NEA

Action for Warm Homes

Water Poverty: The Consistency of Social Tariffs

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Introduction

In a modern world, water is recognised as a human right. It is understood to be essential to life and yet some are so concerned about the cost of it that they actively decide not to use the water they vitally need and find themselves falling into debt or self-rationing their water use. These families may also be making impossible choices between heating and eating, at the same time as restricting bathing to once a week, all sharing the same bath water, because the cost of their water, and the cost of heating it, is just too high.

The water sector recognises the need to address affordability and its role in delivering increased public and social value when managing this essential service. They already offer a range of welcome support options to customers, but support levels vary across each company and are mainly funded through customer cross-subsidy. The amount a customer pays in cross-subsidy in 2020/21 prices ranges by £14.00 across England and Wales. This unfortunately means that in some areas with low cross-subsidies customers may not be eligible for support, or may get less support, than they would in an area with a higher cross-subsidy. It's a postcode lottery, and it impacts the physical and mental wellbeing of the people affected by it.

Add to this the current landscape of poverty in the UK, where "one fifth of the population live in poverty, and 1.5 million people experienced destitution in 2017, unable to afford basic essentials" (Alston, 2019) and the challenge becomes even greater. Water companies are expected to deliver safe and reliable water and wastewater services whilst keeping bills affordable for customers (Ofwat, 2019), and the increasing numbers of people struggling to afford their financial commitments makes this ever harder to achieve.

2020 sees a new era for the water sector, as they move into the seventh Asset Management Period (AMP7) since privatisation and a new sector-wide strategic approach to delivering excellence, long-term value and stewardship. But this challenge is taking place at a time of increasing pressure and challenges, both inside and outside of the industry. Illustrating one stark example, Sir James Bevan, Chief Executive of the Environment Agency, has warned that in around 20-25 years we reach the "jaws of death" – the point where we no longer have enough supply of water to meet our needs (Bevan, 2019). Climate change is having a real effect on our ability to meet the growing needs of our country, and with the anticipated increase in population and housing expected in coming years, action is needed now to mitigate the impact. And yet, these are not the only significant challenges that 2020 brings.

The world has entered a global pandemic with the spread of the novel coronavirus, Covid-19[1], with over 100 countries world-wide entering a full or partial lockdown by the end of the first quarter of 2020 (BBC News, 2020). In the UK, the lockdown has resulted in almost two million new claimants for Universal Credit and around 7.5 million people put on 'furlough' whereby the Government are paying up to 80% of their wages; many people are facing a period of significant financial uncertainty even when restrictions end (Lawrie, 2020), meaning more people than ever are going to be looking for support with their essential household living costs.

In a paper entitled 'Water Poverty: A Common Measurement' (2019), NEA explored how adopting a consistent set of approaches to tackling water poverty could lead to successful outcomes for low-income households. The paper reviewed the current approaches to measuring water poverty in England and Wales, and made four recommendations that should be further explored to facilitate eradication of water poverty in the UK:

1. Industry should work towards the 3% measure of water poverty meaning that a household will be in water poverty if it spends more than 3% of the household disposable income on their combined water and sewerage bill(s);
2. A measure of the 'water poverty gap' at both average and aggregate level should be tracked by different household characteristics to understand the depth of the issue and its distribution;
3. Government should look to set out a water poverty strategy and set a statutory target to eliminate water poverty by 2030; and
4. The approach to social tariff eligibility and support levels should be reviewed to ensure customers are treated fairly and not detrimentally impacted due to where they live.

1 The majority of this paper was written prior to the outbreak of Covid 19 in the UK. A separate report, published alongside this paper, addresses the specific details of how the coronavirus crisis has impacted customers, and highlights the issues outlined in this paper in the context of the 'new normal'. This can be found at www.nea.org.uk

In this paper, we take a deeper dive into the fourth recommendation and the current landscape of social tariffs, exploring how they could be improved to remove the 'postcode lottery' . With the potential for thousands more households needing support during this current period of uncertainty, and beyond, and recognising the long-term economic effects of the nationwide lockdown, the three recommendations proposed seek to make social tariff eligibility and support levels fairer, enabling more households to be supported when struggling to pay, without incurring significant additional costs on household bills.

Key Recommendations

1

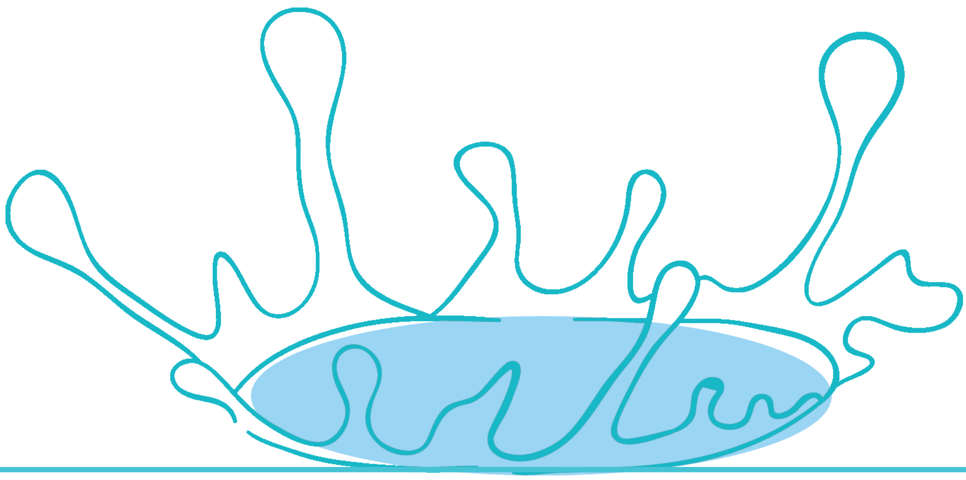
Government should conduct a thorough review of social tariff guidance in consultation with water companies and stakeholders to make the support across England and Wales fairer for all.

