

Preparing for the PR24 Challenge

AMCL Commentary

In this document, AMCL will encapsulate the key takeaways of the Ofwat guidance, and provide commentary based on industry feedback and observations.

Perspectives on PR24

The Price Review 2024 (PR24) guideline from Ofwat has been developed in consultation with the water sector, AMCL has digested the key challenges and opportunities for companies operating in the English and Welsh water sectors and summarised our perspectives based on our experiences from across the regulated infrastructure sectors.

The Ofwat guidance combined with our review provides useful insights into the regulator's plans for setting price controls and summarises what the regulators expects from companies in the submissions for AMP8: 2025-2030. The guidance also offers opinion on potential approaches to policies, targeted performance commitments, and the alignment of operational activities, prior to the finalised PR24 methodologies published in December 2022.

Key Takeaways

Nature-based solutions



There is a continued positive push for sustainable nature-based solutions for PR24. Planned interventions are expected to include NBS oriented options wherever affordability allow these alternatives.

Net zero targets



An accelerated transition to lower carbon solutions aligned to the company commitments and sector-wide government targets. Promoting solutions that provide the most rapid and impactful emission reductions.

Innovation push



Ofwat continues to push for innovative solutions, recently announcing further rounds of funding targeting early-stage innovation and extending their sector supporting innovation funds.

Consistent approach



The guidance took a similar approach to previous years enabling companies to better understand the econometric modelling and simplification of the cost-sharing approach.

Standardised performance



Fewer bespoke Performance Commitments (PC) are well received, with commitments consolidated down to more standardised ones across the whole industry promoting long term thinking and transparent benchmarks.

Stakeholder consultation



Guidance was released slightly earlier than PR19, providing additional time for stakeholders to review it. The 5-year Price Review cycle still presents a significant regulatory burden which could inhibit longer term perspectives.

Water Sector Regulatory Challenges

Challenge

Rising customer expectations

Reflecting a clearer understanding of customers and communities



Challenge

Affordability concerns

Delivering greater environmental and social value



Focusing on the long term



Driving improvements through efficiency and innovation



Challenge

Combatting climate change as well as protecting the environment and enhancing our natural resources



Focus on the long term



With Ofwat's gradually shifting focus onto long-term objectives, its approach is targeted at incentivising companies to align their investment strategies to longer-term Asset Management thinking. This builds upon the already implemented strategic pricing control approaches to catchment sustainability for Water Resources and Drainage Management through the combined regulatory influence of RAPID.

Greater environmental and social value



New approaches to storm overflow with pollution management and Net Zero solutions are encouraged by companies to reduce the impact on the environment. Ofwat is incentivising companies that are able to promote their environmental and social stewardship impacts by making funding available to support the innovative strategies to help combat climate change and bring greater value to the wider community it is central to.

Clearer understanding of customers and communities



Despite recognition as a leading sector in the UK for customer and community interactions, Ofwat wants companies to continue to listen more intently to the voice of the customer. Pushing the boundaries to meet rising customer expectations by driving engagement through transparent engagement and communication.

Efficiency and innovation



As the challenges the UK water sector face continues to grow with the expectation ever-increasing to deliver more for less, companies will look to streamline their operations and focus on leveraging value by delivering innovative solutions. Providing a level playing field by stretching performance standards across the sector, and through the shared innovation fund, as inflationary pressures impact customers with increasing affordability concerns.

Focus on the long term

Commentary:

