agree that it would be wrong to carry out essential work at a pace everyone, even those on the lowest incomes, can afford. This would mean delaying improvements to a service that underpins the standard of living of everyone in society.

8) Industry finance and profits

In England and Wales water customers, not tax-payers, ultimately pay for water investment programmes. But because companies can make use of the financial markets, the full price can be paid slowly over the life of the assets. This has often been compared to paying a mortgage on a house.

The main point is that today's customers benefit as soon as projects are complete, but it is fair for future customers to share the cost because they will benefit too.

To get the work done in this accelerated timeframe means attracting funds from investors in shares and bonds. Obviously this has to be paid for, so a part of the bill, and the industry's profits, goes to lenders and shareholders. Because investment in water companies is unusually high in comparison with most other companies, their profits may look large in relation to turnover. But the level of profits directly reflects the level of investment and accumulated assets.

Profits are an effective way of financing the essential investment and delivering the benefits everyone wants. Like everyone else, shareholders and lenders – many of them pension and savings funds invested on behalf of millions of people – expect a fair return in exchange for the use of their money. In the year to March 2009 the pre-tax return on capital employed in the industry was 6.8%.

For more information please contact:

Water UK Communication
020 7344 1809 (out of hours 07833 450544)

.....

Finance and Investment - Water UK's rough guide to water industry funding
A Decade of Delivery - Water services in England and Wales 2000-2009
www.water.org.uk