2

Particular consideration should be given to alternative options for funding social tariffs schemes. This should include an impact assessment of the current approach to willingness-to-pay as the basis for funding and the resulting designs of social tariffs, alongside alternatives.

3

Government should prescribe 'core' eligibility criteria allowing companies to continue to take account of regional circumstances whilst removing unacceptable variances in levels of support, and to aid the use of powers under the Digital Economy Act for auto-enrolment to mitigate against the lack of customer awareness of social tariffs.



History of Social Tariffs

Prior to considering the changes required to the current approach to social tariffs, it is important to understand how they developed over time, and what the current landscape looks like. This section looks to understand a brief history of social tariffs in water, highlighting the significant milestones in their development.

The Walker Review

Following a commission by Defra and the Welsh Assembly Government, Anna Walker, former Chief Executive of the Healthcare Commission and vice-chair of Consumer Focus, published 'The Independent Review of Charging for Household Water and Sewerage Services' (2009). The review aimed to:

- Examine the current system of charging households for water and sewerage services; and assess the effectiveness and fairness of current and alternative methods of charging including the issue of affordability;
- Consider social, economic and environmental concerns; and
- Make recommendations on any action that should be taken to ensure that England and Wales have a sustainable and fair system of charging in place.

The review team made a series of recommendations in regard to customer affordability, including:

- Refining the WaterSure scheme to include low-income metered households with medical conditions only, capping bills at a level at least as low as the average national bill, average regional bill, or actual metered charges, whichever was the lowest;
- Providing a 20% bill discount on the volumetric bill of low-income metered households in receipt of certain means-tested benefits;
- Offering a volumetric discount tariff to metered and assessed-charge customers in receipt of means-tested benefits and tax credits with one or more children;
- Introducing targeted water efficiency measures and benefit entitlement check programmes as part of existing fuel poverty and energy efficiency programmes;
- Government consulting on who should pay for affordability measures; and
- Ofwat tracking affordability problems, taking appropriate action or providing advice to the UK Government and Welsh Assembly Government, to ensure water services remain affordable, and publishing this position in an annual report on affordability and debt.

In addition to the above, this review also made recommendations to mitigate the impact of significant infrastructure investment costs in the South West being passed back to customers, suggesting either a financial adjustment to bills in that area by Government, an adjustment funded from water bills in other areas of the country, or a package of proposals for customers in the South West to take into account seasonality and other cost drivers.

Following a recommendation in the review, Ofwat conducted more detailed analysis into affordability (Defra, 2011), concluding that affordability problems can be the result of:

- Low incomes;
- High bills because of high cost location;
- High unmeasured bills because of high metering levels;
- High metered bills because of high consumption; and
- Difficulty managing and paying bills.

As part of the UK Water Industry Research Big Questions (UKWIR, n.d.) and the Water UK Public Interest Commitments (2019), a report was commissioned to define water poverty and evaluate the existing information and approaches to reducing it (UKWIR, 2020). The commissioned organisations, CEPA and Sustainability First, "set out the fundamental drivers of water poverty and the future pressures which may impact on levels of water poverty in the future" as:

- Absolute income;
- Unit cost of water;
- Bill and income volatility;
- Living costs (non-water);
- Volume of water required; and
- Customer control and understanding.

The UKWIR project is ongoing, and this report has outlined a number of additional areas for research alongside four key recommendations.

The Flood and Water Management Act

In 2009, the Flood and Water Management Act (FWMA) was consulted on by the Government and introduced in Parliament, resulting in Royal Assent in April 2010 (Defra, 2017). Section 44 of the FWMA "enabled all water companies to include a social tariff in its charges scheme which is designed to reduce charges for those who would otherwise have difficulty paying their water bills… to be funded by cross subsidy from other customers". The impact assessment for the FWMA highlighted the risks of "pressure on companies to bring forward social tariffs when these might be best addressed at national level using existing regulation-making powers… more households [choosing] not to pay their bills in an effort to benefit from a company's social tariff… some customers [being] unhappy that different companies could operate different schemes" (Defra, 2010).

The licences of water companies (Licence Condition E) require them not to exercise undue discrimination between customers, which had often been perceived as a barrier to social tariffs. Ofwat and Water Companies would need to have regard to guidance issued by the 'Minister' prior to introduction of any social tariffs; guidance was issued in 2012 following an extensive impact assessment and consultation on water affordability and the recommendations of the Walker review. Compliance with this guidance, and the inclusion of cross-subsidies in any proposed social tariff would "not in itself constitute undue discrimination or preference in relation to Licence Condition E" (Defra, 2012a).

Government Consultation on Water Affordability

In 2011, the Government consulted on the recommendations made in the Walker Review, including how bill reductions could be paid for (House of Commons, 2016). Given water is policy is devolved, the Welsh Assembly consulted separately. The consultation concluded that it would be "unaffordable" to provide universal discounts or minimum levels of discounts for low-income households with children, instead choosing to "improve the concession available under WaterSure for households with three or more children… with the cost… met by the Government rather than water customers" (Defra, 2011).

