

Cross-Government Review of Water Affordability Report

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Published by the Department for Environment, Food and Rural Affairs. Printed in the UK, December 2004, on material containing 80% post-consumer waste and 20% Elemental Chlorine Free pulp.

Product code PB 10428

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Executive Summary

This report is the result of a cross-Government review of water affordability. A steering group, led by Defra, and comprising Ofwat, HM Treasury, Department for Work and Pensions, Department of Trade and Industry and Welsh Assembly Government, looked at the way in which lower income households are helped with their water and sewerage charges. A wide range of interested parties from outside Government were also invited to participate in the group's work through a series of seminars and bilateral meetings. This report contains the evidence gathered on the scale and nature of water affordability in England and Wales and the Government's decisions on how it, along with Ofwat and the water industry, should progress in tackling the issue.

Conclusions

Scope and scale of the water affordability issue

Water and sewerage charges fell as a percentage of disposable household income between 1999-2000 and 2003-04. They are likely to rise again in 2004-05 and in the years to 2009-10 as set out in Ofwat's final determinations. Nevertheless, for average and higher income groups, water charges will remain a small share of overall disposable household income.

The analysis in this report is based on expected future water charges as set out in Ofwat's draft price determinations in August 2004. The Government will update its analysis to reflect Ofwat's final determinations in due course. However, we do not expect these changes to affect the conclusions reached in the report.

Water affordability is more likely to be a concern for specific income and/ or consumer groups (for example, lower-income working households, non-working households and pensioners). There are also regions where the problem appears to be more significant, for example, Wales and the North West and South West of England.

The evidence presented in this report suggests that lower income customers spend a higher proportion of their income on water and sewerage bills than higher income customers in all areas. In 2004-05, lower income households in the South West region spent the highest proportion at 3.2% and within regions there will be particular household types where the proportion is higher. For example, a single pensioner household living on the minimum Pension Credit and paying an average South West water and sewerage bill may be required to pay 7% of disposable income on water and sewerage charges by 2010.

The majority of households are predicted to spend more as a proportion of income on bills in 2009-10 than in 2004-05. The average water burden for the lowest income quintile across England and Wales is forecast to rise from 2.2% of disposable income in 2004-05 to 2.5% in 2009-10. For the highest

income quintile the figures remains broadly steady at 0.5% of disposable income.

However, for context, these numbers are still less than the proportion of disposable income spent on water and sewerage charges pre 1999-2000 (see Fig. 2) and in real terms, customers will only be spending slightly more in 2009-10 than a decade earlier.

Based on the draft price determinations that Ofwat published in August 2004, the national average household bill will be £282 by 2009-10. However, this masks a significant range between companies: highest bills will be those for South West Water, at £418 by 2009-10, the lowest in Northumbrian and Thames at £244. Average income households in the South West will be spending nearly 2% of disposable income on water and sewerage bills by 2009-10 compared to the national average of 1.1%.

Nationally, by household type, households on fixed incomes, whose incomes do not rise as fast as average earnings, will see their water and sewerage charges rise as a percentage of disposable income by 2010. Typically, these are pensioner households and non-working households with and without children. The Government's assumptions about the future trends in incomes would mean that for working households the average increases in water charges are predicted to keep pace broadly with rises in earnings.

So the affordability problem would appear to be limited to specific income and/or consumer groups and in particular regions. Our objective is to look at ways of delivering better outcomes for these customers.

There is already a range of measures in place to assist lower income households with their water and sewerage charges but there is scope for improving them in the near term. Ways forward for Government, Ofwat and the water industry to progress in tackling this issues are given in this report, include improving existing arrangements in the near term and studies of the effects of the charging system in the longer term.

Government decisions on ways forward

Vulnerable Groups Regulations

The Vulnerable Groups Regulations should be extended to increase eligibility, with measures put in place to increase take up.

Department for Work and Pensions (DWP) Third Party Deduction Scheme

Government, specifically Department for Work and Pensions, should work with stakeholders, including water companies, Ofwat and Ofgem, to explore proposals for possible changes/ extensions to the Third Party Deductions Scheme, including Water Direct.

Local pilot scheme on water affordability

A local scale pilot scheme should be carried out to target water affordability assistance to lower income households, involving the Government, local water company and other stakeholders, with an investigation of the possibility of running this alongside the existing Warm Front scheme. This pilot study would assess the combined impacts of benefits checks, water efficiency measures and metering.

Sharing best practice

Water companies should continue to work together to spread and deliver best practice on key affordability and debt related issues. This would include the targeted promotion of the free meter option to lower income customers.

Updating of Ofwat guidelines on debt recovery

Ofwat should undertake a review of the debt guidelines in 2006 (last updated in 2002). This will involve the updating and promotion of good practice in debt management by companies.

Studies of the effects of the charging system

Government officials should work with Ofwat and Water UK in the coming months to build the evidence base on the likely uptake of optional meters in the 2005-10 period and the likely distributional consequences of costs for water consumers. They should report findings to Ministers by the end of 2005.

Government and Ofwat should update existing analysis of the relative distributional effects of rateable value and council tax in the light of the findings of the Lyons inquiry into local government funding and consider the case for a review of the current rateable value based charging system for households paying an unmeasured charge.

Companies, Ofwat and Government should consider the case for suitable tariff changes for customers to assist with affordability.

These studies would look at how lower income groups may be affected by any change to the current charging system.

Introduction

Water Sector: Governance and Periodic Review 2004

1. In January 2003, the Secretary of State published her Initial Guidance to the Director General of Water Services (Ofwat)¹ as part of the 2004 Periodic Review of water price limits, which made clear that due weight must be given to the economic and social effects of policies, especially the impact of water bills on vulnerable customers. In March 2004, the Secretary of State stated in her Principal Guidance² that she would be reviewing the way in which lower income households are helped with their water and sewerage charges. In October 2004, the Final Guidance³ reiterated the shared responsibility of all those involved in the Periodic Review to weigh the effects of decisions on customers bills. It reported that Defra was leading a review of water affordability by a cross-Government steering group and involving outside stakeholders, with the intention of making an announcement later in the year. Concerns about affordability were also reflected in the formal guidance issued to the Director General from the Environment Minister of the Welsh Assembly Government in March⁴ and September⁵ 2004.
2. Ofwat has sole responsibility for setting price limits as a condition of water companies' appointments. In setting price limits, Ofwat must meet its primary duty of ensuring that companies carry out their statutory functions and that they are able to finance those functions. Ofwat also has a duty to protect the interests of customers. Government determines policies that may affect the factors that determine price limits, advised by the Drinking Water Inspectorate, English Nature and the Environment Agency and taking into account the views of others, including water customers, consumer groups, environmental groups and the water companies.

Water: Affordability Issues

3. Ofwat sets price limits as high as they need to be to enable each company to finance and to run its business efficiently, whilst ensuring that all customers pay no more than is necessary. This follows from the statutory duties set out in the Water Industry Act 1991 (to be updated under the Water Act 2003). This approach is also set in the context of a Government action plan for tackling the wider issue of over-indebtedness⁶ and policies for tackling social and financial exclusion.

¹ <http://www.defra.gov.uk/environment/water/industry/review/jan03.htm>

² <http://www.defra.gov.uk/environment/water/industry/review/mar04.htm>

³ <http://www.defra.gov.uk/environment/water/industry/review/oct04.htm>

⁴ <http://www.wales.gov.uk/subienvironment/content/guidance/water-price-limits-e.htm>

⁵ <http://www.wales.gov.uk/subienvironment/content/guidance/water-pricing-2005-2010-add-guide-e.pdf>

⁶ <http://www.dti.gov.uk/ccp/topics1/pdf1/overdebt0704.pdf>

4. In its report on water pricing (published in December 2003)⁷, the Environment, Food and Rural Affairs Committee recommended that Government should review the way in which lower income households are helped with their water and sewerage charges; that people suffering from serious difficulty in paying their bills should be helped through the benefits and tax system and that mechanisms to help people pay their water bills should take account of the regional variation in those bills. The Environmental Audit Committee supported these recommendations in their report on the Periodic Review 2004 (published in May 2004)⁸. See **Annex A** for the full recommendations of the Select Committees in relation to water affordability and the Government's response.

Affordability Steering Group

5. A cross-Government steering group was set up in February 2004 to review the way in which lower income households are helped with their water and sewerage charges. Membership and Terms of Reference are at **Annex B**. Seminars were held in both England and Wales to capture the views of stakeholders and these were followed by a series of bilateral meetings.
6. The group has looked at the situation in England and Wales. The water and sewerage industries in Scotland and Northern Ireland follow different models of ownership and regulation to their counterparts in England and Wales.

Structure of this report

7. The remainder of this report is divided into two main parts. **Section 1: The Evidence Base** assesses the scale of the water affordability problem, and asks whether there is a case for government or regulatory interventions.
8. Part 1(a) looks at changes in water and sewerage charges over time, and at the expected increases in bills over the next five years. It looks at how bills will change as a proportion of disposable income for different customer groups, both nationally and regionally.
9. Part 1(b) describes the current measures that are in place to assist low-income/ vulnerable consumers, including general tax and benefit support, cross-subsidies within the water charging framework, and specific targeted measures such as vulnerable groups regulations.
10. Part 1(c) draws conclusions on the likely extent of affordability problems over the next five years, and whether government, regulatory or company-focused action might be desirable to put in place additional safeguards.
11. **Section 2: Government's decisions on way forward** sets out measures for tackling water affordability problems.

⁷ <http://www.publications.parliament.uk/pa/cm200304/cmselect/cmenvfru/121/12102.htm>

⁸ <http://www.publications.parliament.uk/pa/cm200304/cmselect/cmenvaud/416/41602.htm>

Section 1: The Evidence Base

1 (a): Is there a water affordability problem in England and Wales?

12. Ofwat published its draft price determinations for consultation in August 2004⁹. They showed an average increase over 5 years of 13% in average household bills, compared with the 29% proposed by companies in their final business plans. This would take average household bills from £249 in 2004/05 to £282 in 2009/10, an increase of £33. Among the big water and sewerage companies, there is a range of bill increase from 3% (Anglian) to 20% (Wessex) and a bigger range within the small water-only companies. The first year (2005/06) average increase is 7% or £17, half the total five-year increase. **Table 1** below sets this out. Final price determinations, which will take account of the Secretary of State's Final Guidance, were announced on 2nd December 2004 and will take effect on 1st April 2005.

Table 1: Average expected household bills¹⁰

(£ 2004/05 prices)	2004-05	2005-06	Year 1 increase (%)	2009-10	5-year increase (%)
Water and sewerage co.					
Anglian	294	300	2	303	3
Dwr Cymru	286	320	12	337	18
Northumbrian	232	239	3	244	5
Severn Trent	221	243	10	257	16
South West	357	386	8	418	17
Southern	259	279	8	303	17
Thames	211	242	15	244	16
United Utilities	269	271	1	315	17
Wessex	277	298	8	332	20
Yorkshire	243	253	4	279	15
Industry average¹¹	249	266	7	282	13

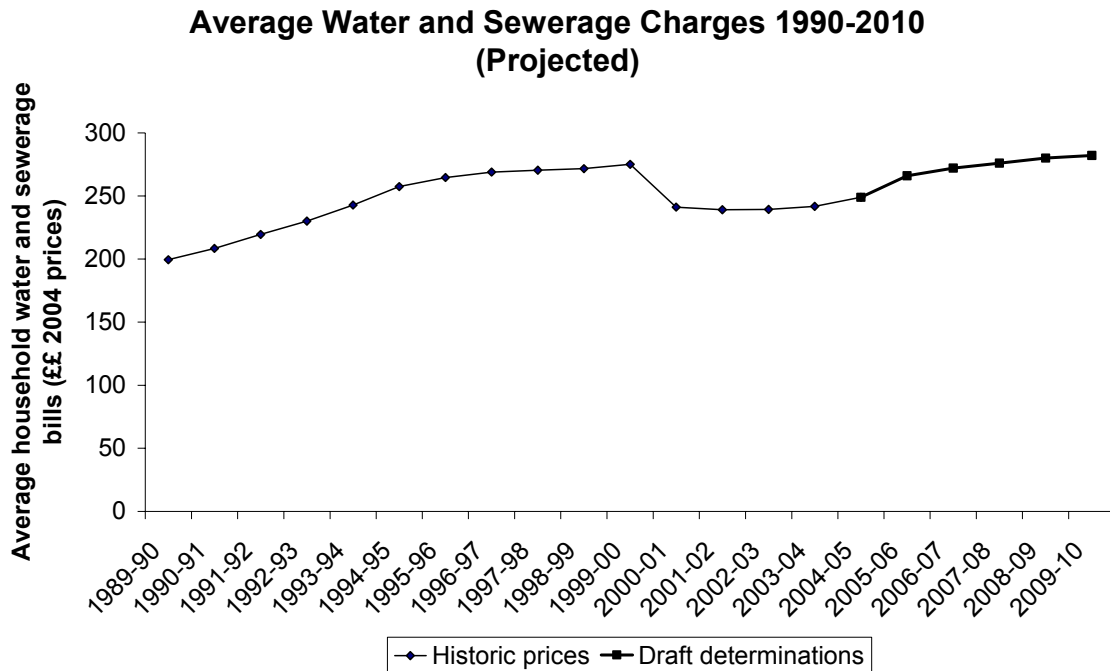
13. The proposed bill increase for the next 5 years must be set in the context of the changes in bills over a longer period. **Fig. 1** shows average household water and sewerage bills since privatization, including projected bill increases to 2010 based on Ofwat's draft determinations. The average household water and sewerage bill decreased sharply in 2000-01 following Ofwat's 1999 Price Control Review. Since then there have been gradual increases in average water charges, which are expected to continue over the next five years. However, in real terms customers will be spending only slightly more in 2009-10 than a decade earlier - £282 compared with £275 in current prices.

⁹ Available at <http://www.ofwat.gov.uk>

¹⁰ In 2004/05 prices excluding inflation based on Ofwat's draft determination numbers

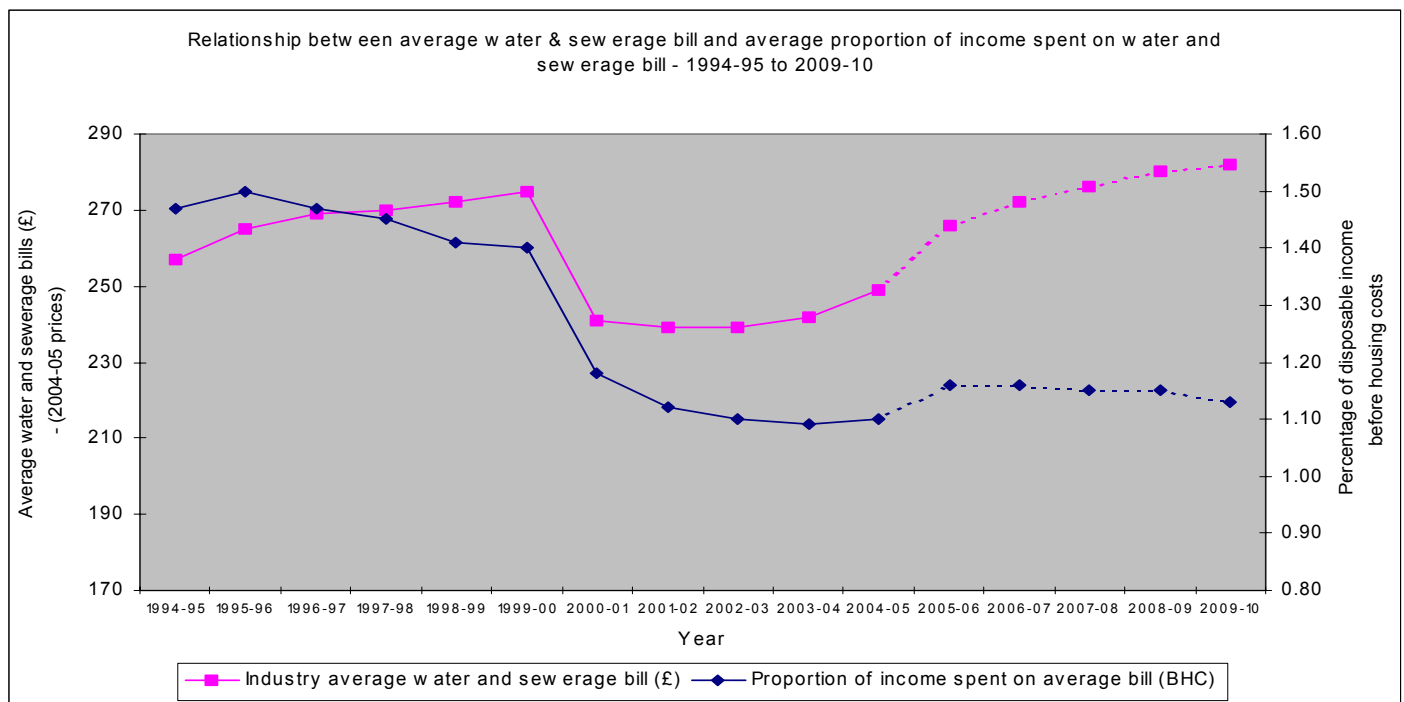
¹¹ Includes water only companies

Fig.1



14. In analysing water affordability, it is also important to measure how changes in water bills have compared with changes in household incomes. **Fig. 2** below shows the relationship between average bills and the proportion of disposable income (before housing costs) spent on bills between 1994-95 and 2009-10. Although water bills are expected to rise over the next five years, the predicted average percentage of income that will be spent on water and sewerage bills in 2009-10 (1.1%) is significantly less than that in the years before 2000-01. This figure shows data at an industry level only and is based on average income levels and average bills.

