

Water Prices and Investment 2005-10 Building On Success

This month water customers in England and Wales begin to pay the first bills of the new 5-year water management period. In this background brief Water UK summarises the case for higher investment in water and wastewater services on behalf of customers and the environment.

The brief is based on updated extracts from public statements made during the 2004 price review process. It is an overview of the main positions that underpin industry policy but is not a formal policy document.



1 The costs of borrowing

In England and Wales the customer pays for water investment programmes, 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, goes to lenders and shareholders.

Profits

To judge from some newspaper comments company profits are still misunderstood. The profit line in company accounts may look large in relation to turnover. But, as Ofwat points out, the profits are an effective (in fact the only) way of financing the investment and delivering the benefits everyone wants. They aren't used to pay big salaries or reward shareholders unfairly at the expense of customers.

The impact of a huge investment programme can be seen in the industry's overall debt. At privatisation in 1989 the companies had virtually no debt. It is now £21 billion. With over 21 million households, this implies a debt of about £1000 for each and every customer.

Company debt

Companies are getting further into debt and this is likely to continue as long as the investment continues, even if more share capital is attracted into the industry. Of course the debt is carefully managed and subject to scrutiny by Ofwat. It's as if the companies were taking on mortgages on behalf of customers. It's an efficient and effective way of delivering value to the country in a vital public service, but it has to be supported. Part of the reason for the higher bills is to pay shareholders and lenders for the use of their money.

2 Building on success: no complacency

We have some of the best water services in the world in this country. This is because we have invested a lot over a relatively short time and been successful. Some people might say enough is enough. Why don't we take a break and enjoy what we've achieved? But our view is that this would be complacent.

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 and protecting the higher quality we've achieved.

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

3 All companies are different

The environment, climate, age and condition of pipes and plant are different in different places, as are the views of customers.

Naturally individual company plans show different levels of investment and charges.

4 Operating and other non-capital spending

Like many businesses, water companies face cost increases they can't do anything about in the short term. These range from changes in taxation and business rates to pension contributions and energy costs.

In the next five years these cost pressures will be largely outside the industry's control but have an immediate impact on customers' bills.

5 Capital programme and national pride

Capital investment of £21 billion covers a wide range of projects. Around one third are required by government and described in its guidance. These days more people know about improvements in drinking water, security of supply, the water environment and biodiversity that have come from earlier water industry investment.

But not everyone realises that this is an important reason why the UK's environmental reputation in Europe has improved beyond recognition. We are no longer 'the dirty man of Europe'.

6 Maintaining crucial assets – priority #1

The capital investment programme will provide improvements in drinking water and the water environment, in the balance between supply and demand and in other aspects of the service, but the largest share goes to maintaining or replacing worn out assets, which threaten the security and quality of supply that are customers' highest priorities.

This is a different emphasis from the 1999 review (in fact all the earlier reviews) when improving drinking water quality and the environment were the main priorities.

At the last review, the industry's proposals for capital maintenance were cut by 25%. We need the scope to plan properly for renewing critical pipes and plant. The problem is that today time-expired assets can be working well, but tomorrow they can fail without warning and cause major disruption. Customers have a right to expect better in 21st Century Britain.

7 Stakeholders – a broad consensus on what has to be done

The biggest difference between the recent water price review and all the previous ones is in the efforts made by all the industry's stakeholders to find areas of agreement while accepting that there must always be tension. There is a broad consensus about what should happen with water and wastewater services.

There is agreement, for example, about the need to invest in securing the services everyone depends on; to continue improving quality subject to analysis of costs and benefits; to tackle sewer flooding; to support those on low incomes who find it hard to pay their bills; to provide a fair return to investors; and to ensure customers get the best possible service at the lowest possible price.

With costs and prices rising, it is never easy, but we believe people will see that building on success makes sense and that the plans are affordable for most customers. As the Environment Minister, Elliot Morley, said about water investment, 'you don't get owt for nowt'.

8 Customers

In 2003 the industry, regulators and interest groups jointly tested customer opinion on companies' draft business plans. In every area we found common views. About existing services: they were pleased with them. About protecting drinking water quality and security of supply: they were the most important things. And, perhaps surprisingly, about willingness to pay for a better service: a majority were in favour. There was support for new investment in the environment but at a lower level.

It was encouraging that around two thirds were 'certainly or probably' willing to pay more for a better service, but that left a large number who didn't want to see bills go up. This makes it particularly important for people to have as clear a picture as possible of what is planned.

Customers and 'polluter pays'

Our customers pick up the bill for a lot of work that really ought be paid for by others. For example the costs of water treatment, which are increased by many millions of pounds every year by the need to remove pollution from agricultural land, roads and industrial sites.

This is not sustainable in the longer term. New and more demanding standards for the water environment are on the way, such as those in the Water Framework Directive. Water companies will manage a lot of the relevant work, but the price must be shared fairly with those who cause the pollution in the first place. In fact the overall bill to society could be reduced if we implemented this principle.

Low income customers

Then there is the important question of affordability. This is a real issue for a group of low-income customers who genuinely find it hard to make ends meet.

It is clear from their guidance that Ministers appreciate the affordability issue and they are working with the industry and regulators to explore possible ways forward.

The government's involvement is important, because supporting people on low incomes must be a national public policy issue. Beyond a certain level the majority of customers can't be expected to pay for a social security cost of this kind. And everyone would agree it would be wrong if we had to slow down making essential improvements to a vital service to the speed the poorest in society could afford.

9 Value for money and efficiency savings

We believe that water charges are good value for money. We could show this by making comparisons with other household expenses or consumer products like fizzy drinks. But the changes in bills over the years speak for themselves when you set them beside what has been delivered.

In 1999 water charges were cut by more than 12%. Bills for 2004-05 were still lower in real terms than in 1999. Or take a longer perspective. Since 1989 the average water and sewerage bill has gone up by 25% in real terms. But during this time there have been major improvements to the service and the environment, improvements that would have meant much bigger increases without company efficiencies. In fact Ofwat calculated that 70% of the cost was absorbed by companies in this way.

10 Value and price

Water bills are good value because the actual cost in pence per day, or pounds per week, or whatever, is low relative to other expenses. In the big scheme of things, water bills are a fairly small part of most family budgets.

But, this is not true for everyone. We are dealing with bills that everyone has to pay, so it is our job (that includes the regulators and the government), to show positively why it is worth paying a little more for high quality essential services.

In other words, to put the focus for once on the value of a secure water supply and a clean environment, not just the price.

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