The consultation responses (Defra, 2012b) highlighted that companies asked for more clarity around which households should benefit from social tariffs, acknowledging that people on means-tested benefits and/or tax credits would naturally be passported onto a social tariff, with CCWater believing these should form the basis of eligibility. Others felt independent income assessments were better for eligibility checking, as they would capture other financial situations, not just reliance on certain benefits. When asked what level of cross-subsidy would be deemed acceptable, some companies offered figures in the region of 1.5% of an average water and sewerage bill, whereas some felt that "only social support from the Government was equitable".

Government considered the responses of this consultation both in their White Paper 'Water for Life' (HM Government, 2011) and in developing the guidance required by the FWMA for companies to introduce social tariffs, using the cost/benefit information to conduct a thorough impact assessment. In addition, the Government responded to the recommendations for addressing disparities of water charges in the South West, by introducing a £50, Government funded, reduction in bills of South West Water customers (House of Commons, 2013).

Social Tariffs - Guidance to water and sewerage undertakers

The final guidance, required by Section 44 of the FWMA, was written to "allow companies as much freedom as possible to design tariffs appropriate to their customers. It does not specify eligibility criteria for social tariffs, the level or type of concession which should be made or the amount of cross-subsidy from other customers that can be used to fund a scheme" (Defra, 2012a). The guidance:

- States that schemes should be broadly acceptable to the customer base, evidenced through engagement with customers;
- Explains that proposals need to be underpinned by an impact assessment;
- Provides a detailed list of requirements that any impact assessment should address;
- States the Government view that a charge of up 1.5% of the average annual household bill would be a reasonable amount of cross-subsidy;
- Expects undertakers to apply "the most generous reduction" when a household is eligible for both the company's social tariff and WaterSure; and

- Encourages companies to promote metering as an affordability measure, stating companies should include advice on metering and efficiency when promoting social tariffs, whilst ensuring social tariffs are applied to metered and unmetered customers.

Citing local and regional differences as the reason, highlighting social tariffs as an "opportunity for undertakers to address local affordability problems in light of local circumstances" (Defra, 2012a), the guidance does not:

- Specify thresholds of acceptability for social tariffs through customer engagement;
- Propose which households should benefit from a social tariff;
- Specify an appropriate method of assessment of affordability; or
- Outline what concession should be offered.

At the time of this guidance, Government felt that "water and sewerage companies are best placed to design schemes which meet the needs of their own customers and… national consistency is neither feasible nor necessarily desirable". This was later challenged.

Other Affordability Proposals

In 2014, during the committee stages of the Water Act, and following the introduction of three water company social tariffs and plans for a further 12, Thomas Docherty, Shadow Minister for Environment, Food and Rural Affairs, moved a new clause which would "require the Secretary of State to bring forward a National Affordability Scheme with an eligibility criteria prescribed by the Secretary of State in the form of a statutory instrument… to end the postcode lottery by ensuring every water company has a social tariff… funded and delivered regionally" (House of Commons, 2014a). A similar amendment was moved by Lord Whitty during the Third Reading stages in the House of Lords for the same Bill (House of Commons, 2014b). Both amendments were withdrawn, with the Minister, Owen Paterson, stating that "a nationally mandated social tariff would be difficult to introduce… because of regrettable disparities in income between different parts of the country… different numbers of people would be eligible in different water company areas… the burden on the remaining customers would vary by area".

WaterSure

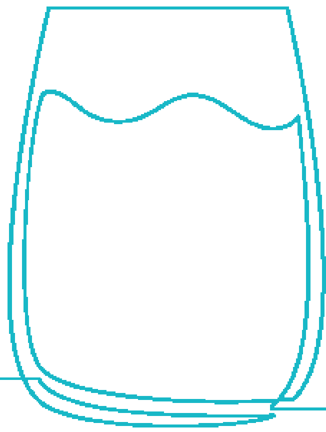
"The Water Industry (Charges) (Vulnerable Groups Regulations were introduced in 1999 to require water and sewerage undertakers to make special provision in their charges schemes for providing assistance to consumers on low incomes who may struggle to afford their bills" (Defra, 2015)) and can be seen in section 5 of The Water Industry Act (1999). This assistance is now known as the 'WaterSure tariff'.

The scheme is available for customers with a water meter who are in receipt of one or more of a specified list of benefits, and additionally either:

- Are in receipt of child benefit for three or more children under the age of 19; or
- Have someone living at the property who has a medical condition which requires significant additional use of water.

If a customer qualifies for WaterSure, they will "pay no more than the average household bill" for their company, even if using more than the average amount of water (Ofwat, 2020b).

Following the introduction of the FWMA (2010) enabling water and sewerage undertakers to include social tariffs in their charging schemes, the 2015 regulations introduced an additional provision whereby "where an undertaker has introduced a social tariff that provides an equal or more generous reduction in bills for all households eligible for WaterSure then it will no longer be required to make the WaterSure tariff available separately" (Defra, 2015).



History of bill support in Energy

The previous section reviewed the history of social tariffs in water, highlighting the significant milestones in their development, and outlining how the current postcode lottery has emerged. Prior to considering the changes required to the current approach to social tariffs, it is also important to understand the experience of delivering similar support in other essential service sectors.

The energy sector also has a history of social tariff offerings, starting with the voluntary agreement of the 'Big Six' companies in 2008 which was replaced in March 2011 with a statutory scheme for the purpose of reducing fuel poverty as set out in the Energy Act (2010). This section highlights the milestones in the energy journey for consideration for any potential changes in the water social tariff model.