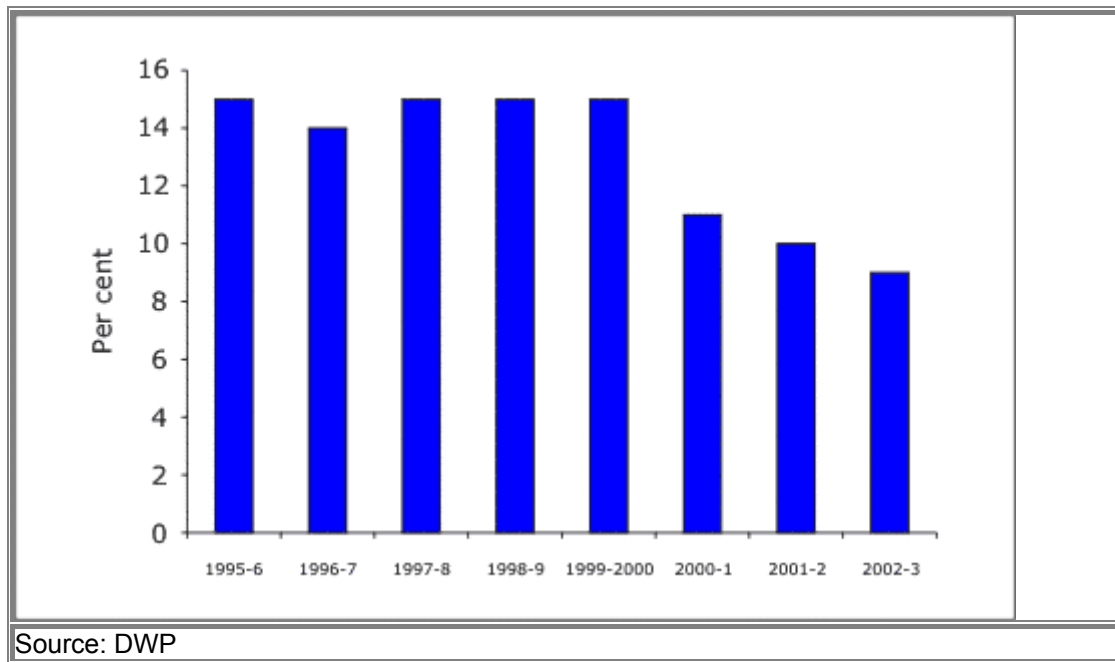
Fig. 2



15. Water affordability is one of Defra’s sustainability indicators and **Fig. 3** below, from Quality of Life Update 2004¹², shows the percentage of households in Great Britain spending more than 3% of total household income on water charges (1995-6 to 2002-3). Between 1997-8 and 2002-03, the proportion of households spending more than 3% of their income on water charges fell by 6 percentage points - from 15% to 9%. Prior to 1999, the proportion of households spending more than 3% of income on water charges was fairly constant at around 15%.

¹² <http://www.sustainable-development.gov.uk/indicators/national/index.htm> - Indicator Q3

Fig. 3: % of households in Great Britain spending more than 3% of income on water charges: 1995-6 to 2002-3

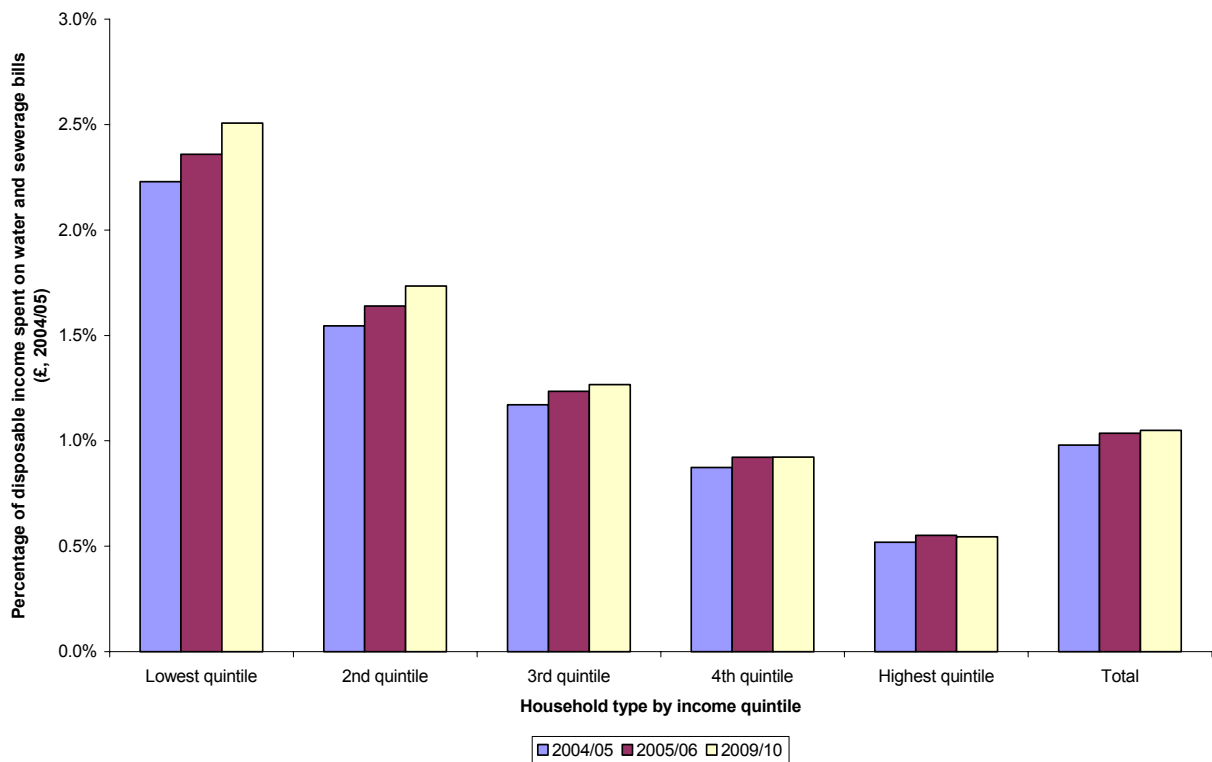


16. More detailed evidence on the extent of the water affordability issue has been collated, using forecast price rises as published in Ofwat's Draft Determinations and survey data from the Family Resources Survey (2001-02 and 2002-03). This data has been used to assess the impact of bill increases on domestic customers at a national (England and Wales), regional and household group level from 2004-05 to 2009-10.

National level (England and Wales)

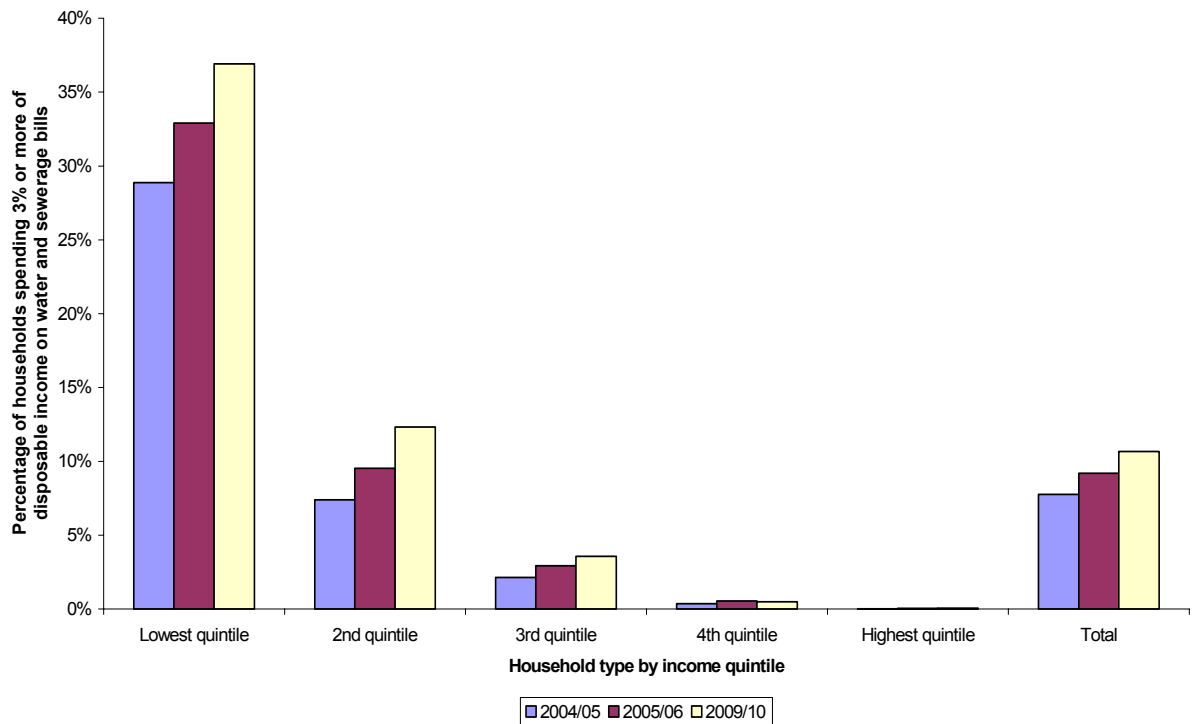
17. **Fig. 4** below shows, for England and Wales, the percentage spent on water and sewerage charges on average, and by each income quintile group, in 2004-05 and as predicted for 2005-06 and 2009-10.

Fig. 4: Percentage disposable income spent on water and sewerage by quintile: England and Wales



18. **Fig. 5** below shows, for England and Wales, the percentage of households in total, and in each income quintile group, spending more than 3% of disposable income on water and sewerage bills. On average, the percentage of households paying more than 3% of disposable income for water is estimated to rise from 8% in 2004-05 to 11% in 2009-10. However, for lower income households the figure will rise from 29% to 37%.

Fig. 5: Percentage of households spending 3%+ of disposable income on water and sewerage: England and Wales by quintile

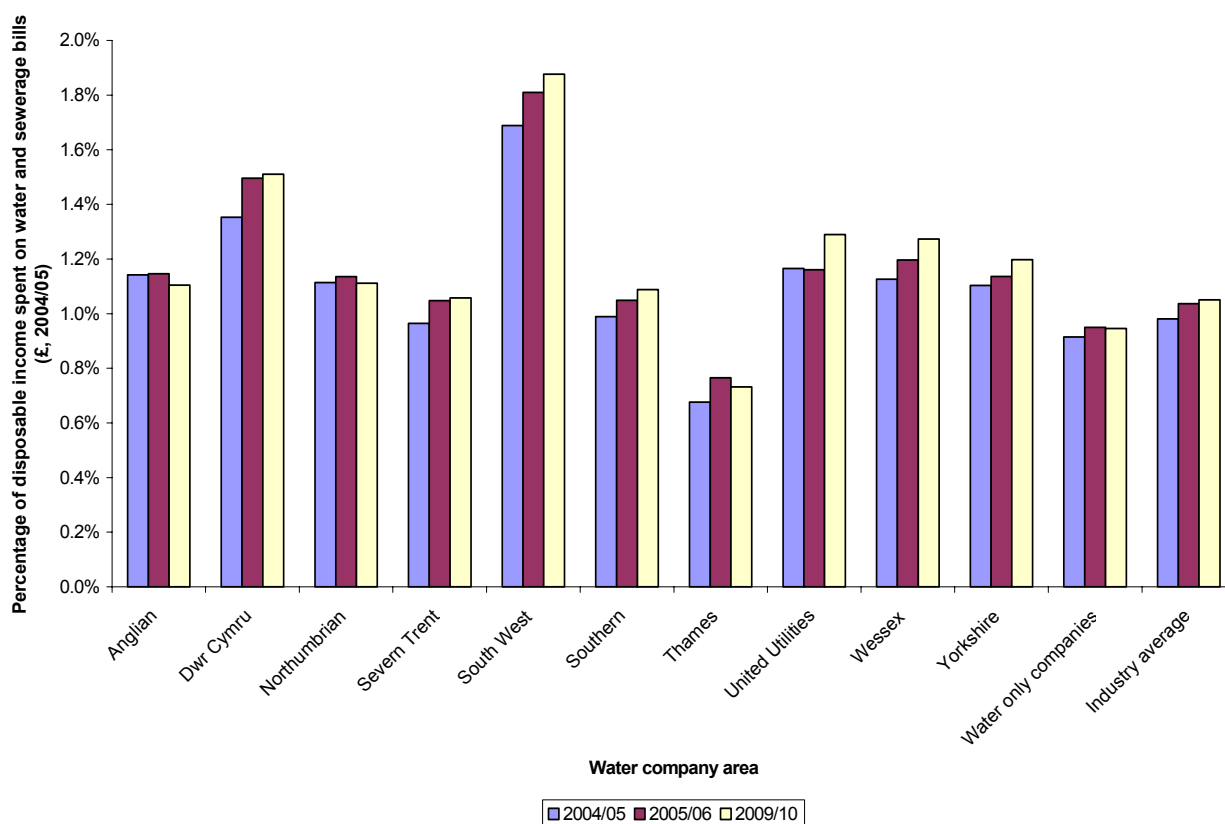


Regional level (by company area)

19. The national picture, however, masks a number of regional differences between company areas.

20. **Fig. 6** below shows, for each water and sewerage company area, the percentage of disposable income spent on water and sewerage bills in 2004-05 and as predicted for 2005-06 and 2009-10. It can be seen that whilst in some areas, for example, Thames Water, the average percentage spent on bills remains under 1% even by 2009-10, customers in other areas for example Welsh Water and South West Water will be required to spend much higher percentages of disposable income on water bills. This is likely to be due to a combination of higher bills and lower than average incomes in these areas.

Fig. 6: Average percentage disposable income spent on water and sewerage by company area

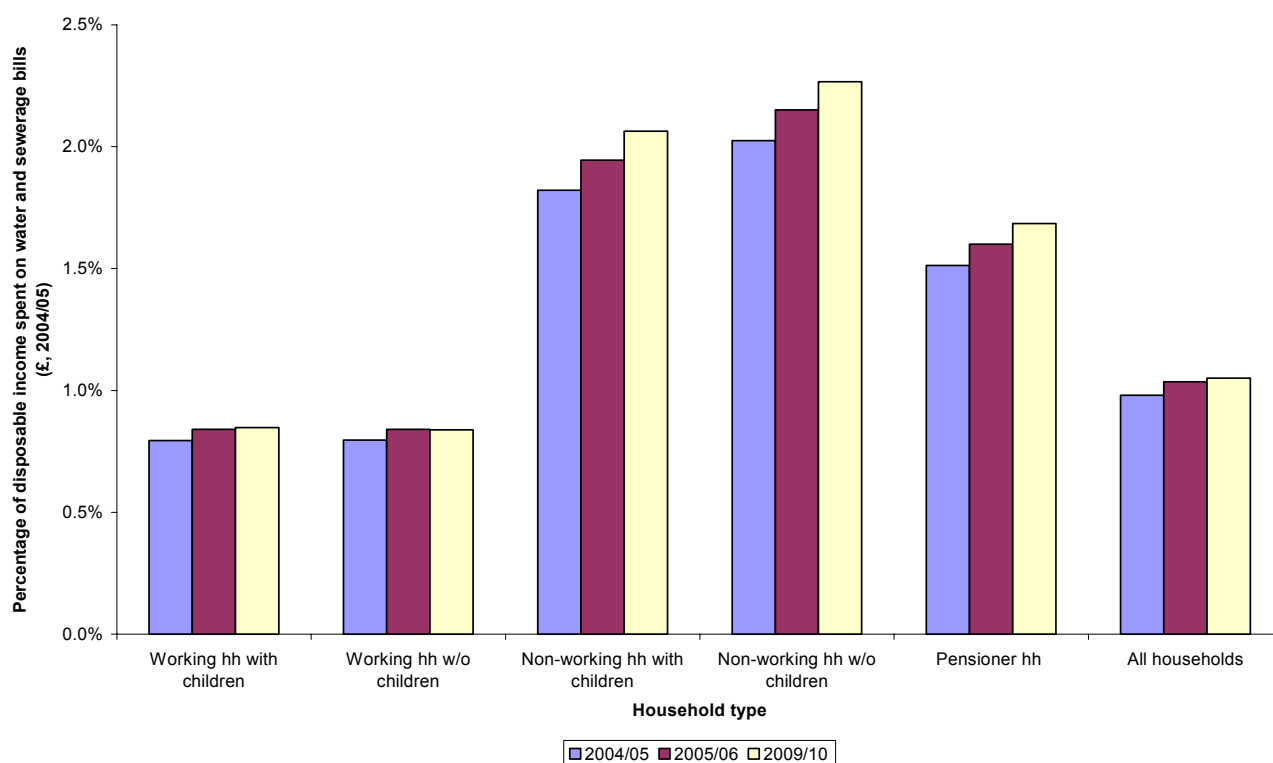


21. The above figures are based on average income levels. Lower income households will be required to spend higher percentages of their disposable income on bills in all areas, both now and in 2009-10. Further regional analysis of the bill effects on lower income customers is set out in **Annex D** along with regional detail on the proportion of households that will be spending more than 3% of disposable income on water bills.

