22nd April 2025

Global Infrastructure Investor Association (GIIA) third party response to the CMA's Water PR24 Price Redeterminations

The Global Infrastructure Investor Association (GIIA) is the membership body for the world's leading investors in infrastructure and advisors to the sector. Collectively, our members are responsible for over $2 trillion of infrastructure assets under management distributed across 70 countries and six continents. They have substantial and diverse investments in the UK, including water, renewable energy, telecoms, ports, and airports, totalling some £273 billion.

In the water sector specifically, over 25 GIIA members hold stakes in two thirds of the privately held regional water companies in England and Wales – supplying over 37 million UK citizens. These investors are long-term stewards of critical infrastructure assets throughout the country. They are targeting investments that have the capacity to provide steady and predictable returns. These investments are often financed by pension fund capital, which entails a responsibility to deliver returns to millions of people who depend on these funds for their pensions. Our research indicates that over 12 million UK public and private sector employees have a stake in water companies through their pension fund savings, highlighting the direct public interest in maintaining the sector's viability and profitability.

Since privatisation in 1989, the water sector in England and Wales has undergone a fundamental transformation. At the heart of this shift has been sustained private investment, more than £230 billion over the past three decades, which has driven improvements in infrastructure and service quality. Annual capital investment is now more than double what it was before privatisation, enabling the modernisation of a system that was, at the time, in a state of serious decline.

This third- party submission to the Competition & Market Authority's Water PR24 Price Redeterminations offers a perspective that captures views from within our membership (a full list of members can be found here).

Background

The CMA's PR24 redeterminations come at a pivotal time for the UK water sector and for the wider sentiment towards the UK as an investment destination. Once viewed as a global benchmark for regulatory stability, the UK water sector is now perceived by many long-term investors as among the riskiest regulated utilities in Europe. Over recent years, a combination of low headline returns, regulatory overreach, volatile policy and an increasingly punitive approach to performance have damaged the UK's reputation for stable and investable infrastructure regulation.

This decline is not occurring in a vacuum. The water sector plays a critical signalling role within the UK's broader infrastructure landscape. It was among the first major sectors privatised in the UK and has long been viewed as a bellwether for the health of UK regulated utilities. Investor sentiment in the sector now serves as a proxy for broader confidence in the UK's regulatory model. The fact that six companies appealed Ofwat's final PR24 determinations, an unprecedented level of challenge, should send a strong signal to the CMA: the stakes are high, and the implications of these decisions will be felt beyond the water sector.

These redeterminations will help shape international and domestic infrastructure investor sentiment towards the UK. It is essential that the CMA approaches this redetermination not only as a matter of regulatory fairness, but as a decision with broader macroeconomic and reputational consequences for the UK. These redeterminations offer an important opportunity to correct misjudgements made by Ofwat in its PR24 final determinations. We highlight three critical areas where Ofwat's approach has undermined investor confidence and led to fundamental challenges in the framework for AMP8.

Ofwat's miscalculation of the risk/reward balance

At the heart of investors' concerns with the PR24 final determinations lies a fundamental miscalculation of the cost of capital. Ofwat's proposed allowed return is simply out of step with prevailing market conditions and the heightened risk profile facing the sector. By setting an unattractive Weighted Average Cost of Capital (WACC), Ofwat has disregarded both the macroeconomic environment and the increasing complexity and volatility that characterise the water sector today.

This determination is particularly consequential given the scale of the challenge facing the water sector. The sector is now grappling with escalating demands: ageing infrastructure, rising customer expectations and increasingly stringent environmental obligations. These challenges mean that the risk borne by investors is materially greater than in previous regulatory periods. This heightened risk has been explicitly recognised by credit rating agencies. Moody's has twice downgraded its assessment of the UK water regulatory framework – in 2018 and again in 2024 – citing increased political and regulatory intervention, diminished confidence in companies' ability to earn fair returns, and the unpredictability of the regulatory regime. These downgrades directly affect companies' credit ratings and borrowing costs, further compounding the financial pressure on the sector. Rather than reflecting this in a commensurate return, Ofwat has compressed the WACC on offer creating a pronounced imbalance between risk and reward.

Crucially, the regulator's approach also diverges from practice elsewhere. In sectors facing comparable capital intensity, such as energy transmission, investors typically expect equity returns in the range of 8 to 12 percent. By contrast, Ofwat's proposed return for the water sector falls well below this benchmark, despite seeking to attract capital into a sector that is demonstrably riskier, more politically exposed and currently facing a far greater set of operational and reputational challenges. There is also little coherence in how Ofwat calculates core WACC inputs when compared to other regulators. Ofgem, for example, takes a different view on the risk-free rate and the cost of embedded debt, and has been more transparent in acknowledging the importance of ensuring not just financeability, but also investability.

