



**Water UK**

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[www.water.org.uk](http://www.water.org.uk)

# Finance and investment

## Briefing note 1

### Priorities and prices - What is PR19?

#### Summary

Water and sewerage services are vital to our well-being; so vital that society must be fully involved in setting priorities for those who provide them. In England and Wales these essential public services are supplied by private sector companies.

Company priorities are decided through a process of price regulation based on consultation with the public, customers, and other groups with wide interests.

The process is known as the 'Price Review'. It is led by the water regulator Ofwat and the companies themselves. Its most visible outputs are controls on the prices companies can charge for the 5 years following a review. The next price review is in 2019, called PR19 for short, and will set prices for the period from 2020 to 2025.

But the focus on prices is only half the story. The review is also a shared effort to research and agree major investment programmes that will allow companies to give consumers a better service and make environmental improvements required by the government.

#### A public service

*The aim is the best of both worlds – the ethos of public service combined with private sector expertise and access to capital.*

Water supply and sewerage are essential public services. This is not questioned by anyone involved in providing, regulating or setting the policy framework. In England and Wales, the services are provided by private companies who own and manage the plant and infrastructure.

This structure is intended to give the best of both worlds: the ethos of public service combined with the expertise and access to capital markets provided by private sector management.

The companies are subject to statutory obligations. Their performance is monitored by a primary regulatory authority – Ofwat in England and Wales – in cooperation with drinking water and environmental quality regulators.

#### Priorities

*Water company priorities are set by the people they exist to serve. They reflect local needs and wishes and national standards.*

The process used to set priorities and price limits is led by Ofwat and the water companies, overseen by ministers. It has continuously evolved since it was introduced in 1989 when the water and sewerage companies were privatised.

Its main characteristics are thoroughness and consultation. Priorities are published in company business plans looking 5 years ahead in detail,

#### About Water UK

Water UK represents and works with the major water and wastewater service providers from both the private and public sectors in England, Scotland, Wales

and Northern Ireland. Our vision is of a water sector that provides customers and communities with world-class services and enhances the UK's quality of life.

25-plus years in broader terms. The 5-year plans contain chapter and verse on operations, capital projects, income and expenditure forecasts, and prices net of inflation.

At every stage the emphasis is on understanding customer priorities through research and engagement with customers and their representatives, and debate between companies, regulators, government to ensure that the outcome of the price review delivers these priorities.

Ofwat begins the price review by consulting on how it will assess the company plans and set price controls. The regulator must take account of government guidance on behalf of society as a whole – this leads to legal obligations for companies to deliver specific improvements through their plans.

## Customers at the heart of price reviews

To develop their plans, companies research customer wishes and needs. They consult the public on key aspects such as planning for continuity of supply.

The Consumer Council for Water, the official customer watchdog for England and Wales, is an influential voice in the price review. Its contribution is based on extensive research of consumer attitudes and opinion.

In addition, each company has established a 'Customer Challenge Group' to provide independent scrutiny of how companies have investigated customer priorities and built them into their plans.

Companies also work with all their regulators to ensure that business plans take account of legal requirements, especially quality standards, and seek the views of local and regional organisations, consumer, environmental and business interest groups.

Water company priorities are set by the people they exist to serve. They reflect both national standards and local needs and wishes.

## Prices

*No one wants to pay more than necessary for something they can't do without. Analysis of cost and value for money are inseparable from deciding priorities.*

The 5-yearly review culminates in Ofwat setting price controls for each company. The regulator summarises its role as enabling, incentivising and encouraging companies to find new and better ways of delivering services, so that customers will get more of what really matters to them.

Such a wide brief means working with fellow regulators: the Environment Agency, Natural England and Natural Resources Wales (for water resources and wastewater management) and the Drinking Water Inspectorate (for tap water quality).

The basis of the review is the 5-year company business plan.

No one wants to pay more than necessary for something they can't do without. Obviously, this includes reliable water services. So, analysis of cost and value for money are inseparable from deciding priorities.

Companies use the business plan to set out their priorities and show in detail how they will meet them through day to day operations and capital investment. They show the standards and levels of service they expect to deliver and propose investment projects with explanations of costs and benefits.

Finally, they estimate, for each year in the plan, customer prices, company revenues and operating profits.

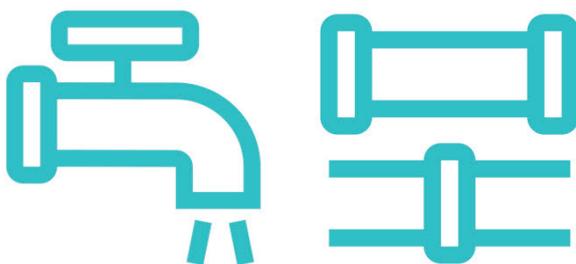


## Setting price limits for 2020-2025

Date	Action
During 2017	Ofwat developed, consulted on and finalised its approach to the 2019 price review
September 2018	Companies published business plans
January 2019	Ofwat publishes its initial assessment of business plans
March/April 2019	Ofwat publishes early draft price controls for consultation
July 2019	Ofwat publishes other draft price controls for consultation
December 2019	Ofwat publishes final price controls
April 2020	New price controls come into effect

Companies work with customers and stakeholders to develop their plans, which focus on the outcomes that customers want to see. For each priority outcome, companies make commitments for the performance levels they will deliver.

Companies published their plans and submitted them to Ofwat in September 2018. Water UK published A Manifesto for Water, which provided an overall summary of the water industry's plans in England for 2020-25. Highlights included proposals for: over £50 billion to be spent across 5 years; domestic bills to fall on average of more than 4% in real terms; leakage to be cut by 16%; and 8,000km or river improvements.



Ofwat will review the plans in the light of its duties and the companies' legal responsibilities. It looks at whether companies are focussing on the right things, whether their commitments are stretching enough, and on the revenue companies say they will need to cover the costs of delivering the service and financing investment.

Investment falls into 4 categories:

- Keeping the plant and infrastructure fit for purpose;
- Improving drinking water and environmental (wastewater service) quality;
- Maintaining and where needed improving the resilience of services;
- Improving specific customer services.

Ofwat makes assumptions about how far the company can be stretched to improve cost-efficiency in both its operations and its management of investment projects, and whether companies could deliver more of what customers want.

It compares the efficiency of the companies against each other and against other sectors and sets targets to incentivise the least efficient to catch up with the most efficient.

In January 2019, Ofwat will publish their initial assessment of business plans, splitting companies into four categories depending on how much more work is needed on the plans.

Next, Ofwat will set draft price controls for each company for the 5 years, with the companies whose plans need less work getting their draft price controls first.

At this point there is one last public consultation – effectively a value for money test – before the business plans and price limits become legal obligations for the company. It will obtain the revenue it needs to finance its obligations, as long as it is efficient.

## Incentive to deliver more for less

If the company can meet its obligations by spending less than the regulator has assumed, or deliver more of what customers want, it is said to 'out-perform'. It gets a reward for this – either additional revenue or keeping some of the cost savings.

Together with the consultation on priorities this provides a 'win-win' situation. The company has an incentive to deliver more of what customers wants for less, so customers gain if the company is successful.

## Find out more

More information on the water industry is available at [www.working4water.org.uk](http://www.working4water.org.uk).

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