Household type

22. National and regional breakdowns also hide a variety of effects between household groups. **Fig. 7** shows, for the five main household types, the percentage of income spent on water and sewerage charges in 2004-05, 2005-06 and 2009-10. This shows that non-working households and pensioners in particular will be required to spend a higher percentage of disposable income on bills in 2009-10. Working households do not face such marked increases as incomes are predicted to rise at a faster rate for this group (as earnings tend to rise faster than inflation and therefore faster than incomes for non-working households).

Fig. 7: Percentage income spent on water and sewerage by household type – England and Wales average



23. It must be noted that the above graphs show the average percentage spend of income on water/ sewerage bills as taken from respondents to various government surveys. Within these numbers will be a wider range of percentages that will not be reflected. For example, a single pensioner household in the South West region, living on the minimum Pension Credit allowance and paying the average water charge for the area, is forecast to be spending 7% of their disposable income on water by 2009-10.

24. Lower income customers living in the Southern Water or Welsh Water charging areas are forecast to be spending 3.5% of income on water and sewerage bills by 2009-10. Obviously, these percentages will be higher if the household's bill is above the area average.

25. **Table 2** sets out further detail of the percentage of income spent on water by 1) single pensioner households living on minimum pension credit 2) average income earners and 3) lowest quintile income earners in 2001-02, 2004-05 and as predicted for 2009-10. In all cases the household is assumed to be paying the average bill for the company area. This therefore will hide a range of different level of bills. Typical bills for any individual household will vary according to the level of rateable value for unmeasured customers or consumption level for measured customers.

Table 2

COMPANY (01-02 prices)	¹ Average household Bill 2001-02 (£)	% of income spent on bills		
		² Pensioners	^{3a} Average income earner	^{4a} Lowest quintile income earner
Anglian	262	N/A	1.17%	3.38%
Welsh	272	N/A	1.23%	3.34%
United Utilities	225	N/A	1.00%	2.72%
Northumbrian	209	N/A	0.91%	2.68%
Severn Trent	205	N/A	0.91%	2.44%
South West	312	N/A	1.37%	4.07%
Southern	241	N/A	1.03%	3.30%
Thames	198	N/A	0.77%	2.33%
Wessex	244	N/A	1.07%	3.18%
Yorkshire	216	N/A	1.00%	2.50%
Average	224	N/A	0.98%	2.79%
 				
COMPANY (04-05 prices)	⁵ Average household Bill 2004-05 (£)	⁶ Pensioners	^{3b} Average income earner	^{4b} Lowest quintile income earner
Anglian	289	5.27%	1.21%	3.51%
Welsh	287	5.23%	1.22%	3.31%
United Utilities	271	4.95%	1.13%	3.09%
Northumbrian	244	4.45%	1.00%	2.94%
Severn Trent	221	4.03%	0.93%	2.48%
South West	361	6.59%	1.49%	4.43%
Southern	259	4.72%	1.04%	3.33%
Thames	208	3.80%	0.77%	2.31%
Wessex	275	5.02%	1.14%	3.38%
Yorkshire	241	4.40%	1.05%	2.63%
Average	249	4.54%	1.02%	2.92%
 				
COMPANY (04-05 prices)	⁷ Average household Bill 2009-10 (£)	⁸ Pensioners	⁸ Average income earner	⁸ Lowest quintile income earner
Anglian	303	5.00%	1.15%	3.33%
Welsh	337	5.57%	1.30%	3.52%
United Utilities	316	5.22%	1.19%	3.26%
Northumbrian	259	4.28%	0.96%	2.83%
Severn Trent	256	4.23%	0.97%	2.60%
South West	418	6.90%	1.56%	4.64%
Southern	303	5.00%	1.10%	3.53%
Thames	244	4.03%	0.81%	2.45%
Wessex	332	5.48%	1.24%	3.69%
Yorkshire	279	4.61%	1.10%	2.76%
Average	283	4.67%	1.05%	3.01%

1 Figures provided by Ofwat

2 Minimum Pension Credit was not available in 2001-02.

3a&4a Source: Office of National Statistics - Average and lowest quintile income are disposable income figures (original income plus cash benefits less direct taxes and employees NICs) - based on analysis "The effects of taxes and benefits on household income" published on ONS website in September 2003

3a&4a Income provided in survey April 2002 prices.

3b&4b Source: Office of National Statistics - Average and lowest quintile income are disposable income figures (original income plus cash benefits less direct taxes and employees NICs)

3b&4b Income provided in survey in April 2002 prices. Inflated to 2004-05 price base.

5 Average household bill 2004-05 taken from Ofwat's average water and sewerage bills 2004-05 leaflet

6 Pensioners income 2004-05 based on minimum Pension Credit of £105.45 per week. Does not take account of any other benefit entitlements, savings, private pensions funds etc.

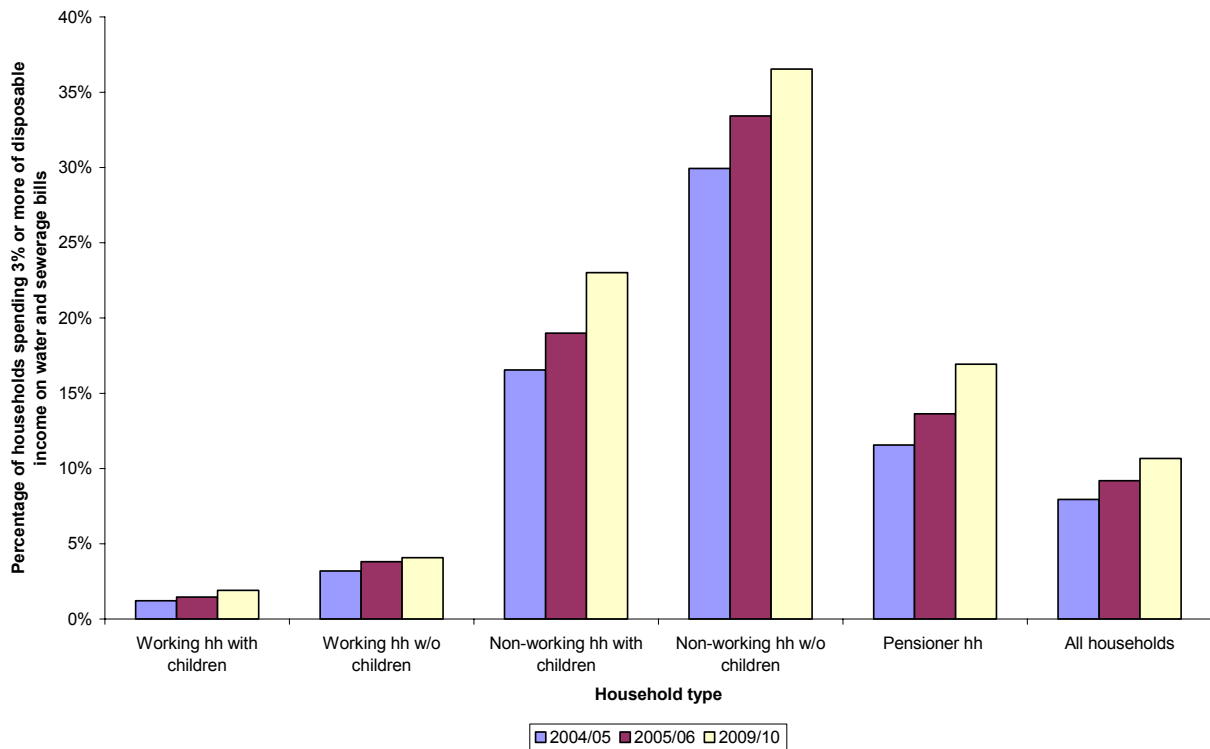
7 Average household bill 2009-10 taken from Ofwat's Draft Determination figures

8 Real income growth between 2004-05 and 2009-10 assumed to be 2% pa for each group - no inflation assumed as increases in water bills shown exclude inflation. (04-05 prices)

NB: Income data provided by ONS as shown by government office region. These regions do not correlate exactly with water & sewerage areas and therefore some assumptions have been made.

26. **Fig. 8** below shows the percentage of households in each of the main household types that will be spending more than 3% of income on bills in each year. It can be seen that a high percentage of non-working households are expected to be spending more than 3% of disposable income on water bills, particularly by 2009-10.

Fig 8: Percentage of households spending 3%+ of disposable income on water and sewerage: England and Wales Average



27. Figs. 7 and 8 are based on each household type with an average income level. More detailed analysis showing the percentage of disposable income spent on water and sewerage charges and the percentage of households spending more than 3% of income on bills by each household type with lower income can be found at **Annex C**.

28. Evidence for the impacts of the changes to the tax credits and benefits system on household incomes is given in paragraph 32.

29. Further data tables relevant to the scope and nature of the water affordability issue can be found at Annex C, along with a more detailed note of how the calculations have been undertaken at **Annex D**.

30. Water affordability needs to be set in the context of rises in other areas of household expenditure, for example, gas and electricity bills, council tax and interest rates. The issue of water affordability could be heightened, as water companies will be competing with other creditors for limited funds.

1 (b): Existing measures relating to affordability

31. This section describes the current measures that are in place to assist lower income and other vulnerable consumers. It is important to recognise that there are already a number of safeguards in place which should help customers afford and/or pay their water and sewerage bills. These measures range from the very general, for example, improvements in the tax and benefit safety net for lower income groups, to the specific, such as the vulnerable groups regulations.

Changes in taxes and benefits

32. Financial support for families and pensioners on low and moderate incomes has risen significantly in recent years. The increases reflect the Government's overall welfare priorities of providing work for all those who can and financial support for people unable to work and targeting available resources towards the most vulnerable groups. For example, as a result of personal tax and benefit measures implemented since 1997, in September this year, in real terms:

- families with children were, on average, £1,350 a year better off;
- families with children in the poorest fifth of the population were, on average, £3,000 a year better off
- pensioner households were, on average, £1,350 a year better off and
- the poorest third of pensioner households were, on average, £1,820 a year better off.

33. These increases in benefits have significantly outweighed increases in water and sewerage bills over the past five years. This has been an important factor in alleviating water affordability problems, as shown by the reduction in the number of households spending more than 3% of disposable income on water bills (see Figure 3).

Cross-subsidy in rateable value system

34. A degree of cross-subsidy is inherent in the rateable value (RV) unmeasured charging system, which is the basis on which three quarters of household pay their water bills. Customers who live in low RV properties will have lower bills. The degree to which lower income customers live in low RV properties is not, however, clear. Under this system, customers usually pay a standing charge and, in addition, an amount that varies in relation to the rateable value of their property. The costs that water companies incur in supplying customers depend ultimately on the amount of water that customers use. High RV customers tend to use more water than LV customers use. But the link is not very strong. Consequently many customers with low RVs pay less than it costs to supply them, while many customers with high RVs pay more than it costs to supply them .

35. The extent to which bills are lower for those in low RV properties will vary according to the tariff structure for any particular company. For example, Anglian Water has a large fixed charge whereas Severn Trent does not have one at all (unmeasured bills are made up completely of the RV variable charge). Therefore, lower RV customers of those companies with a high RV modifier (fixed charge) won't see as great a difference in bills as customers living in low RV properties of companies with no RV modifier. Ofwat's powers to approve charges schemes have only applied over the last five years. Neither Ofwat nor companies have wanted to make radical changes to tariff structures due to the disruptive effects this could have on winners or losers, an approach, which has been reinforced by Ministerial guidance.

Table 3: Average RV (unmeasured bill) for each WASC¹³ in 2003-04; average bill for a customer living in a property with half the average RV for that area and percentage difference

Company	Average RV Bill (2003-04 prices)	Low RV Bill	% Difference
Anglian	£316.73	£244.58	23%
Welsh	£301.74	£237.97	21%
United Utilities	£247.55	£141.27	43%
Northumbria	£220.96	£170.73	23%
Severn Trent	£219.63	£109.81	50%
South West	£416.22	£259.66	38%
Southern	£258.70	£160.92	38%
Thames	£206.38	£125.69	39%
Wessex	£276.78	£145.39	47%
Yorkshire	£239.09	£144.55	40%
Average	£244.36	£174.06	29%

Rural/ urban cross subsidies

36. It is generally more expensive to supply water and sewerage services to rural areas. Therefore, averaging of bills across company areas provides a degree of cross-subsidy from urban to rural areas, ensuring that rural households' bills are reduced.

Specific existing protections in water for vulnerable and low income groups

37. The Water Industry Act 1991¹⁴ bans the disconnection (for non-payment) of households and some other categories of customers. This has been judged to prohibit the use of flow restriction for non-payment, and thus effectively any remaining scope for pre-payment units, which have now been withdrawn in the water sector.

¹³ Water and Sewerage Company

¹⁴ As amended by the 1999 Water Industry Act

38. This is in contrast to the energy sector where cut-offs for non-payment are permitted, as a last resort, although there is a moratorium for pensioner households from October to March. Following consultation with a range of interested parties, under the umbrella of the Energy Retailers Association (ERA), suppliers have given a voluntary commitment not to disconnect vulnerable customers at any time of the year. A customer is defined as vulnerable if for reasons of age, health, disability or severe financial insecurity, they are unable to safeguard their personal welfare or the personal welfare of other members of the household. Energy suppliers have set out their approach to vulnerable customers in a document, 'Protecting Vulnerable Customers from Disconnection'¹⁵, which was published by the ERA in September 2004, following the consultation exercise.
39. All water companies have a statutory duty to promote efficient use of water. Their strategies are approved and monitored by Ofwat; however, as around 75% of household customers are on unmeasured supply, there is a limited role for water efficiency in addressing water affordability, unlike the situation in the energy sector.
40. Other provisions in the Water Act 1999 restrict compulsory metering of households in England and introduced the option for household customers to ask for a meter free of charge and to subsequently revert to an unmeasured charge within twelve months if they so choose. The cost is borne by all customers. This could help, for example, single pensioners on low incomes in high rateable value properties.
41. There are no equivalents to the targeted public spending and transfer payments that exist in energy, for example, the Warm Front scheme, though regulations do deliver extra protection for the vulnerable.

Vulnerable Groups Regulations

42. Under the Water Industry (Vulnerable Groups) Regulations 1999, certain lower income metered customers who need to use large amounts of water for medical reasons, or because they have large families, can apply to companies to have their metered bills capped. They will then pay no more than the average household bill for their area. Take up of the scheme to date has been very low; in 2003-04 only 7,200 customers were reported to be on the tariff. The EFRA Select Committee's recent report into water pricing highlighted the need to increase the impact of the scheme.

Other measures

43. Other measures to protect and assist low income and vulnerable groups include:

¹⁵ Report available at http://www.energy-retail.org.uk/pdfs/Disconnections_Report_Sep_04.pdf

- Availability of a range of accessible and frequent payment options (e.g. paying weekly at the Post Office) – the Ofwat approval of charges schemes process ensures that customers can use these methods at no or limited cost (essentially being subsidised by other customers, for example, Direct Debit payers).
- Availability of third party deductions –around 120,000 customers currently have water service charges deducted directly from benefits. DWP administers the scheme, which applies only for those who are or have been in arrears, are on specified benefits and where it would be in the interests of the family.
- Availability of charitable or hardship funds in some areas – some water companies run payment matching schemes to help ‘restart’ bill payment in households that have got into debt whereas others actually write-off outstanding amounts (relating to water and/or other debts).
- Companies also provide advice to customers on steps that they can take to manage and reduce their debt, including where appropriate referral to Citizens Advice Bureau, Money Advice Centre etc. Many companies donate money to advice agencies such as these.
- Ofwat’s Debt Guidelines set out how companies’ policies and procedures might best take account of customers who genuinely find themselves in financial difficulty. The Guidelines are consistent with good revenue collection practice. Water Voice monitors individual water companies’ performance against the Guidelines.
- Companies are also required to produce Codes of Practice on dealing with indebted domestic customers. Ofwat approves codes under Licence Condition H.

1 (c): Conclusions on the extent of the affordability problem

44. When taken together, the evidence indicates that:

- Water bills are likely to rise over the next few years. However, the average proportion of household disposable income spent on water bills is expected to remain fairly constant and significantly lower than it was before 2000/01.
- In 2005-06, when price rises are greatest, there may be difficulties for lower income groups to adjust to a big price rise, even if it is a relatively small proportion of disposable income, especially in the context of other rising bills.
- There are significant regional differences in bills and in the proportion of disposable income spent on bills between different income groups and household types.