Voluntary Arrangement

In the 2008 Budget, the Chancellor announced that "Energy companies currently spend around £50 million a year on social tariffs; the Government would like to see that figure rising over the period ahead to at least £150 million a year… the Government will draw up a plan for voluntary and statutory action to achieve that… the Government will legislate to require companies to make a fair contribution" (HM Treasury, 2008). In response to this, as part of the July 2008 review on social programme spending, Ofgem defined social tariffs to ensure that any tariff labelled as a social tariff "must be at least as good as the lowest tariff offered by that supplier to a customer in that region on an enduring basis… regardless of that customer's payment method and including online tariffs" (Ofgem, 2009). At the end of 2008/09 just over 1 million customers benefitted from the social tariffs provided by the 'Big Six' suppliers under the voluntary agreement; this increased to around 1.3 million customers by the end of the voluntary agreement in 2011 (Ofgem, 2011).

Warm Home Discount

It is important to note that section mainly focuses on the eligibility for Warm Home Discount, and the related data-matching process for the 'core group'. Other elements of the scheme, such as the rebate process and industry initiatives are briefly referenced but have not been considered in detail for this review of social tariff schemes. These are themes which could be considered for further improvements to the financial support of the water sector.

In 2010, the Government looked to solidify support for low income customers in law. The main drivers for this were noted in the consultation document where it stated: "many suppliers also offer discounted tariffs [in addition to social tariffs] to vulnerable groups… which are cheaper than their standard tariffs. However, this form of unit price discount does not meet our principles. It does not provide a clear or targeted benefit, as different suppliers may offer different benefits to different groups of customers". The Consultation on the Warm Home Discount therefore proposed a scheme which encompassed "the best elements" of the voluntary agreement while also looking to address the concerns that stakeholders raised, delivered under five principles (Department of Energy and Climate Change, 2010):

1. Delivers a clear benefit for consumers;
2. Better focuses support on vulnerable households;
3. Delivers value for money;
4. Consistent with competitive energy markets; and
5. Ensures a smooth transition from the current arrangements.

The proposal was for a fixed rebate, the level of which would be set by Government to "ensure that all consumers receive the same benefit" as these fit most closely with the guiding principles, providing "certainty for the consumer on the absolute level of support that they will receive", enabling Government to design a scheme "within a given spending envelope which includes a carefully targeted Core Group" and enabling each supplier "to predict their spending requirements… so that no one supplier is required to fund a disproportionate number of benefits".

The Government also sought to introduce an innovative approach for targeting this support and proposed a "system of secure data matching and a supportive administrative process to identify members of [the Core Group]". This proposal was to deal with the effectiveness of the targeting of social tariffs, recognising that "there are very real difficulties in identifying and targeting the fuel poor" and making use of the provisions in the "Pensions Act 2008 to enable DWP to share its data on pension credit recipients with energy suppliers so they can target their assistance to these vulnerable customers" (Ofgem, 2009). The consultation responses (Department of Energy and Climate Change, 2011) agreed that "Pension Credit subsets needed to be as easy as possible to explain publicly and to those eligible" with some comments suggesting "some customers seemed to experience confusion in understanding which element of Pension Credit they were on".

The Government stated that anyone who was eligible for Pension Credit but did not claim it would not receive the Warm Home Discount and highlighted that the value of the WHD rebate on their electricity bill might be sufficient enough to encourage greater take up of Pension Credit. Despite this hope, unclaimed benefit entitlements remain endemic; 40% of those in Great Britain who are eligible for pension credit failed to claim the benefit during the 2016/17 tax year, leaving them missing out on an average of £2,500 for the year (Money Saving Expert, 2018).

In addition to energy bill rebates, the Warm Home Discount scheme also allows meeting the obligation through the funding of programmes to help fuel poor and vulnerable customers. These programmes are referred to as 'Industry Initiatives', and can include activities such as debt write-off, benefit entitlement checks, measures, energy advice, energy advice training and financial assistance.

The Warm Home Discount scheme came into effect in April 2011, and, at the end of scheme year seven (SY7) in March 2018, approximately 2.2 million customers benefited from the £140 a year rebate on their energy bills, providing over £327 million of support (Ofgem, 2018). The current scheme is due to end in March 2021, and NEA believe it is critical this is extended, and that the envelope of the programme needs to increase so that the mandatory broader group receive the full rebate automatically.

Safeguard Tariff and Price Cap

In the 2017 Conservative Party manifesto, there was a pledge to introduce an 'default tariff price cap' for the whole market, which would build on the existing 'safeguard tariff' (a tariff cap for WHD core group customers), and the prepayment meter cap (a CMA mandated price cap for customers with prepayment meters). In 2018, this policy was put into statute, and shortly after was put into force by Ofgem. This new price cap would cover all standard variable (or default) tariffs across all suppliers.

In addition, the Pre-Payment Price Cap also provides energy customers with relief from unpredictable price increases, greater transparency in the pass through of energy related policy costs and the prospect that bills could fall if input costs drop. Each price cap works in a similar way. Ofgem determines the cost of each individual element of the energy bill (generation, networks, cost to serve, policy costs etc), attributing each to a either a unit rate or standing charge (day rate). These are then summed, with a small profit allowed for. The prepayment cap is currently due to end in 2020, whilst the default tariff price cap will end in 2021 at the earliest (if certain competitive market conditions are met), or in 2023 at the latest.

The default tariff price cap applies to approximately 11 million customers in the market. Ofgem estimate that the cap saves customers around £75 to £100 per year, based on analysis of energy prices since April 2015. The prepayment cap applies to 4m customers, and likely represents a larger saving than the default tariff cap, as prepayment costs used to be typically higher than standard variable tariffs, and the caps are now at approximately the same level. It should be noted that, by Ofgem's own admission, it is impossible to estimate an exact savings figure going forward as suppliers can no longer price above the level of the cap.