The implications are already visible in the market. In the current climate, debt is more expensive and equity is more cautious. Junior debt markets have ground to a halt, and senior debt costs have risen significantly, an indication of just how far the perceived risk profile has shifted. The result is a sector that is increasingly unable to attract the capital it needs to meet its long-term goals, let alone to finance the step-change in investment required for AMP8.

Ofwat's position on the cost of capital has become the defining issue in PR24. It is also one of the central reasons that six companies have now appealed their determinations to the CMA. Left uncorrected, this misjudgement will result in the sector struggling to crowd-in the capital needed to put it on a stronger footing. These redeterminations represent an essential opportunity to restore a credible, competitive, and evidence-based return that reflects the risks of long-term infrastructure stewardship in the water sector.

A performance framework that punishes rather than incentivises

One of the key features of the PR24 framework is the continued reliance on Outcome Delivery Incentives (ODIs) and Price Control Deliverables (PCDs) as the central tools for performance management. While these mechanisms were originally conceived as a means of aligning company incentives with customer outcomes, they have evolved into a rigid and punitive system that often undermines, rather than supports, long-term investment and operational improvement.

The problem lies in the way the framework is calibrated. Performance expectations are increasingly decoupled from operational baselines, with Ofwat imposing stretching targets without sufficient regard to geography, legacy infrastructure or historic performance trajectories. The use of industry-wide upper quartile benchmarks, applied uniformly, fails to account for meaningful variation across companies and regions. This creates a system in which even well-performing companies risk being penalised, simply because the targets set do not reflect their specific circumstances.

The consequences of this approach are twofold. First, it introduces a consistent downside bias: companies are more likely to incur penalties than to achieve rewards, particularly where delivery is contingent on external dependencies like planning consent. Second, it creates a cycle of underperformance and reduced financial capacity. Companies that fall short of unrealistic targets are penalised, reducing their ability to invest, which in turn makes it harder to improve performance in subsequent periods. Far from driving sector-wide improvement, the current structure entrenches disparities and increases financial stress.

The PCD mechanism compounds these effects by tying large portions of investment funding to prescriptive outputs at a project-by-project level. While the intention is to ensure accountability for delivery, the practical result is inflexibility and heightened execution risk. In a context of climate volatility, planning delays, and uncertain supply chains this rigidity discourages adaptive investment and prudent risk-taking. Companies are left with little room to respond to new challenges or opportunities.

Taken together, the performance framework in PR24 distorts incentives and diminishes the appeal of long-term infrastructure stewardship. It turns ambition into liability and undermines the delivery resilience that the sector needs.

Unrealistic and inflexible cost assumptions

A third failing in the PR24 final determinations lies in Ofwat's use of top-down econometric modelling to determine base expenditure allowances. While benchmarking can play a role in setting efficient allowances, Ofwat's modelling is overly rigid, insufficiently granular, and conceptually flawed in how it translates historical data into forward-looking needs.

Ofwat has relied too heavily on backward-looking data and past delivery, without adequately accounting for the changing context of AMP8 and beyond. This includes rising environmental standards and the unique delivery challenges many companies face. The models also focus on a narrow subset of activities and fail to account for the diversity of conditions across the sector. Factors such as geographic challenges and underlying asset health all have a direct impact on cost structures. Yet these differences are largely smoothed out or ignored in Ofwat's standardised approach, resulting in allowances that are often far removed from the real cost of sustainable delivery.

This modelling approach continues a pattern of long-term underfunding for capital maintenance, which was shaped in part by regulatory pressure to keep bills flat during a period of low interest rates. Companies were given little flexibility to address underlying asset deterioration, and we are now seeing the consequences of this in the form of reduced asset resilience and performance. In particular, companies operating in challenging geographies or with older networks are significantly disadvantaged, with no meaningful mechanism to reflect their higher baseline costs. The consequence is a cost framework that assumes continued historical cost compression without recognising the scale of future investment need. This creates incentives to defer essential maintenance or avoid necessary but capital-intensive upgrades, all of which are at odds with the sector's long-term objectives.

Compounding this, Ofwat's use of retrospective penalties, where companies are penalised for outputs not subject to prior targets or ringfenced funding, undermines confidence in the regulatory regime. It introduces a new and unpredictable risk for companies, in contradiction to the principles of a totex-based approach that is meant to encourage efficient delivery. This type of retrospective adjustment erodes regulatory trust and introduces an additional deterrent to capital.

What is needed is a more bottom-up, engineering-led approach to cost assessment, one that reflects real delivery conditions, ensures adequate maintenance funding and supports resilience over time. Ofwat's current methodology falls short of these goals. It pushes companies into plans that are often unworkable and exposes them to delivery and financial risk. Left uncorrected, it will distort investment decisions, undermine financeability, and weaken the sector's ability to attract the scale of capital needed to deliver for customers and the environment.