- Price increases between 2005-06 and 2009-10 are likely to be offset by predicted rises in benefits for lower income working groups.
45. Given the conclusions outlined above, the Government, Ofwat and the water industry should push ahead with targeted short-term measures that address specific problems, pilot new ideas and consider longer-term studies of the effects of the charging system.

Section 2: Government's decisions on ways forward

46. This section looks at a number of areas where current assistance could be improved in the near term and in addition, looks at the need for longer-term studies of the effects of the charging system.

Improvements to the Vulnerable Groups Regulations

Current Regulations

47. The Water Industry (Vulnerable Groups) Regulations, introduced on 1st April 2000, were drawn up to help people who might otherwise be afraid to turn on their taps, possibly compromising their health and the health of others, because of worries about affording their bill. To qualify under the current regulations, a customer must:

- have a water meter;
- be eligible to receive certain benefits or tax credits and
- either be responsible for three or more children under 16 residing in the property or have (or have a child that has) a specified medical condition, which causes the household to use a significant amount of extra water.

48. The criteria are narrowly defined to ensure that help reaches those who need it and the cost of the help provided does not have an unacceptable impact on the bills of other customers, many of whom may also have low incomes. The Regulations do not apply in Wales, although companies do offer similar tariffs on a voluntary basis.

49. It is estimated by Defra that 100,000-200,000 households would be eligible under the current Vulnerable Groups Regulations, although it should be recognised that these figures are very uncertain, especially when estimating households that might be eligible on medical grounds. Changes made to the Regulations, to reflect the changes made to the benefits and tax credits system in 2002, came into effect from April 2003 and have brought an estimated 12,000 additional households within the scope of the scheme. However, latest Ofwat numbers report current take-up across water companies in England and Wales to be only 7,200.

50. The low number of households that have taken advantage of this scheme is partly a result of the narrowly defined criteria. However, it is believed that there is also a low take up by households who are eligible, regardless of the uncertainties surrounding the estimates of eligibility. This is likely to be due to factors such as low awareness of the scheme, complexity of the

application process, or reluctance to provide medical details or to claim for other reasons such as embarrassment.

Stakeholder Views

51. After a preliminary review of how the regulations had operated from the water companies' perspective, a consultation paper was launched in February 2003 setting out and inviting views on proposals for amending the vulnerable groups scheme. Defra received 30 replies from a range of organisations and the discussion and decisions proposed in this report takes account of the views expressed in that consultation. The consultation showed broad support for the broad principles of the current scheme and the Government intends that these remain the guiding principles when introducing changes.
52. Responses to the consultation addressed the technical criteria under which households are eligible for the scheme, and also the means of increasing take up. On the criteria, the general views of stakeholders who responded to the consultation were:
- 16-18 year olds (still in full time education) should count towards the total of 3 children;
 - the scheme should not be extended to include metered customers on low incomes with **two** or more children;
 - the scheme should not be extended to help large families with **unmeasured** supplies;
 - metered bills for single person households with qualifying medical conditions should be capped at 75% of the average;
 - the requirement that the person should be receiving treatment for the condition should be dropped from the regulations;
 - the requirement that the person with the medical condition has to be the person in receipt of the benefits or tax credits should be dropped and
 - the prescribed list of medical conditions should be extended.
53. In the stakeholder seminar/ bilateral meetings as part of the water affordability review, some considered the existing scheme to be too narrowly targeted to have any significant impact. However, there was general agreement that extending eligibility and increasing take-up through improved promotion could improve the scheme.

Way forward

54. The response to the consultation paper recommends:

- extending assistance to include dependant children (in full time education and residing in the property) up to the age of 19 instead of 16 as at present;
- allowing doctors' certificates to be introduced as qualifiers for assistance for conditions not on the specified list (evidence of treatment is acceptable evidence for conditions which are on the list);
- extending the list of qualifying medical conditions so that it is not exhaustive and specifically includes the additional conditions of Crohn's disease and Ulcerative Colitis;
- dropping the requirements that the person should be receiving treatment for a particular medical condition and that the person with the medical condition also has to be the person in receipt of the benefits or tax credits and
- a strategy for the development and sharing of good practice in advertising and publicising the scheme:
 - utilising Ofwat, Water Voice and Water UK to set up a workshop for water company officials prior to introduction of the new Regulations to share good practice in the day to day running of the scheme and discussion of good practice by Water Voice committees at Regional Managers meetings. Best practice can also be shared on the ease of the application process, training of call centre staff and naming and publicity of the scheme.
 - company publicity of the scheme through information on bills, leaflets with bills, targeted leaflet drops and wider circulation to doctors' surgeries, citizens' advice bureaux, libraries, low cost supermarkets and other public buildings. Also ensuring community workers and others who have regular contact with the public, e.g. district nurses and benefits agency staff, are fully aware of the scheme and can pass information to their clients. Defra is already working with other departments (for example, Department for Work and Pensions) to publicise the scheme through other Government literature.

55. It is also recommended that the benefits health checks be used under the Warm Front scheme to signpost customers to the Vulnerable Groups scheme (see paragraph 77). This will increase take up by helping to ensure that households who are eligible for the scheme are aware of their

entitlement. Eaga Partnership Ltd., which is one of the operators of Warm Front, is now including signposting as part of its benefits health checks.

56. Following the consultation exercise, the Government does not intend to:

- extend assistance to households with unmeasured supplies
- offer additional reductions to qualifying single person households. Although the Government recognises the attractions of a single person reduction, it is persuaded that the inherent difficulties of verification make the option impractical, at least for the time being.

57. In reaching its conclusions on the Vulnerable Groups scheme, the Government wishes to make sure that a balance is struck between building a scheme that makes an effective difference to the households on which it is targeted, and the potential burden on other customers, some of whom will themselves be on low incomes, who bear the cost of the scheme. If the regulations are to continue to offer assistance in the form of a bill capped at the average level for the area, and if the scheme is to continue to be funded by other customers, it is essential that the burden on the wider customer base is not excessive otherwise the average bill will increase and the assistance offered to qualifying vulnerable customers will become less effective.

58. The aim is for the revised Regulations to come into effect from 1st April 2005.

Developing ideas on Water Direct

The role of Water Direct

59. 'Water Direct' is one element in the Third Party Deductions (TPD) scheme operated by the Department for Work and Pensions (DWP). An established feature of the income-related benefits system, it is designed to act as a last-resort safety net for a minority of vulnerable people on benefit who have run up arrears of household bills and could face action. Where conventional payment methods have been tried but failed, a standard amount towards the arrears – currently £2.80 – plus an amount for current consumption can be deducted by the DWP from weekly benefit and paid directly to the creditor.

60. As well as water charges the scheme can be applied to arrears for gas and electricity (known as 'Fuel Direct'), housing costs, rent arrears, council tax and unpaid fines. Customers must be receiving income support, income-based Jobseeker's allowance or Pension Credit (i.e. the main means-tested benefits). Either the benefit claimant or the creditor can make an application for deductions, which DWP decides by reference to prescribed qualifying conditions (for example, the amount of the arrears).

61. In recent years there has been a steady decline in the number of deductions for Fuel Direct and Water Direct – while there were over 150,000 deductions from benefit for Water Direct in August 1999, by August 2003 this had declined to just over 114,000. However, it is important to bear in mind that falling numbers on the scheme may be more to do with ‘external’ factors such as a strong economy, high employment and significant movement from welfare to work and Government measures to tackle poverty than other ‘internal’ factors. Such internal factors include DWP adhering strictly to the guidelines on eligibility, change in structure of Benefits Offices and set up of Jobcentre Plus.
62. DWP acknowledges too, however, that applications for direct utility payments may not always be dealt with consistently across different regions or districts. A number of improvements to working practices have therefore been introduced, supported by Ofwat and the water industry and the Joint Statement of Intent – the long-standing working agreement between the DWP and the water and fuel industries on how the scheme should operate on the ground – has recently been overhauled and reissued, the revision also drawing attention to the procedural areas where shortcomings have been identified.
63. However, over and above taking steps to ensure that all those who might qualify for the current scheme have access to it, both the water and fuel industries would like to see the scope of the scheme itself radically broadened out. Ofgem have taken the lead here, and hosted a seminar to discuss the proposals, to which members of the water affordability steering group were invited, along with stakeholders from the utility industries, consumer groups and the Post Office.
64. Ideas for consideration included:
- extending what can be a useful budgeting tool to people who are not in arrears on an optional basis;
 - expansion of the scheme to include a wider range of benefits (e.g. disability living allowance, attendance allowance, long-term incapacity benefit and retirement pension) and
 - new mechanisms for DWP to operate deductions more cost effectively, loosely based on the Irish Household Budgeting Scheme, so that they can be extended to those not in arrears (e.g. as modified form of direct debit scheme administered through banks and post offices).

Stakeholder Views

66. Some stakeholders view the scheme as a useful budgeting tool but believe that it should be extended to customers who are not in arrears on an optional basis.

67. Stakeholders have also drawn attention to the Money Advice and Budgeting Scheme (MABS) operated in the Republic of Ireland by the Department of Social and Family Affairs. This scheme has similarities to the current TPD scheme in that recipients of certain social welfare payments (normally those who are in arrears with their fuel bills) can have a percentage of their benefit deducted and paid to the fuel supplier(s). However, one element of MABS is the “special account scheme” which is operated in conjunction with credit unions. A client pays an agreed amount to a credit union weekly and MABS use this to pay both current bills and an amount towards settling arrears. While there is obviously merit in this scheme it is difficult to see how it might translate to areas in the UK without healthy credit unions.
68. Ofwat and other stakeholders would also like to see the TPD scheme become more widely available, particularly to customers not in arrears but also to recipients of a wider range of benefits than at present. Evidence from research shows that customers find the option helpful.

Department for Work and Pensions’ Views

69. DWP’s initial misgivings about proposals of this kind are that they could run counter to the Government’s policy – in tandem with its payment modernisation programme – of promoting and fostering financial inclusion. DWP and other Government departments are currently making strenuous efforts to encourage as many people as possible into the financial mainstream, where by opting for conventional products like bank accounts they will, among other things, gain access to advantages familiar to most people such as the discount available when customers elect to pay bills by direct debit.
70. The proposals discussed at the Ofgem seminar, by contrast, could in this form have the opposite effect (albeit innocently) of making people think they can manage perfectly well *without* a bank account. This might have a particularly unhelpful impact, for example, on people who, moving from benefit into work, subsequently find they have to manage bill payments themselves when they have become used to having it done for them; indeed for some people it might place a barrier in the way of accepting a job in the first place.
71. Another issue within this debate is the contention by the utility industries that the scope and provisions of the current scheme are failing to meet the needs of an unquantifiable number of people who, while not actually in debt, may be prone to it and that the opportunity to use deductions from benefit as a budgeting aid might prevent it.
72. However, while the existence of such a group is not ruled out, no evidence has yet been produced (other than anecdotal) that there is a significant number of vulnerable people who are not catered for by the existing scheme; in other words, that the safety-net provided by deductions from benefit is not wide enough already. Nor does it seem to have been

considered to what extent such a putative group of actual or potential strugglers, if there is one, are all or even mostly people who are on benefit at all.

73. While fully prepared to engage in further discussions, therefore, DWP would need to be persuaded that suggestions by interested parties to widen the scope of the scheme are commensurate with the Government's over-arching social security aims and objectives. In sum, any new proposed scheme needs to demonstrate that it would:

- help and encourage people without bank accounts to open them, and thus support the Government's financial inclusion agenda;
- facilitate payment by direct debit so that customers can save on their bills;
- protect people against the adverse effect of direct debit payments which 'bounce';
- be cost-effective for DWP to introduce and administer;
- allow seamless direct debit arrangements so that when people move from benefit into work they can keep the same bill paying arrangements and
- not present a barrier to making the step from benefit into work or militate against the government's aim of promoting and maintaining a climate of personal financial and social responsibility.

74. On the particular suggestion around a system analogous to the Irish Household Budgeting Scheme, there are logistical snags about using a modified form of the direct debit scheme through banks and post offices, for example, the Post Office card account does not have the facility to make direct debits and there are expected to be over 3 million benefit recipients with these accounts by April 2005.

75. DWP has no current plans to extend the list of benefits from which TPDs can be made.

Way forward

76. Government, specifically Department for Work and Pensions, should work with stakeholders, including water companies, Ofwat and Ofgem, to explore proposals for possible changes/ extensions to the Third Party Deductions Scheme, including Water Direct.

Water affordability pilot study linked to Warm Front

Background

77. Government is keen that new approaches to tackling water affordability problems should be tested and lessons learned that might be more widely applicable. One such approach would be to pilot a scheme to offer targeted, detailed assistance to lower income households in a geographic location to help them access all available assistance, and (for metered customers) do more to use water efficiently to minimise their household water bills. Such a pilot could also help to promote the revised Vulnerable Groups Regulations.
78. The idea of targeted, detailed assistance is analogous to the Government's Warm Front initiative in the energy sectors. Eaga Partnership Ltd. (which is one of two organisations responsible for operating Warm Front across England) provides a range of insulation and heating materials and advice to a range of vulnerable households. Eaga estimates that benefits entitlement checks, which are offered to householders not in receipt of qualifying benefits when they apply to the Scheme, can increase incomes by up to £25 per week.
79. Eaga's Watersmart project estimated in 1999 that spending £50 per property on water efficiency measures could reduce household water consumption by about 11% (40 litres/property/day).
80. One of the purposes of a pilot would be to test the potential benefits that a number of actions taken together could achieve in the water sector today.

Principles of the pilot study

81. The primary objective of the pilot study would be to ease water affordability problems. Although it would not be conceived as a drive for metering or water conservation, it would also have benefits for water efficiency.
82. Such a pilot would ideally include:
- benefits entitlement check;
 - debt management or repayment plan advice;
 - check for eligibility for Vulnerable Groups Tariff;
 - check for eligibility for Water Direct scheme;
 - water efficiency advice;
 - installation of water efficient appliances and devices, for example, cistern displacement devices, tap inserts, efficient showerheads;

- check for water leakages and
 - check to see if switching to a metered supply could be cheaper, when all the other aspects of the scheme are taken together.
83. Some of these measures will only assist metered customers (for example, water efficiency measures).
84. The success of the pilot would be measured by means of monitoring the proportion of income spent on water and sewerage bills for households who had accepted the additional measures, before and after participation in the scheme.
85. There are a number of overlaps with the Government's Warm Front Scheme, in terms of those who could benefit from such assistance and so a separate scheme for water might result in a duplication of effort and it would be less simple for customers. A pilot that runs alongside the Warm Front could therefore be pursued. Households which experience fuel poverty may be the same households who have difficulty in paying their water and sewerage bills.
86. The Warm Front scheme covers England; however, the pilot would concentrate in a chosen locality in order to test its success in reducing the proportion of household income of lower income customers spent on water and sewerage charges and whether it is something which should be extended to other areas. The pilot would best be carried out in an area with the following characteristics:
- relatively high water and sewerage charges and
 - large proportion of low income households
87. We would wish to work with the local water undertaker to identify areas for a pilot and possibly also to channel suitable customers towards it.
88. Within the pilot area, the aim should be to cover a range of households, e.g. measured, unmeasured, urban, rural, high and low rateable value or council tax bands, to observe a spread of the impacts.
89. About 1000 households would provide a sufficient baseline for monitoring the pilot study. We would initially investigate the possibility of Warm Front delivery agents asking those who apply for the scheme if they would also be interested in assistance to potentially reduce their water and sewerage bills. The households would need to sign up to the pilot study and agree to be monitored over coming months.
90. The additional measures required for water affordability would be simple and non-disruptive and would be developed to ensure that they do not have a negative impact on the Warm Front scheme.

91. Once a pilot and the practical details are agreed (through discussion with stakeholders) we would envisage delivery over a period of about 3 months. The effects of this assistance would be monitored over a period of at least 12 months, specifically any change in the proportion of household income spent on water and sewerage charges.

92. The initial data that would need to be recorded for each household offered the assistance would be:

- whether or not they accepted the additional offer of assistance;
- the size of each household's last water and sewerage bill (and the period it covered) both in £ and volume used, if applicable;
- which measures were accepted by the household (all should be offered where appropriate) and
- details of household – number and age of occupants, household income

93. The pilot would then follow up by monitoring:

- the size of the subsequent water and sewerage bills (£ and volume used) received. In linking the increase/decrease to the measures the project had implemented, external factors would have to be taken into account, for example, weather, change in number of occupants, changes in income, changes to tariffs and
- feedback from customers on the additional measures, for example, by a questionnaire or telephone interview.

94. There is a range of appliances and devices that could be provided to metered customers and some examples are given below. However, it is recommended that only some of these be offered to customers, to minimise costs, disruption to the household and the need for training/recruiting staff to fit the appliances. This would limit the savings that could be made but the more expensive appliances could be reconsidered if the pilot was expanded in the future and more funding was made available.