For the majority of customers who don't (or can't) engage in the energy market, these policy interventions continue to be a positive development and have ensured there is much greater, and more consistent, protection for energy customers. Previous sections have shown that this level of consistency has not yet been achieved in the water sector. The next section outlines some broader issues with social tariffs that water companies themselves have experienced in implementing them.

Experience of water companies

Over the eight years since the guidance was issued, all 17 water companies in England and Wales have developed their own social tariffs, broadly accepted by their customers, and now supporting over 500,000 households with their water and sewerage bills. Eligibility criteria and support levels have adapted over time; companies regularly conduct their willingness-to-pay research with customers, and as a result, changes to cross-subsidy can occur outside of a price review. But, while the guidance was written to allow companies flexibility in designing their social tariffs, there are inevitably issues that have arisen as a result of putting the tariffs into delivery. This section explores some of the issues highlighted directly by teams supporting customers with their social tariff applications.

Housing Costs

Housing costs vary greatly across England and Wales; the average rental values for February 2020 were lowest in the North East at £517, with the highest in Greater London at £1,650. Excluding London, the highest was in the South East at £1,018 – almost double that of the North East (HomeLet, 2020).
The regional monopolies of the water companies can cover vast areas, and some companies have multiple licence areas in different parts of the country. One water company recognises this as an issue across their customer group, telling us:

"As this is included in their overall income, even if it is paid as housing benefit this can take customers over the income cap. We have the challenge of if we excluded the housing costs, we could end up unfairly benefitting customers who are overpaying on a mortgage or have a very large home so diverting from the customers we want to assist."

Income

A long-standing issue with any financial support model based on income is understanding what income actually is. There are some significant variables that can be considered to be income, similarly that are a large number of deductions that can be made. One water company calculates income to be all income from all sources for all permanent residents of the billed property. Including salaries, wages and Pensions, benefits and allowances – including Housing and Child benefits and any others – and excluding disability payments. Another excludes housing benefit, council tax reduction and disability/carer benefits and premiums from their income calculations.

The range in factors included in income calculations makes it hard for customers to understand if they meet the income thresholds required to get support. For example, one company told us:

"Customers do not always understand their income level or consider it to be household income. This can particularly be around housing benefit or childcare costs as these can regularly take customers over income level."

Large Families

Water companies have told us that they often engage with large families (three or more children) who, by default, use larger amounts of water, but rarely fall under the income threshold for support under their social tariff schemes. One company told us:

"This is a difficult area, and there are so many different situations to understand how best to approach, but it can feel unfair as we do see examples of customers who are struggling with their essential bills. With [us] having the other tariff for customers who have a deficit budget we do have a route of support available, but feel we are missing the 'just managing' customers."

Budgeting Concerns

Metering is often marketed as a way of saving customers money on their water bills, but there is no guarantee that this will be the case for all, particularly if the household water usage is higher than average. Companies have responded to this by extending the period of time which customers can choose to switch back to unmetered billing when having a water meter fitted – this is now usually 24 months (CCW, 2020a). Despite this, customers are still wary when considering moving to a meter in case their bills increase. Most social tariffs do not require the household to be metered, but the WaterSure tariff does. One company told us:

"There continues to be a lack of trust or possibly budgeting concerns from metering which means that customers are not comfortable to move to a meter even though this may save them money. Although we do not insist on a meter in these cases at present, this could be a route in the future for fairness to others especially if we run out of cross subsidy funds."

Pension Credit

Customers in receipt of pension credit are deemed eligible for support under some company social tariff schemes. Other companies have drafted data sharing agreements for DWP under the powers of the Digital Economy Act (2017) to undertake data matching, using pension credit as a proxy for social tariff eligibility under the assumption that their incomes are low enough to qualify against the prescribed income thresholds. But take up of pension credit remains low; Money Saving Expert recently estimated that around "1.5 million eligible households don't claim the top-up, often because they don't know they can" (Money Saving Expert, 2020). One company, who uses a bill-to-income ratio of 3% as their eligibility criteria for social tariff, told us:

"We have been promoting Pension Credit for the last year and sign up numbers remain low. We currently have just over 3k. Martin Lewis has recently promoted this on his TV show which created a lot more interest, however as we only support those customers with a bill over 3% of net income (i.e. in water poverty) they are not eligible as their bills are low. With these customers, as their income is very low the disposable income is small so it may exclude those that really need some help."

WaterSure

The eligibility criteria for WaterSure is prescribed within The Water Industry (Charges) (Vulnerable Groups) Regulations (Defra, 2015), and so does not differ by water company. Customers must be metered, in receipt of a means tested benefit and have high water usage due to either having a large family or a medical condition requiring additional water use. One company told us:

"We have seen a number of customers who we would really like to help as they have high water usage due to medical conditions or a large family but they are not on means tested benefits. For these customers, if their income is over the income threshold they will not be eligible and we are unable to help. These customers feel penalised because of the meter."

In addition to this, customers have commented on feeling insecure about their ability to budget following WaterSure support; if a customer was eligible for the discount due to having three or more children under the age of 19, once they no longer meet this criteria they will no longer receive the discount, yet they may still have the children living at home with them. This can result in households choosing not to access the support for risk of future budgeting problems, particularly when their children are approaching the ineligible age range.

Profiling of social tariffs

The current guidance for social tariffs allows "companies as much freedom as possible to design tariffs appropriate to their customers… allows companies to design schemes in consultation with their customers and organisations which represent customers… schemes should be broadly acceptable to the customer base and this should be evidenced through engagement" (Defra, 2012a). The agreed cross-subsidy is a 'limit' – the maximum amount companies can apply without seeking additional approval from their customer base.