- As a whole, the water industry demands a long-term approach to best meet its social and environmental stewardship commitments. Ofwat has already begun pointing towards long-term thinking in both PR14 & PR19 and sees the benefit of continuing this approach for PR24 and beyond. Asking companies serious questions in terms of their long-term strategies pushes them to focus more on sustainable business operations and less on shorter-term targets. In turn, this helps develop industry-wider Asset Management decision-making capabilities collectively in the right direction.
- Water companies aligning their 5-year plans with longer 25-year catchment wide and regional strategies for Water Resources and Drainage Systems is an excellent tool to ensure that long-term benefits that need to be realised for customers and the environment are not forgotten in a 5-year cycle and are sustained and actively implemented over a long-term period. This theme is strongly aligned with investment planning as part of the wider Asset Management System that will be crucial for organisations to deliver benefits over the long-term.
- Ofwat is reliant on an incentive and penalty-based approach to performance that often drives short-term behaviours when its intent is the adoption of more long-term focused business plans with the key assessment criteria being based on quality and ambition. This in theory means that companies with more expansive approaches detailed in their business plans can get access to the available funding which can help facilitate these ideas. Historically we've seen that only the larger water companies have sufficient resource capabilities to develop and implement these plans tailored to the regulator potentially leaving smaller companies at a disadvantage.

01



Ofwat are offering incentives to companies to align their long term objectives

02



Company push for the development of business plan & delivery strategies to forecast the next 25 years in line with Ofwat objectives

03



Focused investment spending by companies to positively impact the customer now, and over the long term

Greater Environmental and Social Value

Commentary:

- In PR24, Ofwat worked with the Environment Agency, Drinking Water Inspectorate and the Department for Environment Farming and Rural affairs to help set targets for the environmental Performance Commitments. This collaborative effort with the goal of protecting the environment is expected to demonstrate how good policy implementation can promote a long-term vision for water companies' place as stewards of their environment.
- The consolidation of a more common Performance Commitments is a positive approach to maintain focus on the comparative improvement in the environment across the different companies. Ofwat will continue to follow an outcome-based approach with the Environmental Agency (EA) to grow the prominence of the Water Industry National Environment Programme (WINEP) a more unified strategic approach that increases the likelihood of successful outcomes.
- Building social value has also been highlighted as an important component of PR24 the continued use of common Performance Commitments around improving bathing waters and river water quality shows the desire to positively affect all elements of the way people utilise the wider water environment and how water companies are well placed to unlock this social value as stewards of this environment.

01



Price reviews by Ofwat support companies spending additional available capital towards maintaining and growing environmental stewardship capabilities

02



Standardised Performance Commitment 'penalties and rewards' continue to encourage enhanced pollution management, reducing the impact of storm overflows and the resultant Greenhouse Gases of the companies' asset lifecycle choices

03



The Performance Commitments also extend to improved bathing water and river water quality decision-making

Clearer understanding of Customers and Communities

Commentary:

- Fewer bespoke Performance Commitments will lead to far less confusion for customers, businesses, and community stakeholders allowing them to hold water companies more accountable.
- Some assumptions are being made on the effectiveness of Performance Commitments and customer demands that will require close monitoring to ensure customer benefits are consistently realised. It is expected that research and subsequent adjustment may be required to these measures to account for the relative success of behaviour change interventions on customer demand profiles.
- Customers and communities should see a faster rate of change and improvement for the long term due to more substantial financial incentives across all Performance Commitments which aim to drive collective 'sector wide' innovative research thereby reducing the amount of duplicated research required for each individual company at a cost borne by the customer.
- The Water Industry response to Interruptions to Supply has improved in each AMP as it has built more resilient assets and established improved contingency. PR24 will place even more Performance Commitment pressure on the number and duration of interruptions to supply facilitated through enhanced Asset Management practices, smarter decision making across the asset and system lifecycles drawing on an understanding of how to balance Totex Cost, Risk, and Performance to give optimum value outcomes.
- Ofwat wants to ensure companies deliver the best possible value for the customer within the set expenditure allowance. Where modelled funding gaps emerge associated with a perceived lack of efficiency Ofwat appear less willing to let customers fund the required investment shortfall and are committed to ensure that companies turn to shareholder funds instead.