Toilets

- About 31% household water use.
- Dual flush retrofit devices (which give the option of full or smaller toilet flushes) cost in the region of £10-20, but would require some know-how to fit.
- **Cistern displacement devices** (hogs, hippos, etc) - likely to be very cheap, but likely to offer lower water savings.

Kitchen/bathroom sink taps

- About 24% household water use.
- **Tap Magic (spray tap inserts)** - 10 for £12 (manufacturer claims 70% water saving, but may be some issues in hard water area).
- Re-washing dripping taps is also quite cheap and effective.

Showers

- About 5% household water use.
- **Water efficient shower heads** - £12-16 (manufacturer claims 40-50% saving dependent on current flow within the household)

Outside supply

- About 4% household water use.
- Water butts - £20

(NB: the other means of household water use are the bath (15%), dishwasher (1%) and washing machine (20%). Percentages depend upon the area of the country, property type and tenant type.)

95. The appliances/ devices that are recommended should be offered to metered customers are: spray tap inserts, water efficient showerheads and cistern displacement devices. Water efficiency advice and leakage repair could also result in a potentially significant saving for metered customers.
96. We will be discussing with the local water company how this pilot study could be taken forward and funded.
97. It would be an opportunity to gather evidence and the results could be shared with the water company and with other water company areas with a view to extending the scheme (and maybe increasing the assistance offered). The pilot study is linked to debt management and the Government's financial inclusion agenda (through the benefits entitlement check and advice).
98. It is likely that the pilot study will lead to an increased number of lower income and vulnerable customers switching to a measured supply. The Joseph Rowntree Foundation Report, 'Green taxes and charges: reducing their impact on low-income households' ¹⁷ notes that a significant proportion of unmeasured lower income households would financially benefit from switching to a measured supply.
99. If the pilot was a success in terms of lower income households reducing the proportion of their income spent on water and sewerage charges, by making savings on their water bills and/ or increasing their income through benefits checks, it could be extended. However, there would be important issues to address then:

¹⁷ <http://www.jrf.org.uk/bookshop/eBooks/1859352472.pdf>

- funding: Warm Front is scheme in the English energy sector and will have £250m Government funding in 2007-08. How much would a water scheme be likely to cost?
- legislation: Payments made through Warm Front are covered by legislation in the Social Security Act. This might need to be amended to include water as well as energy.
- targets: if Government were to provide funding on a larger scale, it would probably require targets for delivery, as there are for fuel poverty.

Stakeholder Views

100. Several stakeholders support the pilot in principle but think that the water efficiency measures will have a very limited impact on bills.

Way forward

101. A local scale pilot scheme should be carried out to target water affordability assistance to lower income households, involving the Government, local water company and other stakeholders, with an investigation of the possibility of running this alongside the existing Warm Front scheme. This pilot study would assess the combined impacts of benefits checks, water efficiency measures and metering.

Sharing of best practice between companies

Background

102. There is evidence that water affordability difficulties are likely to continue to grow, for certain households in certain regions, in the coming years to 2010. This may lead to higher levels of non-payment as a result and it is therefore in the interests of all customers that companies offset this with improved management of customer debt as a whole.

103. The likely rise in water charges in the coming period suggest there is a stronger case than ever for companies to pool ideas and even resources to increase understanding on how best to support lower income customers having trouble with bills or in debt to the water company.

104. Water companies already have various structures in place to discuss these issues and share best practice.

- Water UK Debt Focus group and its 6 working groups;
- Water UK led research shared with companies;

- customer service network and
- seminars

105. However, the steering group believes that developing these structures will help companies be better placed to face the challenges ahead. Key areas where evidence suggests that water companies could do better by working more closely together include:

- promotion of Vulnerable Groups Regulations (a strategy is proposed in the response to the consultation);
- referring customers to debt advice agencies where appropriate (links to Government's financial inclusion agenda);
- availability of charitable trusts;
- range of payment options;
- effectiveness of various debt collection methods and
- promotion of free meter option (targeted at lower income customers)

106. The targeted promotion of the free meter option may be an effective option for addressing affordability but the levels of promotion and take-up vary between companies.

107. Water UK would be best placed to facilitate improved structures for the sharing of best practice as they already have frameworks in place. There are also other opportunities to share best practice, for example, Water Voice's best practice register.

Way forward

108. Water companies should continue to work together to spread and deliver best practice on key affordability /debt related issues, with an initial focus on:

- promotion of Vulnerable Groups Regulations (a strategy is proposed in the response to the consultation);
- referring customers to debt advice agencies where appropriate (links to Government's financial inclusion agenda) ;
- availability and effectiveness of restart funds and charitable trusts;

- range of payment options;
- debt collection methods and
- promotion of the free meter option (targeted at lower income customers)

109. Ofwat and Defra should agree with Water UK ways of reporting on these new mechanisms.

Updating of Ofwat guidelines on debt recovery

Background

110. Ofwat's debt recovery guidelines set out how companies' policies and procedures might best take account of customers who genuinely find themselves in financial difficulty. The guidelines cover what Ofwat considers to be the main issues for vulnerable customers, with reference to the various approaches companies employ, and expose Ofwat's expectations. Although not intended to act as evidence on effective debt recovery, the guidelines are consistent with good revenue collection practice.

Recommendation

111. It is recommended that Ofwat undertake a review of the debt guidelines in 2006 (last updated in 2002) to update and promote good practice by companies. This may involve commissioning/ contributing to further debt research where appropriate, for example, UK Water Industry Research, with a view to gaining a better understanding of debt issues which can then be used to feed into the review of the Guidelines in 2006.

Studies of effects of charging system

Current charging system

112. The majority of household customers in England and Wales have an unmeasured charging system. 24% of households have a measured charging system, increasing by about 2% a year.

113. Unmeasured bills generally consist of a fixed (standing) charge and a variable charge which will be in the form of an amount per £ of rateable value (RV). The fixed charge covers customer-related costs (including billing). In some cases it also includes an 'RV modifier' which companies use to vary the proportion of fixed to variable charge in their tariff structures. For example, Anglian Water has a large fixed charge whereas Severn Trent Water does not have one at all (unmeasured bills are made up completely of the RV variable charge).

114. A degree of cross-subsidy exists within the unmeasured charging system, in that customers on lower incomes may live in low RV properties and therefore have lower bills (RVs are broadly socially progressive). The extent to which bills are lower for those in low RV properties will, however, vary according to the tariff structure for any particular company.
115. The assumption that low-income customers will be living in low rateable value properties may not actually be the case. There may be some higher income customers living in low RV properties and lower income customers living in high RV properties (where the option to switch to a meter may help protect against high unmeasured bills).
116. The reason for different levels of RV modifier (the fixed charge element) dates back to the tariff structures in place in previous years. Since the Approval of Charges Schemes process began in 2000, Ofwat has not been keen for companies to alter the unmeasured tariff structure due to rebalancing implications (especially on lower income groups). However, it is difficult for Ofwat to prohibit changes that would reflect tariff structures already approved for other companies. Any variation made to tariff structures in this way could have significant consequences for certain groups. Reducing the fixed charge (and as a consequence increasing the variable element), for example, will not help lower income customers living in high RV properties. Equally, increasing the fixed charge will disadvantage customers living in low RV properties.
117. The measured bill generally has two elements - a standing charge which is fixed irrespective of consumption (typically around £20 for water and higher for sewerage as this normally includes an amount to cover surface water drainage), and is the same for all customers on the tariff, and a volumetric charge. The higher the fixed (standing) charge, the less variability in bills if consumption alters. High standing charges lessen the incentives for customers to control their consumption. However, there are a number of fixed costs that companies must recover, regardless of how high (or low) an individual's consumption, for example to cover meter reading and billing. This could be particularly important for second home owners, for example, where the level of water consumption is likely to be relatively low but the fixed costs incurred by the company in supplying the customer, for example, meter reading and billing, will remain the same as for other customers.
118. Two companies - Anglian Water (including Hartlepool Water) and Mid Kent Water - have a metered tariff for low usage households. The tariffs are structured with no standing charge and a higher than standard volumetric charge. To benefit from the tariff, customers must use no more than the break-even volume (the volume above which the tariff is no longer beneficial). This is currently 75m³ per year. However, whilst this tariff may benefit low usage low-income households, it would also benefit high-income low usage households (for example single professional households) or second homeowners.

Other tariffs

119. Other than the Vulnerable Group Tariff, there are currently very few 'social' tariffs within the water sector. The Secretary of State has given guidance to the Director General of Water Services that said that where companies devise well considered and workable proposals for social tariffs, which do not have an unacceptable impact on other customers' bills and do not represent 'undue discrimination,' the presumption should be that such tariffs should be allowed in charges schemes. However, to date, no such proposals have been judged to meet the criteria.
120. Ofwat will continue to consider proposals for new social tariffs where companies can show that they are properly targeted and will only have a small impact on other customers' bills. However, Ofwat will not require companies to introduce such tariffs without further guidance from the Secretary of State or the introduction of new legislation.
121. More sophisticated tariffs, such as rising block tariffs (where a specified amount of water is charged at a lower rate than subsequent usage) have been discussed by some companies, but none are yet in existence. This type of tariff would only be workable for measured customers and would require the installation of 'smart' meters.
122. Ofwat thinks that rising block tariffs are a poorly targeted form of social assistance. Although they may benefit some lower income households, they disadvantage lower income households that need a lot of water for essential purposes, for example, large families. They also benefit higher income households with low water use, for example, second home owners.

Free meter option

123. The Joseph Rowntree Foundation Report, 'Green taxes and charges: reducing their impact on low-income households' ¹⁸ notes that a significant proportion of unmeasured lower income households would financially benefit from switching to a measured supply.
124. However, the free meter option has implications for lower income customers' bills who remain unmeasured, as there are rebalancing effects to the rest of the tariff basket when customers who would benefit switch to a meter.
125. Metering could be a clear way for Government to emphasise that conservation is important for environmental reasons and to encourage customers to take responsibility for the volume of water they use.

¹⁸ <http://www.jrf.org.uk/bookshop/eBooks/1859352472.pdf>

Universal metering

126. There is a view amongst some stakeholders that all customers should be metered.
127. It is not the Government's policy to press household customers to adopt metering. Metering has clear advantages in the longer term as a method of water charging and is increasing steadily though customers' own choices.
128. Ofwat are against universal metering. Aside from the increasingly severe impact on the bills of the dwindling unmeasured household customer base and other practicality issues, Ofwat consider that, in many areas, the extra costs might outweigh the benefits in water savings.
129. Water Voice has revisited its stances on metering and has recently clarified its position. In its policy statement¹⁹, Water Voice considers that most customers, in the long term, should pay water and sewerage bills on the basis of a metered supply, but that lower income customers should receive help through the benefits and tax credit system. It identifies some of the hurdles that would need to be cleared before proceeding to universal metering across England and Wales.

Maxwell Stamp study and Lyons inquiry

130. In 1998, Maxwell Stamp carried out a study for DETR on the distributional effects on households of changing from the RV basis for charging to alternative measured and unmeasured options. Specifically the report examined the impact of a move to unmeasured charges based on council tax bands or a flat charge and measured charges based on a variety of tariffs, for example, rising block and seasonal tariffs. The analysis showed that, although certain groups would gain from these changes to the charging system, a significant number would lose and they would be likely to be in the lower income bands. As a result, Government did not recommend the changes and the charging system remained the same.
131. The Independent Local Government Finance Review is currently being conducted by Sir Michael Lyons²⁰ to examine how to make the council tax system fairer and more sustainable. Any reform could have an impact on the potential effects of moving to a water charging system based on council tax bands. Sir Michael Lyons will report to the Deputy Prime Minister and the Chancellor by the end of 2005.

¹⁹ Full Water Voice policy statement on metering:

<http://www.watervoice.org.uk/aptrix/ofwat/publish.nsf/Content/wv29%2F04>

²⁰ News release at http://www.odpm.gov.uk/pns/DisplayPN.cgi?pn_id=2004_0172

Stakeholder Views

132. In Ofwat's consultation paper 'Approval of Companies' Charges Schemes 2001-02' views were sought on social tariffs. The conclusions (published in MD165²¹) noted that the majority of respondents were opposed to the introduction of social tariffs over and above those already provided for under the Vulnerable Groups Regulations. Respondents (including companies and consumer organisations) generally felt that the water charging system was not the appropriate mechanism for the delivery of social policy objectives and this matter should be decided by Government rather than by companies. Additionally, social tariffs would increase the extent that one group of customers is cross subsidised by others. Customer research has shown that customer support for cross subsidies to help 'vulnerable' customers is limited. Stakeholders confirmed these views at Ofwat's Forward Programme Workshop (November 2003). Ofwat has not accepted new proposals from companies who wish to introduce low user tariffs. Anglian Water and Mid Kent Water were not required to withdraw their existing low user tariffs due to the adverse effects this would potentially have created for customers already on the tariff.
133. Although the affordability review has been essentially driven by the importance of identifying the scope for improving the *existing* mechanisms, many stakeholders have argued the case for more fundamental reforms, for example to council tax bands or in regard to the policy on metering.
134. Several stakeholders have emphasised that in the longer term the outcome of the Lyons Inquiry of the council tax system may provide opportunities for addressing water affordability and replacing the RV system. These stakeholders supported a revisit to the Maxwell Stamp study.

Government's views

135. The Government recognises the argument that only fairly radical changes to the current regulatory and legislative framework would be likely to deliver a significant change to the water affordability agenda and the way in which households are currently charged. However, instability will always be a drawback to changing the charging basis that presents customers with great uncertainty. The Government also recognises that the gradual move towards metering projected by Ofwat will change the terms of the debate over time, though it is not clear what the distributional consequences of that switch (or an accelerated move) might be. Ofwat believes that a switch (or an accelerated move) will result in more cost-reflective charging, but that the social cross subsidy to lower income, low RV customers will be unwound.

²¹ MD165 – Approval of Companies' Charges Schemes in 2001-02 – (September 2000)

²² MD165 – Approval of Companies' Charges Schemes in 2001-02 – (September 2000)

136. In light of that, and the Lyons inquiry of council tax funding, scheduled to report at the end of 2005, we think it would be advisable to do some further groundwork to better understand these issues, and, in light of that work and the Lyons inquiry, to consider the case for a more fundamental review of charging options. At present, the law prevents the use of council tax as a charging basis.

Way forward

137. Government officials should work with Ofwat and Water UK in the coming months to build the evidence base on the likely uptake of optional meters in the 2005-10 period and the potential distributional consequences for water consumers. They should report findings to Ministers by the end of 2005.

138. Government and Ofwat should consider the case for a review of the current RV based charging system for non-metered households in the light of the findings of the Lyons inquiry²³ into Local Government funding.

139. Companies, Ofwat and Government should consider the case for suitable tariff changes for customers.

140. The recommended studies would look at how low-income groups may be affected by any change to the current charging system.

Further stakeholder suggestions

Changes to the tax and benefits system

141. Several stakeholders have advocated a link between water charges and the tax and benefits system to help lower income households pay for their water bills. For example, in their report on water pricing published in December 2003 the Environment Select Committee said, *“People suffering from serious difficulty in paying their bills should be helped through the benefits and tax credits system”*. Specific suggestions include:

- Including an individual allowance for water and sewerage charges in qualifying benefits, for example, income support, tax credits, equivalent to the current amount for water and sewerage charges payable by the individual customer (instead of the current notional amount of unknown quantity) and paid directly to the water company.
- Voucher/passport issued on entitlement to qualifying benefit to cover customer's current amount for water and sewerage charges.
- Water Charges Benefit (akin to council tax benefit) - local authorities to extend council tax benefit applications to cover water and sewerage charges through a water charges benefit. Local authorities issue

²³ http://www.odpm.gov.uk/pns/DisplayPN.cgi?pn_id=2004_0172 for OPDM Press Notice

certificate to water and sewerage companies who claim reimbursement from Government.

142. Ofwat considers that it would reduce the accountability of water companies to their customers and have potentially damaging long-term effects on water use and conservation if the principle that water charges should be broadly reflective of costs were abandoned. Accordingly, apart from such relatively small changes as the proposed amendments to the vulnerable group regulations proposed in this report, Ofwat considers that if the Government wishes to offer further assistance to less well off water customers for social policy reasons, such assistance should be paid through the benefit system, supported by the tax payer, rather than at the expense of water customers generally.
143. The Scottish Executive is also currently consulting on a proposal to offer a discounted tariff to those households in receipt of council tax benefit²⁴ rather than the existing approach of offering a discount to single occupiers and second home owners (i.e. those in receipt of council tax discount which does not reflect income level). However, this approach would not be directly applicable in England and Wales, given differences in the water charging arrangements north and south of the border.