When considering cross-subsidies, the guidance states that "it is Government's view that a charge of up to 1.5% of the average annual household water bill would be a reasonable amount of cross-subsidy to expect non-qualifying households to provide (around £5 in 2011/12)". However, as the guidance explicitly states that cross-subsidies and the design of any social tariff scheme must be broadly acceptable to the customer base, the actual cross-subsidy charge varies greatly by water companies dependent on the responses they receive during their 'willingness-to-pay' research and customer engagement. The current range (2020/21 bill levels) is around £14 from lowest to highest and can be seen in *Figure 1*.

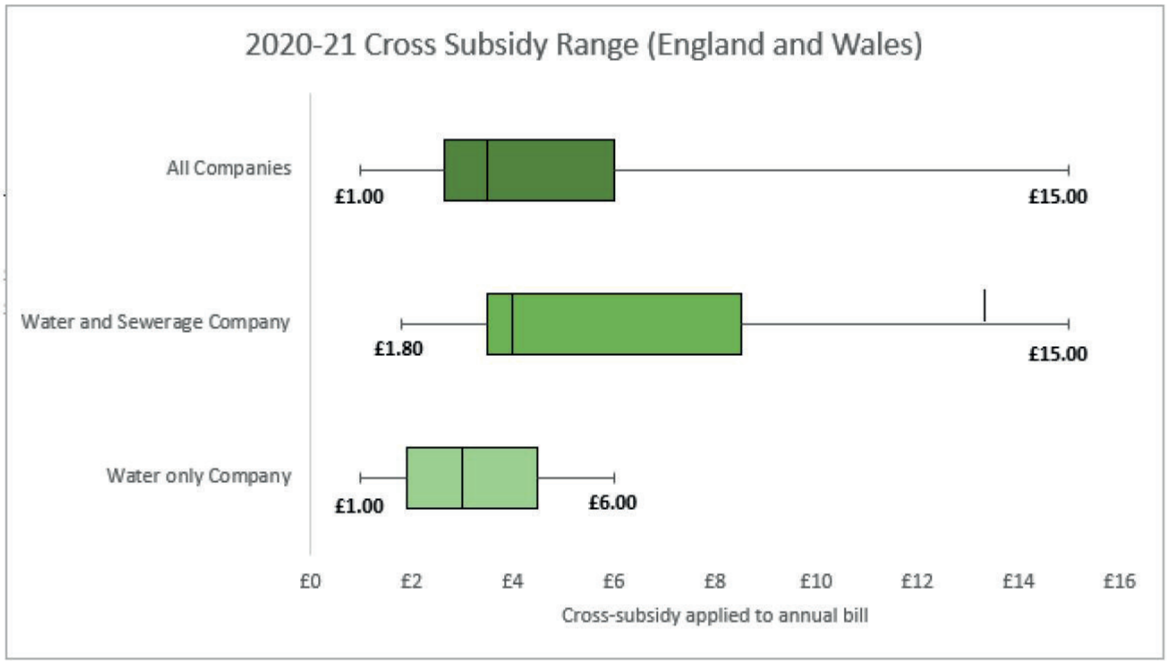


Figure 1. Range of cross-subsidies across England and Wales

The table below shows the 2020/21 cross-subsidies as a proportion of both the 2020/21 company average bill, and the average 2020/21 bill in England and Wales, in-line with the government guidance of a suggested charge of up to 1.5% of the average annual household water bill:
This shows that there is a relatively even split across all companies in their level of cross-subsidy as a proportion of the bill. For reference, a charge of 1.5% on the average 2020/21 combined bill in England and Wales would be £5.96 and £2.79 for the water only bill.

		20/21 company bill	E&W 20/21 avg. bill
All companies	**<1.5%**	50.0%	45.0%
	≥1.5%	50.0%	55.0%
Water and sewerage companies	**<1.5%**	54.5%	54.5%
	≥ 1.5%	45.5%	45.5%
Water only companies	**<1.5%**	44.4%	33.3%
	≥ 1.5%	55.6%	66.7%

The amount of cross-subsidy agreed during the willingness-to-pay research determines the basis for both the level of support offered and who is deemed eligible for that support by a water company's social tariff – though the PR19 price review process has also seen some companies commit to shareholder funding to 'top-up the pot' for additional support (Ofwat, 2019). In designing their schemes, companies must determine their own eligibility criteria, typically using one or more of four key elements as shown in *Figure 2*.

Who falls through the gaps?

Vulnerability is multi-faceted, and many situations can result in increased levels of financial difficulty, on a long-term or transient basis. The ability of companies to be flexible in determining who they support is of utmost importance if they are to adequately support those experience transient vulnerabilities, but they can be more prescriptive for longer-term circumstances.

As an example, WaterSure has been designed to support those who use large amounts of water due to having medical conditions or a large family, providing the household is metered and are on a means-tested benefit(s).

Mr and Mrs Smith both work fulltime on the national living wage (£8.72/hour as of 1st April 2020), they have three children, all of whom are in primary school, and they have to pay for childcare outside of school times three days a week in order to work their hours.

They receive child tax credits, which makes them eligible for WaterSure, but they live in a block of flats which they have been told cannot be metered. They earn too much as a household to qualify under their company's social tariff scheme, despite their outgoings placing them into a negative budget. Despite asking for help, they are told there is nothing their company can do.