01



A requirement to demonstrate affordable plans that prioritise vulnerable customers

02



Effective engagement and partnerships between customers and water companies to drive behavioural changes in customer usage of water and sewerage services

03



Company-specific engagement is now expected, especially when communicating longer-term benefits to customer

Efficiency and Innovation

Commentary:

- Increased scrutiny of evidence supporting decision-making, should result in water companies prioritising areas of lower performance and looking for alternative intervention options. Over the course of AMP7, several companies have embedded enterprise-wide investment planning solutions which target better prioritisation using a range of scenarios and value outcomes. We can expect this to continue in AMP8 as companies refine their approach to gathering the supporting information and enhance their adaptive planning and model building capabilities.
- It's encouraging to see the prominence of continuous improvement as part of the criteria for attaining 'Enhanced' status for the highest performing water companies. This prominence recognises that the sector cannot remain stagnant, that performance outcomes are interdependent, to ensure the UK can continue to provide great service for generations to come.
- Ofwat is keen to propose an approach to further promote the use of external benchmarks allowing for a more standardised approach to assess water sector efficiency, resilience, and maturity of approach, stretching water companies with the hope they can rise to the challenge.
- Water companies will face intense pressure to deliver higher levels of performance, for the same level of base expenditure, and diminishing returns (e.g. leakage below economically viable levels). Historically this has led to so-called perverse incentives and there is a risk that in AMP 'reactive target setting' such as the latest combined storm overflow targets bypass the requirement for evidence based performance targets associated with the urgency to mitigate political pressures.

01



Aligned to the ongoing push for greater environmental and social value Ofwat continues to pursue the introduction of more scope for innovation in developer services and bioresources

02



A large efficiency step-change will be required for water companies to meet expenditure challenges, which should be realised through cost and risk sharing

03

**£200
MILLION**

The £200 million innovation fund continues to help incentivise companies to drive more value to customers



Conclusion

AMCL promotes the use of a continually improving Asset Management system that facilitates adaptive planning and scenario building to collaboratively deliver challenging sector-wide objectives. Although the Price Review processes are driven by the economic regulator the increasingly joined up approach to the regulation of environmental and societal stewardship reaffirms the importance of evidence based decision-making drawing on integrated perspectives on value, risk, and performance to secure an effective AMP8 and beyond.

AMCL has been actively involved in the innovative application of technologies to enhance the prominence of interventions that are connected to an understanding of organisational and stakeholder value. It remains vital that the great people in the sector at the heart of great decision-making processes continue to be supported by the right technologies drawing on the optimum quality data & models.

Call to Action

How Can AMCL help?

AMCL's Investment Planning & Asset Decision Making Service Offerings

Supporting organisations to develop investment planning capabilities through defining and implementing business processes, advising on the adoption of appropriate tooling and conducting lifecycle modelling.

- Investment Planning Process Development
- Investment Options Development & Analysis - WLC
- Asset Management Plan Development



AMCL's Sustainability Service Offerings

Supporting organisations to incorporate innovative direction into their net zero roadmaps and embedding sustainability through integrated business approaches, understanding that sustainability is integral to everything an organisation does.

- Carbon Accounting
- Value Frameworks Development & Embedment
- Net-Zero Offering



AMCL's Delivering Technology Change Service Offerings

Supporting organisations to develop Asset Information Systems and technology requirements that de-risk implementation projects, including support to navigate the technology marketplace and select solutions that fit their needs.

- Modelling and Gap Analysis of As-Is and To-Be Business Processes.
- Vendor Assessment and Procurement
- High-level Implementation Roadmap and Benefits Case



If you'd like to know more about the role of Asset Management in PR24 and how we can help, please contact a member of the AMCL Water Sector team.

**“We help our
clients deliver
more with less**

Introduction to the **AMCL Water Sector team**

Who can help?

AMCL has been leading Asset Management for the last 25 years. We have been instrumental in developing the core principles and tools that underpin the industry and continue to play a leading role in the Institute of Asset Management (IAM) and the Global Forum on Maintenance and Asset Management (GFMAM).

AMCL is part of the Turner & Townsend and CBRE family of businesses. Turner & Townsend are internationally-renowned specialists in project delivery, while AMCL specialises in the management of assets throughout their lifecycle and disposal. Together, we aim to offer a holistic, sustainable, whole-life approach.



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