Reasons for not recommending

144. The Government does not intend to introduce an explicit linkage between the tax and benefit system and water charges. Financial support for families on low and moderate incomes and for pensioners has risen significantly in recent years (see paragraph 32). The Government will press on with its policies of work as the best form of welfare, promoting fairness and using changes to the tax and benefit system to tackle poverty, for example child and pensioner poverty.
145. Even without changes to the tax and benefits system, part of the increase in water bills will automatically be offset through uprating adjustments to benefits. Average increases in water bills will be reflected in ROSSI, the index used to uprate Income Support and Jobseeker's Allowance, and in the RPI that is used to uprate Child Benefit and the Basic State Pension.
146. The Government believes that making further links between water charges and taxes and benefits would have significant drawbacks. Each of the specific suggestions listed above is a variation on the theme that the individual cost for water charges for low-income customers should be identified and then provided for as a payment separate to all the other disbursements for which benefits and tax credits are intended.

²⁴The Scottish Executive consultation, 'Paying for Water Services 2006-2010,' is at <http://www.scotland.gov.uk/consultations/environment/pfws-00.asp>.

147. In general the tax credit and benefit systems do not provide targeted support for the costs of particular goods or services. There are exceptions to this, for example Housing Benefit and the childcare element of the Working Tax Credit. But rents and childcare costs typically represent a far larger proportion of household expenditure than water and sewerage charges. Extending the range of the goods and services whose costs are directly supported through tax credits or benefits in a targeted way would complicate the systems and increase administration costs at a time when the Government is seeking to simplify the benefits system.
148. Any corresponding reduction in benefit rates which would necessarily result from making payments for water and sewerage charges separate from benefits would have the effect of reducing the benefit of non-householders who do not have water charges to pay. The Government has no plans to reduce the current benefit rates of non-householders.
149. Paying for water charges separately from overall benefit and paying them directly to the water supplier also works against the financial inclusion agenda as it takes responsibility away from the claimant. . This could be problematic at a time when the Government is working to increase the numbers of benefit claimants with bank accounts and encourage the use of direct debits to pay bills. It could also give rise to potential problems in budgeting and paying bills for a number of those people who move from benefit into work.
150. Finally, there would also be significant IT and administrative costs for these options at a time when DWP is facing a reduction in its staffing. The IT costs would be incurred because DWP does not currently have systems that could deliver these options. The administrative costs would be a result of operating the scheme on a day-to-day basis, including gathering information about water charges – while many people would have this information to hand when making a claim, others would not, which could lead to delays in paying benefit.

Improving companies' access to information

151. It has been suggested that water companies would benefit from changes to the data protection laws to help with debt recovery and targeting of assistance to potentially vulnerable customers.
152. However other stakeholders are concerned about the customers' right to privacy.

Reason not recommended

153. The Office of the Information Commissioner has clarified what can be done within the present legislation and this information has been passed to Water UK, to ensure that companies are doing all that is possible. Local

²⁵The Scottish Executive consultation, 'Paying for Water Services 2006-2010,' is at <http://www.scotland.gov.uk/consultations/environment/pfws-00.asp>.

Authorities cannot usually disclose customers' details to private companies but exemptions can be made, for example, in connection with legal proceedings. Any proposed changes to the Data Protection Act would need to be addressed to the Department for Constitutional Affairs.

Merging of water companies

154. Suggestions of mergers between water companies to share high costs across a wider customer base cannot be considered as a way forward.

Reason not recommended

155. There are constraints on mergers, which the Enterprise Act puts outside Ministerial control. Additionally, any merger would not lead to customers of one (low-cost) company subsidising customers of another (high-cost) company. As in previous mergers, customers of the low-cost company would need to be protected from such a change in bills.

Cross subsidy between customers in different company areas

156. There is currently no cross subsidy between customers in different company areas which means that prices can continue to rise sharply in some areas (for example, the South West) whilst being constrained in others (for example, Anglian).

Reason not recommended

157. For customers of one company to subsidise those in another would tend to reduce the accountability of companies to their customers.

Conclusions

158. Ofwat will continue to set price limits to ensure that customers pay no more than is necessary whilst enabling each company to finance and to run its business efficiently.

159. However, water affordability is an issue for some lower income households and is more noticeable for certain households/areas:

- generally, water affordability is unlikely to be an issue for average income earners but may be a problem for specific income and / or consumer groups (for example, low-income, pensioners, non-working households). There are also regions where the problem appears to be more significant, for example, Wales and the South West;
- lower income customers spend a higher proportion of their income on water and sewerage bills than higher income customers in all areas. In 2004-05, lower income households in the South West region spent the highest proportion at 3.2% and
- Most household groups are predicted to spend more as a proportion of income on bills in 2009-10 than in 2004-05. The average water burden for the lowest income group is forecast to rise from 2.2% of income in 2004-05 to 2.5% in 2009-10. For the highest income group the figures remain steady at 0.5% of income. However this is less than the proportion of income spent on water and sewerage charges pre 1999-2000 and in real terms, customers will only be spending slightly more in 2009-10 than a decade earlier.

160. However, the water affordability problem is strongly outweighed by Government action to increase the incomes of lower income households through the tax credit and benefits system.

161. There are already methods of assistance in place to assist lower income households with payment of their water and sewerage charges but there is scope for improving them in the near term. Ways of doing so are outlined in this report, in addition to a description of longer-term studies of the effects of the charging system.

Annex A

Select Committees' recommendations on water affordability and the Government's response

Environment, Food and Rural Affairs Committee

Water Pricing, December 2003

Recommendation 9: Fixing bills at the level that the poorest in society can afford to pay would jeopardise the improvements in services and quality that have undoubtedly been made and would fail to emphasise that water is a valuable resource. But the difficulties some customers face in paying their water bills are a matter of great concern to the Committee. Measures to help vulnerable customers do not appear to have been effective.

Recommendation 10. People suffering from serious difficulty in paying their bills should be helped through the benefits and tax credits system. The Government should review the way in which poorer households are helped with their water and sewerage charges. It should ensure that mechanisms to help people pay their water bills take account of the regional variation in those bills.

Government response: The Government shares the Committee's concerns about the affordability of water. We are giving careful consideration to a review of the way in which poorer households are helped with their water and sewerage charges and will invite views from interested parties in due course.

Current benefit levels are intended to help meet general household bills, including water. The Third Party Deduction Scheme enables companies to collect payments or recoup debts out of customers' benefit payments, where the criteria are satisfied. There is no regional variation of benefits.

The benefits system does provide help to those people who satisfy the qualifying criteria. No separate amounts for specific items are included in the income-related benefit rates - beneficiaries are free to choose for themselves how they spend their benefit. The Government does consider relevant research, like that produced by the Family Budget Unit, when setting benefit levels, but we also need to take into account other objectives like work incentives and controlling public expenditure.

Ofwat is under a duty to set price limits at a level that will allow efficient companies to continue to finance their functions, while also seeking to protect the customers of monopoly utility companies. It will endeavour to set price limits that ensure that customers do not have to pay more than is necessary to provide an efficient service.

The Government recognise that debt levels in the water industry are rising and that some customers may face difficulties in paying their bills. We expect companies to have measures in place to allow them to deal effectively and sensitively with customers in debt.

Environmental Audit Committee

Water: The Periodic Review and the Environmental Programme, May 2004

Recommendation 20: Water prices are going to continue to rise for the foreseeable future. As a result there will be an increasingly large proportion of the population on lower incomes that will find it difficult to pay water bills. If the Regulator is to continue to price water realistically, as is his duty, the Government is going to have to address this issue seriously. We strongly support the EFRA Committee recommendation that people suffering from serious difficulty in paying their bills should be helped through the benefits and tax system.

Recommendation 21: It is unacceptable that paying customers subsidise bad debt by an average of £10 per year, an amount which is likely to increase as water prices rise unless the issue of affordability is addressed. This also results in less money.

Response to recommendation 20: A cross-Government steering group, led by Defra and involving Ofwat, Treasury, Department for Work and Pensions, Department of Trade and Industry and Welsh Assembly Government, is reviewing the way in which lower income households are helped with their water and sewerage charges. The Group is reviewing the existing Government, regulatory and individual water company provisions which provide assistance to vulnerable and lower income customers and will be considering the options for providing further assistance. The views of others from outside Government are welcome. Defra held a seminar, involving a range of stakeholders, on 18th June, which set the scene for further discussions. These will inform the decisions to be made by Ministers.

In general the tax credit and benefit systems do not provide targeted support for the costs of particular goods or services. There are exceptions to this, for example Housing Benefit and the childcare element of the Working Tax Credit. But rents and childcare costs typically represent a far larger proportion of household expenditure than water and sewerage charges. Extending the range of the goods and services whose costs are directly supported through tax credits or benefits in a targeted way would complicate the systems and increase administration costs.

The Vulnerable Groups regulations under the 1999 Water Industry Act set out a number of qualifying criteria for low income and vulnerable metered customers, who are able to switch to a reduced tariff (based on the company's average bill) where they have an above average charge. Changes are being brought forward in the coming months to make the Regulations more effective

from April 2005. This is likely to include changes to the eligibility criteria to bring a greater number of households within the scheme.

Financial support for families and for pensioners on low and moderate incomes has risen significantly in recent years. For example, as a result of personal tax and benefit measures implemented since 1997, by September this year families in the poorest fifth of the population will be, on average, £3,000 better off in real terms. Further, the poorest third of pensioner households will be, on average £1,750 better off this year in real terms, compared with 1997.

Response to recommendation 21: Ofwat's duty is to ensure that customers do not pay for inefficient behaviour by companies. It has encouraged companies to improve their billing procedures and to share best practice but accepted that the overall rise in long-term bad debt is in part associated with the statutory ban on disconnection of domestic water customers. This ban exists to protect less well off customers from the effects of disconnection. It does however have consequences for costs.

Annex B

Steering Group Terms of Reference

Membership

The steering group will be chaired by Defra and will comprise representatives of other government departments as follows:

Defra	Department for Work and Pensions
Ofwat	Department of Trade and Industry
HM Treasury	Welsh Assembly Government

Expertise, input and ideas were provided to the steering group by a range of stakeholders through a seminar on 18th June 2004 and a series of bilateral meetings. Participating stakeholders were:

WaterVoice	Fuel Poverty Advisory Group
WaterUK	Public Utilities Access Forum
National Consumer Council	Eaga Partnership Ltd.
Ofgem	

Overall Objective

The group will, in light of the likely increases to water bills, review existing Government, regulatory and individual water company provisions which protect low income and vulnerable groups, and report with recommendations to Government on possible actions to reduce the impact of any increases on these groups.

Phase 1 Objective

To build up a broad evidence base on water affordability and the mechanisms already in place.

Phase 2 Objective

To look at ways of delivering better outcomes for low income and vulnerable customers, for example, by updating existing schemes, based upon the evidence gathered in Phase 1.

In carrying out its activities, the Working Group will need to have regard to:

- the statutory framework within which the water and sewerage undertakers, Government and regulators operate;
- the United Kingdom's legal obligations, for example with respect to drinking water and environmental standards;

- the interests of all water and sewerage consumers, including through the application of an effective economic regulatory regime and
- wider Government policy on tax and benefits system and support for lower income households.

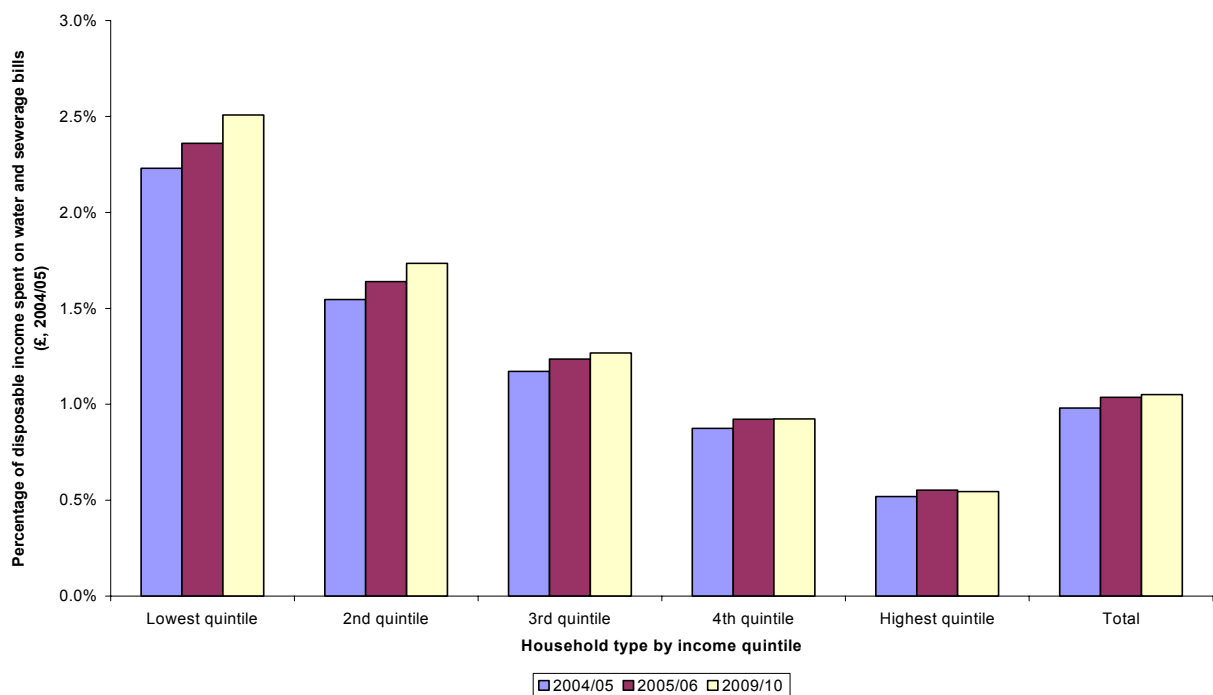
Annex C

Detailed evidence on the extent of the water affordability issue has been collated using bill data from water companies, forecast price rises as published in Ofwat's Draft Determinations, and survey data from the Family Resources Survey (2001-02 & 2002-03). This data has been used to assess the impact of bill increases on domestic customers at a national, regional, and household group level from 2004-05 to 2009-10.

This Annex sets out that evidence in full. This is set out as a stand-alone document, therefore repeating some of the material in the *Evidence* section above.

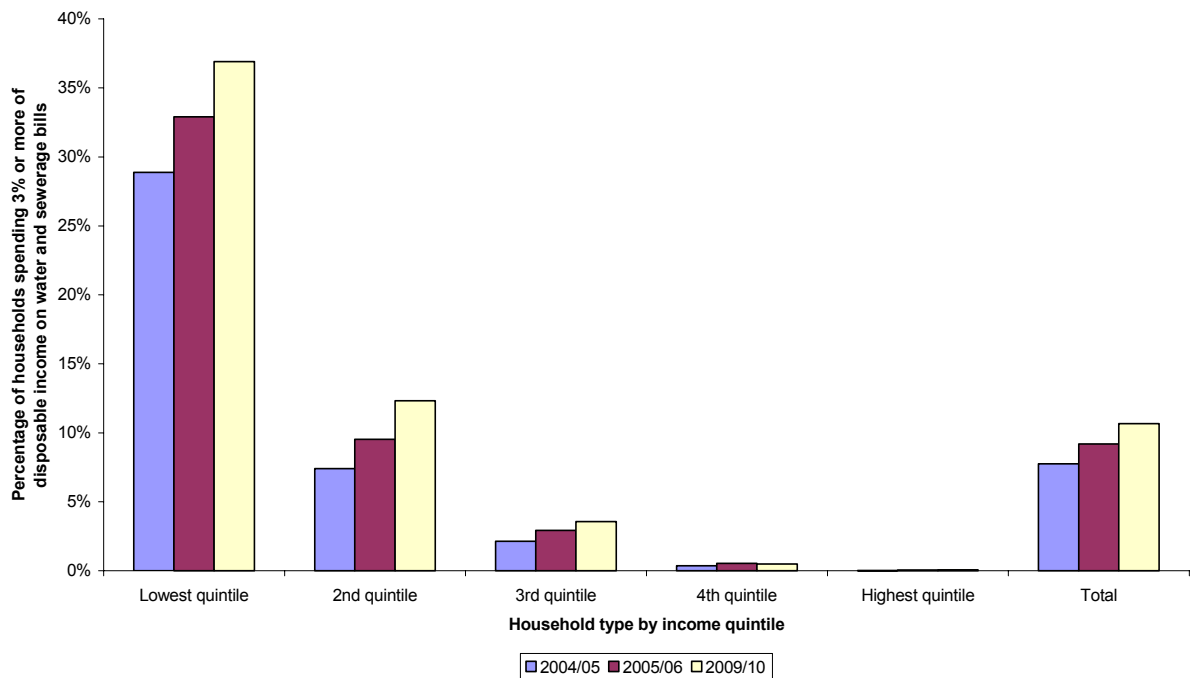
Graph A: The average percentage of disposable income (before housing costs) taken up by water shows at a national level, the percentage spent on water and sewerage charges on average and by each income quintile group in 2004-05, 2005-06 and 2009-10. and sewerage charges is predicted to rise from 1% in 2004-05 to 1.1% by 2010. However, for low-income households (lowest quintile income earners) the average is predicted to rise from 2.2% to 2.5% respectively. Graph A below.