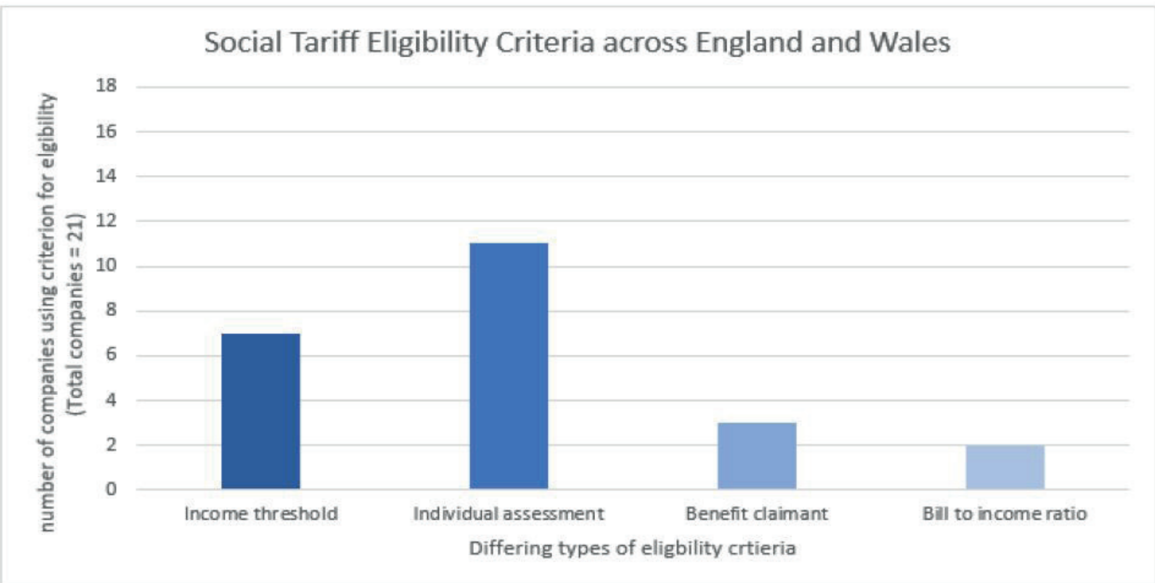


Figure 2. Social tariff eligibility criteria

The level of agreed cross-subsidy also determines the level of support which can be provided. Companies' schemes either limit the bill to a set amount or offer a proportional discount. Some of the percentage discounts are offered on a sliding scale dependent on the level of the customers' financial deprivation, with some customers ensuring the discount offers takes the customers' bills below the 3% water poverty threshold.

In order to illustrate the range of discounts offered, the maximum percentage discounts have been used in *Figure 3*. Where companies offer a limited bill with their social tariff, this has been calculated as a percentage of the average 2020/21 bill for that company.

As can be seen from the three graphs, the agreed cross-subsidies, eligibility criteria and discount levels vary significantly across companies. This creates a 'postcode lottery' whereby customers in similar financial situations living in different water company areas may not both be entitled to receive support, or the same level of support, dependent on the companies' individual eligibility criteria and budget.

Although shown within Figure 3 as the 'maximum discount level offered' it is also worth noting that some companies apply the same discount, or bill limit, to all eligible social tariff customers, regardless of the depth of their financial difficulty, whereas others provide support on a tiered basis, or a sliding scale.

The latter allows the company more flexibility, ensuring support levels are tailored to the customers' needs, and potentially allowing them to support a larger number of households. This approach also accounts for company-wide bill reductions as part of the price review process; ensuring that customers are not left worse-off by overall bill reductions compared to the price they were paying under the social tariff scheme, if they no longer qualify under a bill-to-income ratio assessment.