Graph A: % Disposable Income Spent on Water & Sewerage by Quintile: Eng/Wales



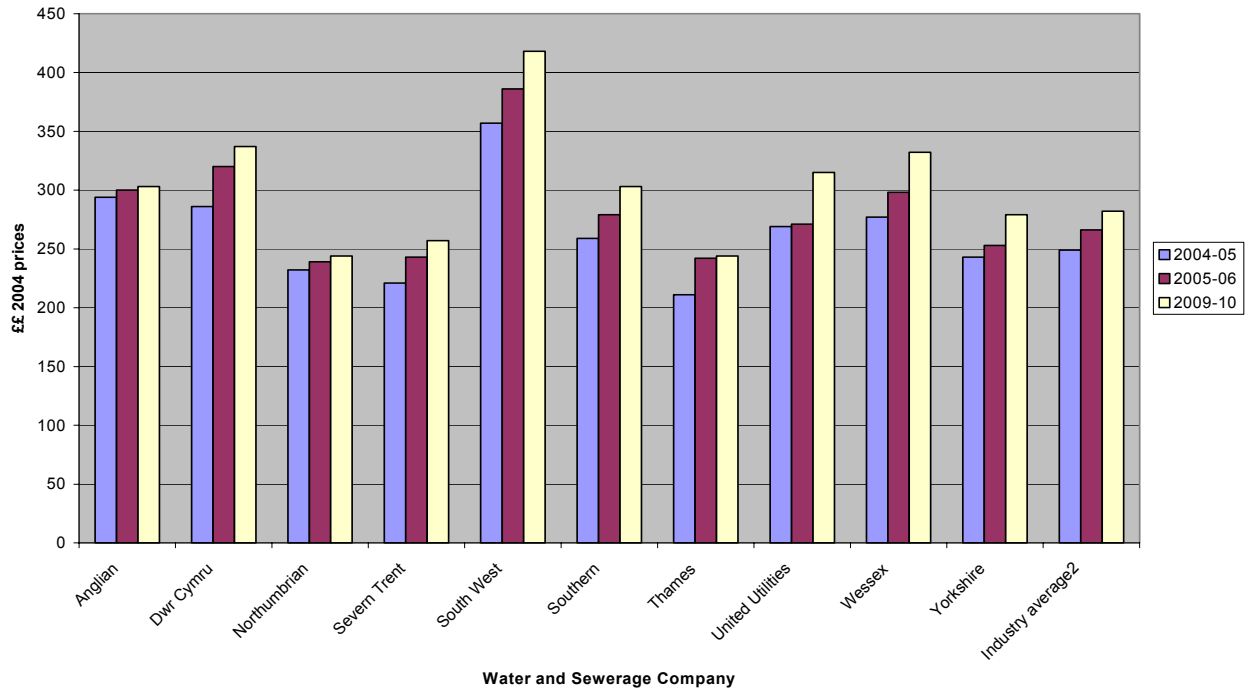
Graph B shows at a national level the percentage of households in total and in each income quintile group spending more than 3% of disposable income on water and sewerage bills. On average, the percentage of households paying more than 3% of disposable income for water is estimated to rise from 8% in 2004-05 to 11% in 2009-10. However, for low-income households the figure will rise from 29% to 37%.

Graph B: % of Households Spending 3%+ of Disposable Income on Water & Sewerage: Eng/Wales by quintile



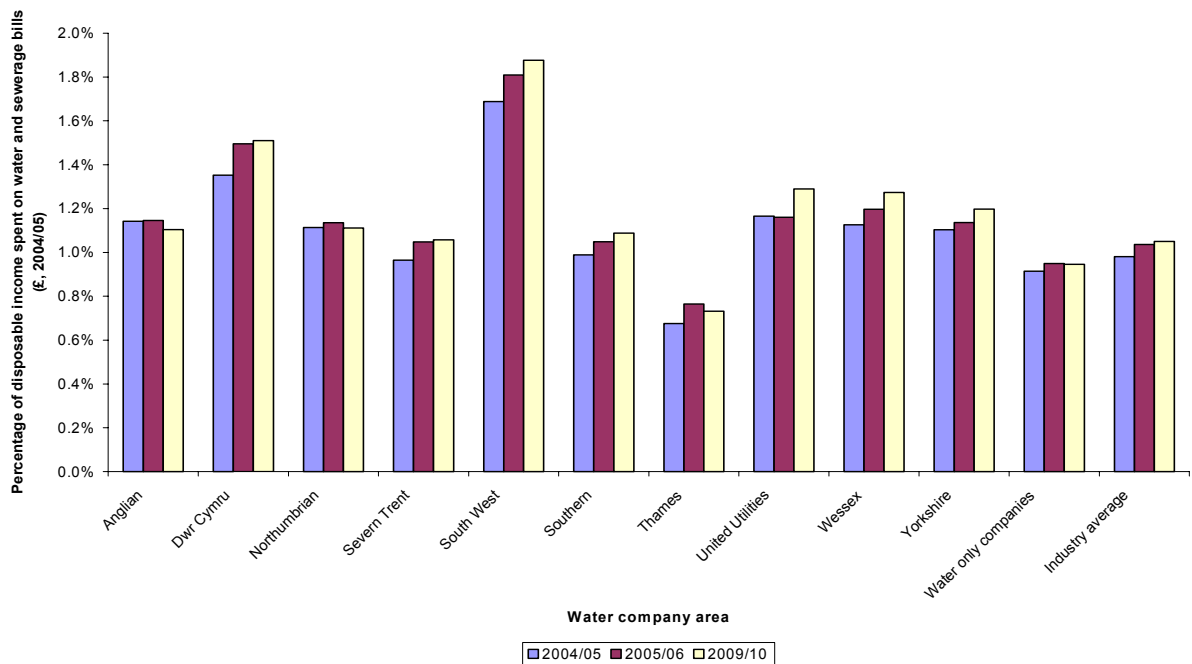
Graph C: The national picture presented above, however, masks a number of regional differences *between company areas*. Graph C below shows the range of average bills in each of the water and sewerage company areas in 2004-05 and as predicted for 2005-06 and 2009-10.

Graph C: Average Water & Sewerage Charges (££): by Company Area



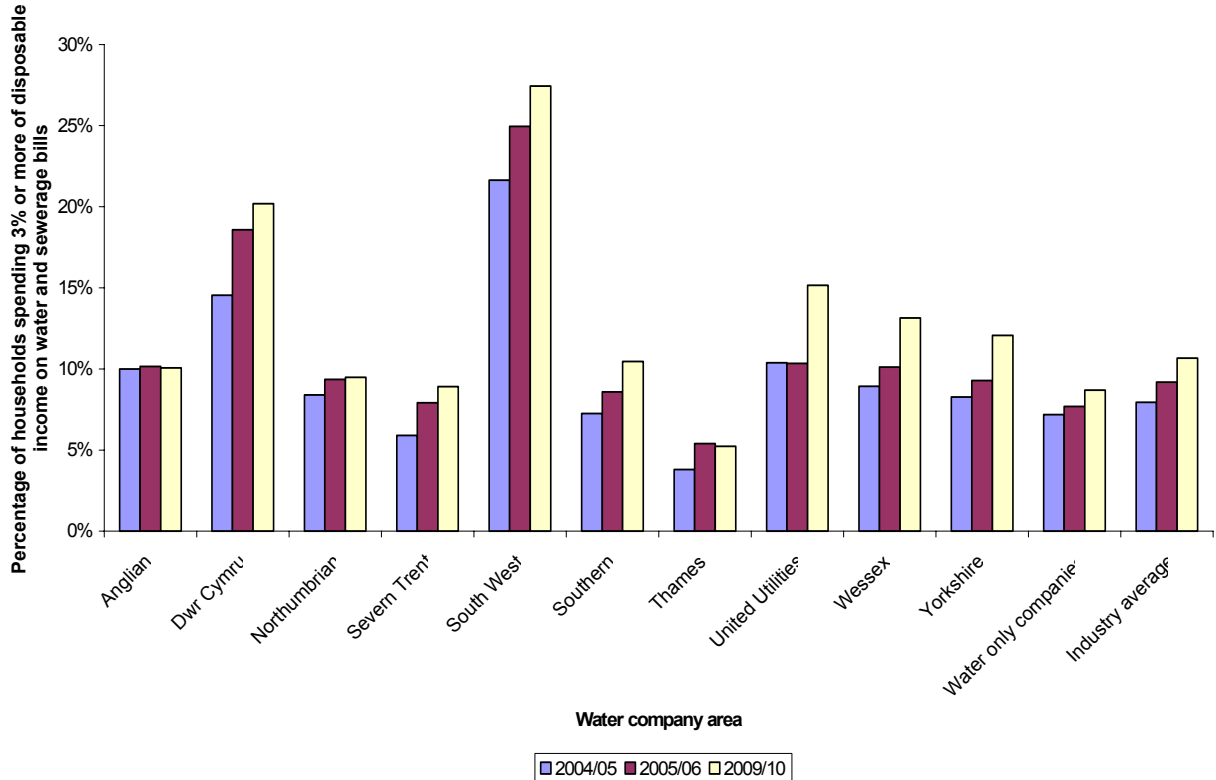
Graph D shows for each water and sewerage company area, the percentage of disposable income spent on water and sewerage bills in 2004-05 and as predicted for 2005-06 and 2009-10. It can be seen that whilst in some areas, for example, Thames Water, the average percentage spent on bills remains under 1% even by 2009-10, customers in other areas for example Welsh Water and South West Water will be required to spend much higher percentages of income on water bills. This is likely to be due to a combination of higher bills and lower incomes.

Graph D: Average % Disposable Income Spent on Water & Sewerage: by Company Area



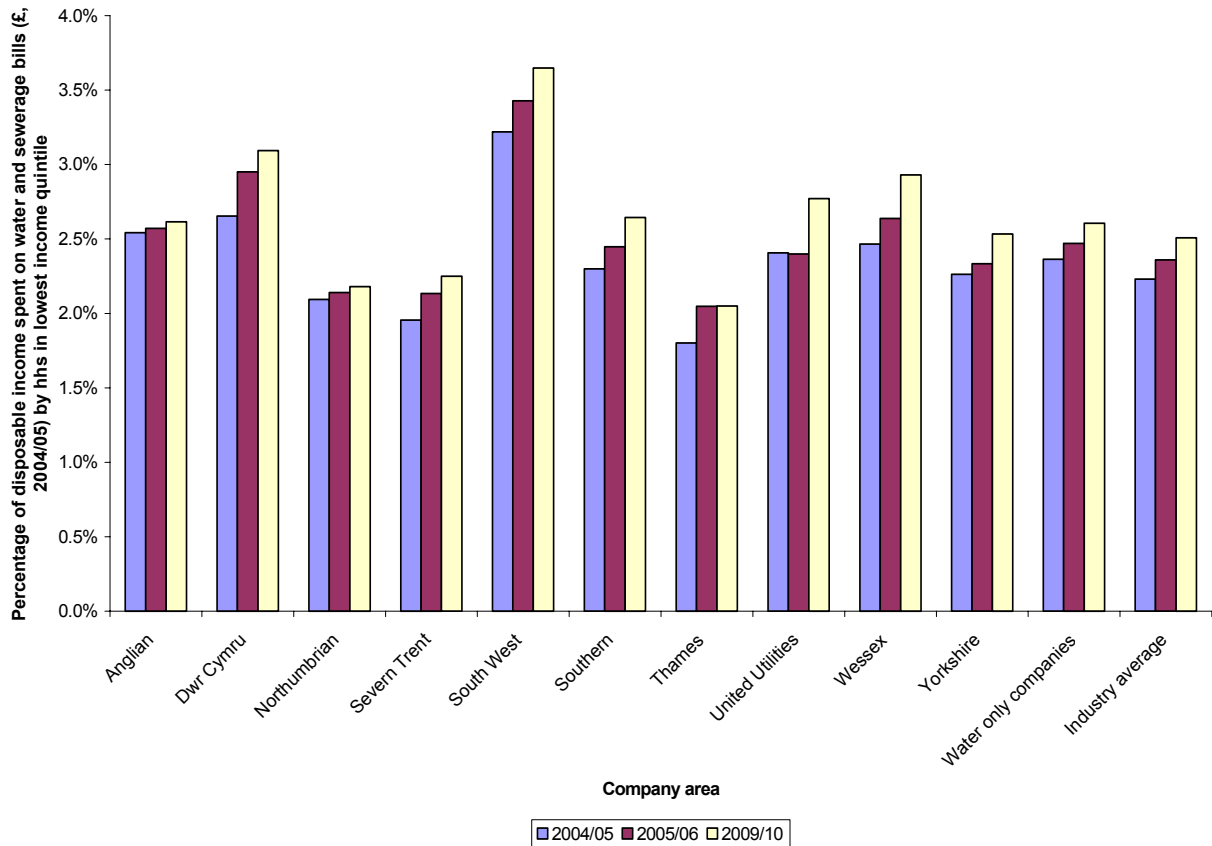
Graph E shows the percentage of households spending 3%+ of disposable income on water by company area. This shows that while the industry average is projected to rise from 8% in 2004-05 to 11% in 2009 -10, the figure is significantly higher in high bill areas such as S-W and Welsh Water.

Graph E: % of Households Spending 3%+ of Disposable Income on Water: by Company Area



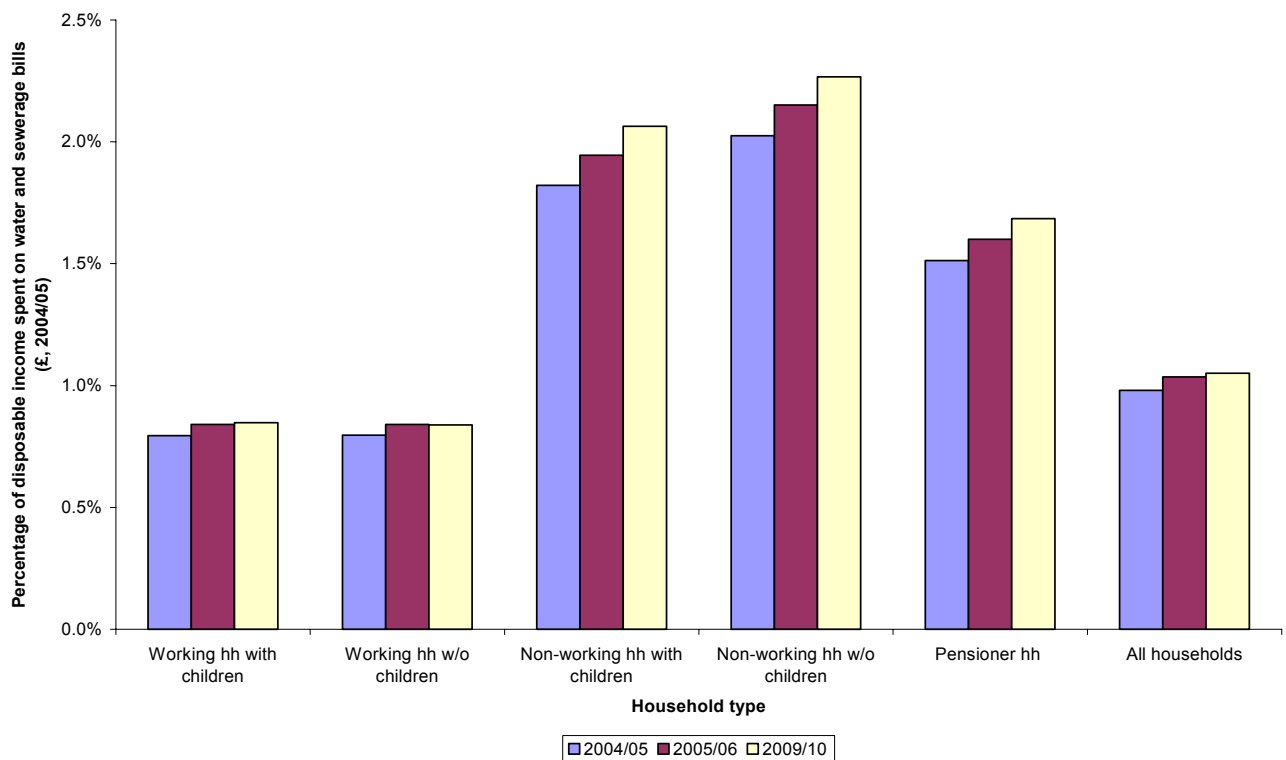
Graph F shows the percentage of disposable income spent on water by the lowest income quintile of the population, by company area. This shows that the average figure across England and Wales is rising from 2.2% in 2004-05 to 2.5% by 2009-10, though this again masks some noticeable regional variations.

Graph F: % of Disposable Income Spent on Water by Lowest Income Quintile: by Company Area



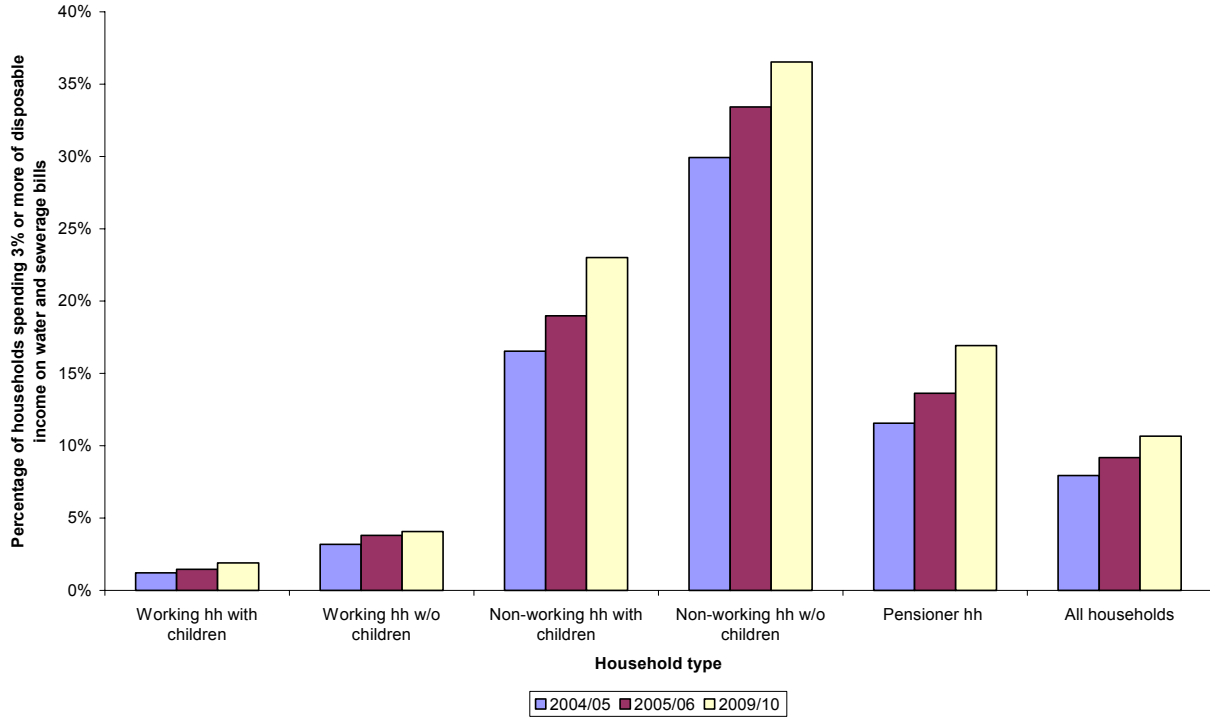
Graph G. There are a variety of effects between household groups, and these can be masked by national and company average figures. Graph G shows for the five main household types the percentage of income spent on water sewerage charges in 2004-05, 2005-06 and 2009-10. This shows that non-working households and pensioners in particular will be required to spend a higher percentage of income on bills in 2009-10. Working households do not face such marked increases as incomes are predicted to rise at a faster rate for this group (i.e. as earnings tend to rise faster than inflation and therefore faster than incomes for non-working households).

Graph G: % Income Spent on Water & Sewerage by Household Type: Eng/Wales Average



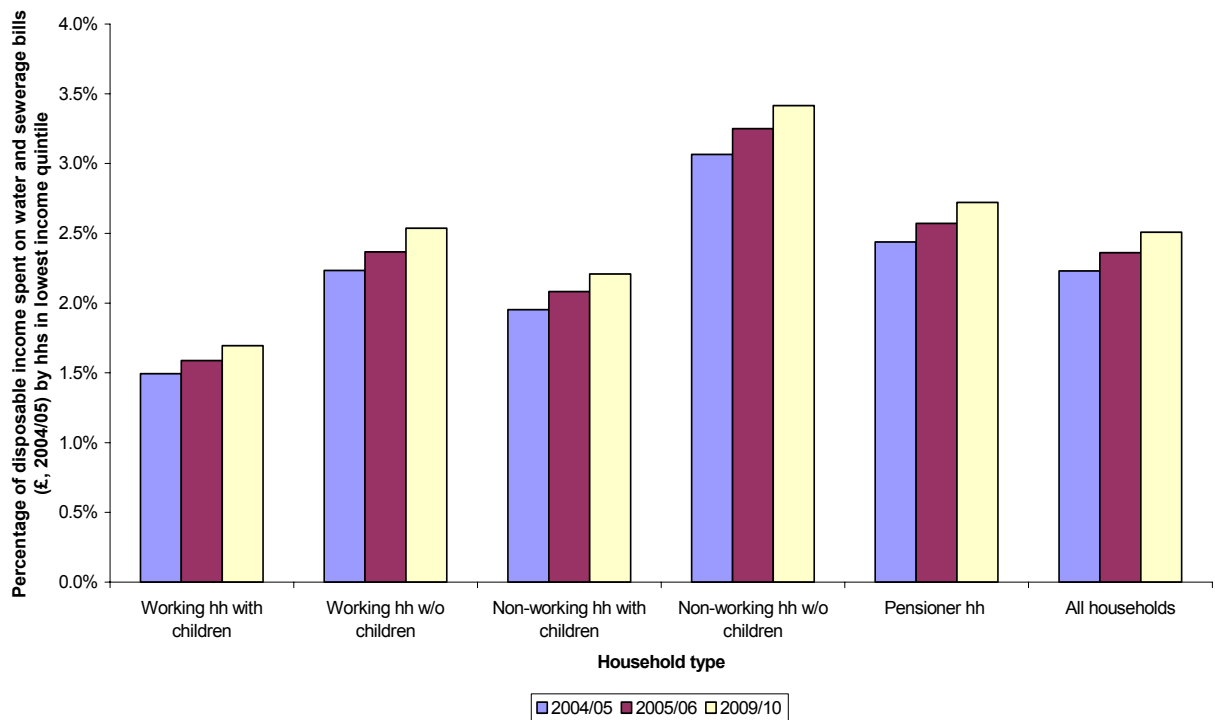
Graph H shows the percentage of households in each of the main household types that will be spending more than 3% of income on bills in each year. It can be seen that a high percentage of *non-working* households will be spending more than 3% of income on water bills, particularly by 2009-10.

Graph H: % of Households Spending 3%+ of Disposable Income on Water & Sewerage: Eng/Wales Average



Graph I shows percentage of disposable income spent on water *by the lowest income quintile of the population* by household on an England/Wales average basis. This shows that non-working households without children are likely to be most affected by increasing water bills by 2009-10, with the average impact of water and sewerage charges being over 3% of disposable income for that group by 2009-10.

Graph I: % of Disposable Income Spent on Water by Lowest Income Quintile by Household: Eng/Wales Average



Graph J shows the percentage of households in the lowest income quintile spending 3%+ on water by household type, across England and Wales as a whole. This shows that more than 50% of non-working households without children in the lowest income quintile will be paying more than 3% of disposable income on water and sewerage charges by 2009-10.

Graph J: % of Households in Lowest Income Quintile Spending 3%+ on Water by Household Type: Eng/Wales

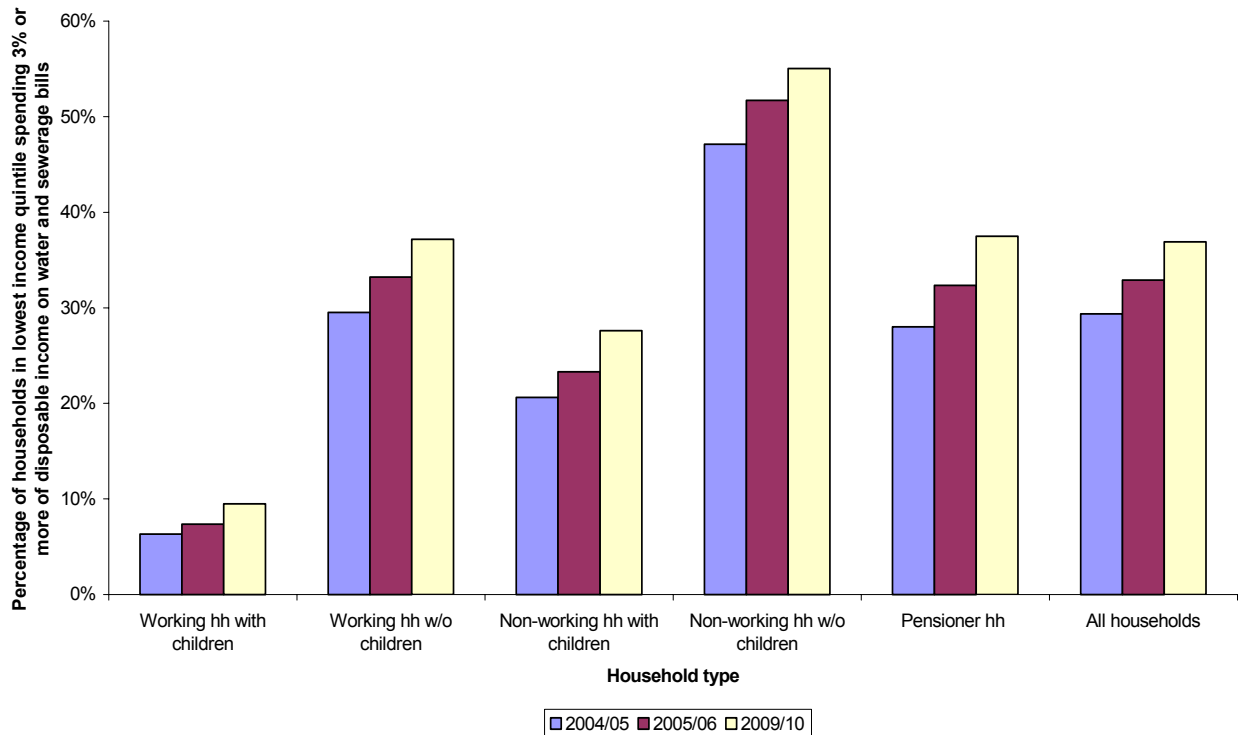


Table A below sets out the raw data used to create the bar charts above.

Table A: Percentage of income spent on bills - nationally (by income quintile), regionally and household type 2004-05, 2005-06 and 2009-10

Nationally (England and Wales)	2004/05	2005/06	2009/10			
Lowest income quintile	2.2%	2.4%	2.5%			
2nd income quintile	1.5%	1.6%	1.7%			
3rd income quintile	1.2%	1.2%	1.3%			
4th income quintile	0.9%	0.9%	0.9%			
Highest income quintile	0.5%	0.6%	0.5%			
Average	1.0%	1.0%	1.1%			
Regionally	average income households			lowest income quintile households		
	2004/05	2005/06	2009/10	2004/05	2005/06	2009/10
Anglian	1.1%	1.1%	1.1%	2.5%	2.6%	2.6%
Dwr Cymru	1.4%	1.5%	1.5%	2.7%	3.0%	3.1%
Northumbria	1.1%	1.1%	1.1%	2.1%	2.1%	2.2%
Severn Trent	1.0%	1.0%	1.1%	2.0%	2.1%	2.2%
South West	1.7%	1.8%	1.9%	3.2%	3.4%	3.6%
Southern	1.0%	1.0%	1.1%	2.3%	2.4%	2.6%
Thames	0.7%	0.8%	0.7%	1.8%	2.0%	2.0%
United Utilities	1.2%	1.2%	1.3%	2.4%	2.4%	2.8%
Wessex	1.1%	1.2%	1.3%	2.5%	2.6%	2.9%
Yorkshire	1.1%	1.1%	1.2%	2.3%	2.3%	2.5%
Wocs	0.9%	0.9%	0.9%	2.4%	2.5%	2.6%
Industry average	1.0%	1.0%	1.1%	2.2%	2.4%	2.5%
Household type	average income households			lowest income quintile households		
	2004/05	2005/06	2009/10	2004/05	2005/06	2009/10
Working household with children	0.8%	0.8%	0.8%	1.5%	1.6%	1.7%
Working household without children	0.8%	0.8%	0.8%	2.2%	2.4%	2.5%
Non-working hh with children	1.8%	1.9%	2.1%	2.0%	2.1%	2.2%
Non-working hh without children	2.0%	2.2%	2.3%	3.1%	3.2%	3.4%
Pensioner household	1.5%	1.6%	1.7%	2.4%	2.6%	2.7%
All households	1.0%	1.0%	1.1%	2.2%	2.4%	2.5%

Table B: Percentage of households spending more than 3% of disposable income on water and sewerage bills: nationally (by income quintile), regionally and household type - 2004-05, 2005-06 and 2009-10

Nationally (England and Wales)	2004/05	2005/06	2009/10			
Lowest income quintile	28.9%	32.9%	36.9%			
2nd income quintile	7.4%	9.5%	12.3%			
3rd income quintile	2.1%	2.9%	3.6%			
4th income quintile	0.4%	0.5%	0.5%			
Highest income quintile	0.0%	0.0%	0.1%			
Average	7.8%	9.2%	10.7%			
Regionally	average income households					
	2004/05	2005/06	2009/10			
Anglian	10.0%	10.2%	10.1%			
Dwr Cymru	14.5%	18.6%	20.2%			
Northumbria	8.4%	9.4%	9.5%			
Severn Trent	5.9%	7.9%	8.9%			
South West	21.6%	25.0%	27.4%			
Southern	7.3%	8.6%	10.5%			
Thames	3.8%	5.4%	5.2%			
United Utilities	10.4%	10.3%	15.2%			
Wessex	8.9%	10.1%	13.1%			
Yorkshire	8.3%	9.3%	12.1%			
Wocs	7.2%	7.7%	8.7%			
Industry average	7.9%	9.2%	10.7%			
Household type	average income households			lowest income quintile households		
	2004/05	2005/06	2009/10	2004/05	2005/06	2009/10
Working household with children	1.2%	1.5%	1.9%	6.3%	7.4%	9.5%
Working household without children	3.2%	3.8%	4.1%	29.5%	33.2%	37.2%
Non-working hh with children	16.5%	19.0%	23.0%	20.6%	23.3%	27.6%
Non-working hh without children	29.9%	33.4%	36.5%	47.1%	51.7%	55.0%
Pensioner household	11.6%	13.6%	16.9%	28.0%	32.3%	37.5%
All households	7.9%	9.2%	10.7%	29.4%	32.9%	36.9%

Annex D

Technical Note on Methodology for Modelling

The modelling was based on data from the Family Resources Survey (FRS), which collects information on the incomes and circumstances of private households in the United Kingdom (or Great Britain before 2002-03).²⁶ Information from the 2001-02 and 2002-03 surveys for England & Wales was combined, giving a total dataset of around 45,000 households, and incomes were updated to a 2004/05 basis. The FRS database includes information on respondents' stated household income and water and sewerage bill, including other details of household composition and expenditure. The database also gives information on the location of each household in the sample, which allows us to work out which water company serves each customer.

The modelling followed a number of steps:

Water bills in the data set were calibrated to match actual 2004/05 average company bills. This was achieved by multiplying each household water bill in a particular water company region by a fixed factor to give the correct average bill for that water company across the dataset.

The calibrated bills were then updated to 2009/10 prices, and the real bill impact applied based on information provided by Ofwat. Household incomes were also updated to 2009/10, based on HM Treasury assumptions about changes in incomes, taxes and benefits.

Bill impacts were calculated as a proportion of household disposable income²⁷ *before housing costs* for 2004/05, 2005/06 and 2009/10. For each grouping the average bill as a proportion of net disposable income (before housing costs) was calculated.

The data was then summarised by averaging the results across households by water company area, and by household type.

Data Issues

It is important to be aware of the limitations of any projections calculated from survey-based evidence. There are three particular data issues that arose in conducting the modelling, which could reduce the accuracy of the results presented in the RIA.

First, there appeared to be some deficiencies in some of the water bill information stated in the initial FRS data:

- Some households reported higher water charges than thought reasonable. It was decided that was no justifiable reason for these high

²⁶ More information is available at <http://www.dwp.gov.uk/asd/frs/>

²⁷ *Disposable household income* is defined as all income, including benefits, minus taxes, but before housing costs.

cases and to replace these with average for their water company. (Water charges above £15 a week).

- Some households reported not paying water charges. All households should face a water charge it was therefore decided to also replace these cases with average for their water company.

Second, some problems were encountered in trying to calculate the average proportion of disposable income spent on water and sewerage bills. In some cases disposable income was not stated in the data set, so adjustments had to be made to take account of these data errors. Similarly, where stated disposable income was very low, this could give lead to an unrealistically high estimate for the impact of water bills as a proportion of income. This was partially corrected for by calculating average bill impacts for each water company as total expected water charges for water company region as proportion of total disposable income for region.

Third, there is a general issue of sample size. Even though the initial sample size is relatively large (around 45,000 observations), when the data is subdivided by company area and/or by household type, the statistical robustness of the results can decline rapidly. It was decided on this basis that company-specific bill impacts should be calculated only for the Water And Sewerage Companies, and not for the smaller Water Only Companies (which have a relatively small customer base).

In summary, the results of the modelling will include a margin of error owing to statistical variations and data problems. Therefore, the figures presented in the Affordability Report should only be viewed as indicative of likely trends in bill impacts over the next five years.