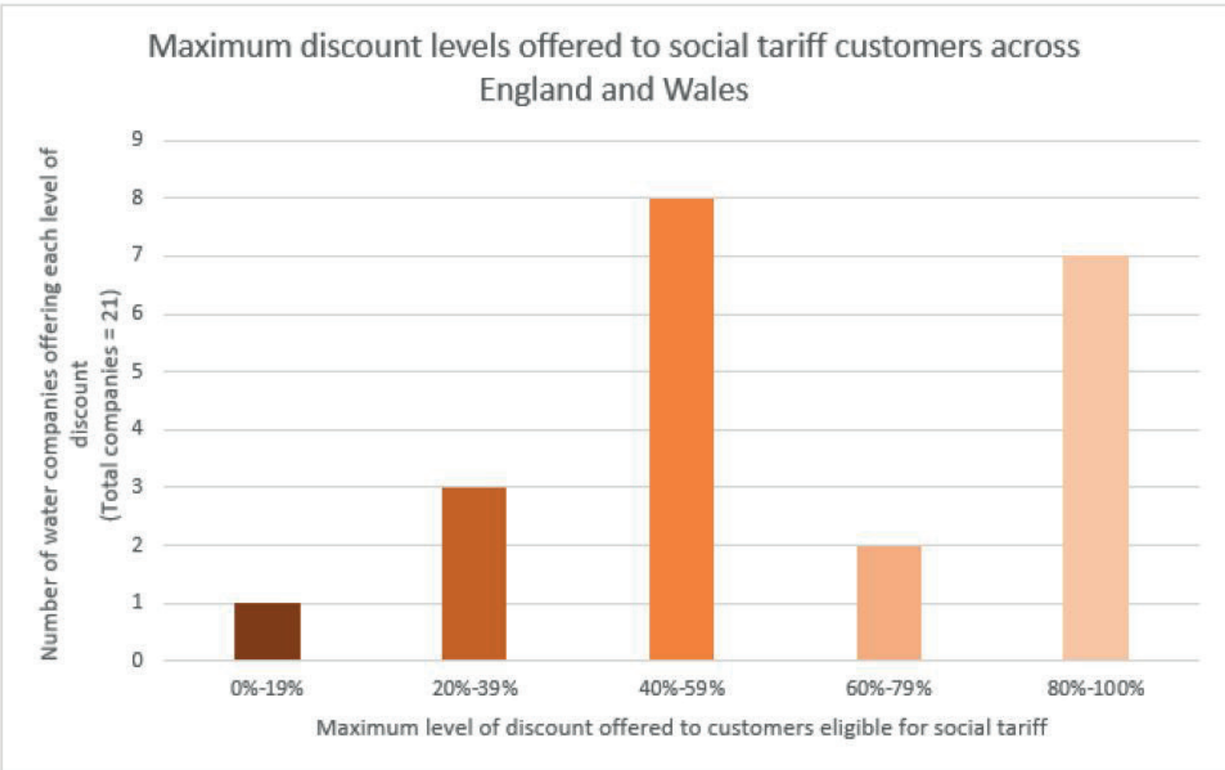


Figure 3. Maximum social tariff offered

Issues identified

While the water company social tariff schemes currently support over 533,000 customers across England and Wales, and WaterSure a further 164,000 customers, 12% of customers surveyed by CCW (2019) deem their bills to be unaffordable; this leaves a potential 2 million customers still struggling to pay for their water bills. NEA believe the social tariff schemes could go further to close this gap and that several issues should be addressed in order to do so.

The social tariff guidance highlighted the "opportunity for undertakers to address local affordability problems in light of local circumstances" (Defra, 2012a). Certain characteristics and influencing factors do differ between regions, but this flexibility has resulted in a postcode lottery developing across the sector. This lack of consistency risks customers in different water company areas being unable to access the same, or similar, levels of support despite having similar financial circumstances; and with combined 2020/21 bill levels varying by up to £170 across the eleven water and sewerage companies (Discover Water, 2020) this causes significant detriment to those unable to access support.

In addition to the aforementioned regional characteristics and influencing factors, the differences in regional support levels have also been caused by the need to have broad customer acceptability, determined through willingness-to-pay research. This research is "an input to companies' business planning processes… alongside customer priorities and demand, companies also take into account legal and regulatory obligations, and the costs of investments, along with customer affordability and company financing constraints… Water companies use customer valuations to understand the benefits of investments that improve or maintain service levels" (ICF Consulting Limited, 2017). During the PR19 business planning stages, one customer panel stated in their report:

"We have little confidence in Willingness to Pay as a dependable way of quantifying customer support for a service proposition, and we question the reliance which Ofwat requires companies to place on it in their Business Plans.

"If it is persisted with after PR19, we feel that customers should be saved the cost of funding multiple [Willingness to Pay] projects in every water company. Instead resources should be combined to do a large survey, with extensive sensitivity testing, preferably within a national framework, allowing results to be pooled and compared regionally and nationally." (South Staffordshire and Cambridge Water Customer Panel, 2018)

In their research on the customer acceptability of the PR19 draft determinations, CCW (2020b) found the following trends:

- *"Uninformed and informed acceptability, and acceptability of ODIs [Outcome Delivery Incentives] increases in-line with household income;*
- *"Similarly, when looking at Socio Economic Classification (SEC), customers in higher SEC bands are significantly more likely to consider the proposed acceptable than those in the lower SEC bands;*
- *"Additionally, those who report having difficulty paying their water bills on time are significantly less likely to find the proposed bills acceptable at any level, including the potential of ODIs; and*
- *"Customers who are on their company's Priority Service Register (PSR) are less likely to find the proposals acceptable at the uninformed and informed levels than those who are not on PSR."*

This raises a few concerns when considering the current approach to willingness-to-pay:

- *Firstly, it appears to differ significantly across companies and regions, possibly due to the methods used, the questions asked, and the customers engaged.*
- *Secondly, the cost of willingness-to-pay research is extensive and is not solely incurred during the business planning process as companies are required to go back out to customers to continuously understand their levels of acceptability.*

- *Thirdly, there are substantial differences in acceptability across customer groups, dependent on income and socio-economic classification. If 20% of customers engaged are within low-income households and don't find the plans acceptable, they could potentially still be approved under the definition of 'broad acceptability' if the remaining 80% of engaged customers agree with the plans. This means the opinions of the customers most at risk of detriment are potentially ignored.*

The current guidance from Government leads to two issues. Firstly, on the prescribed nature of WaterSure, companies have commented on the eligibility criteria being too restrictive, and of the insecurity some customers feel when they are no longer eligible for support. Secondly, as the guidance does not specify eligibility criteria for social tariffs, there is currently no method of consistently applying 'auto-enrolment' as has been seen with the core group of Warm Home Discount.

The Digital Economy Act has allowed companies to submit joint data sharing agreements to DWP in order to data-match for eligibility. The terms of these agreements are specific and restricted, meaning the companies will have to submit a list of customer names and addresses and ask DWP to confirm, yes or no, if they are in receipt of a specific named benefit. The first of these agreements is currently in progress with eight companies collaboratively agreeing on which benefit to enquire about. If 'core' eligibility criteria was more consistent, ideally prescribed by Government, all companies could then data-match against pre-agreed benefit criteria and auto-enrol customers on the social tariff. As well as addressing issues of low customer awareness, this would reduce administration costs as renewals could take place automatically on receipt of positive confirmation that the customer was still eligible.

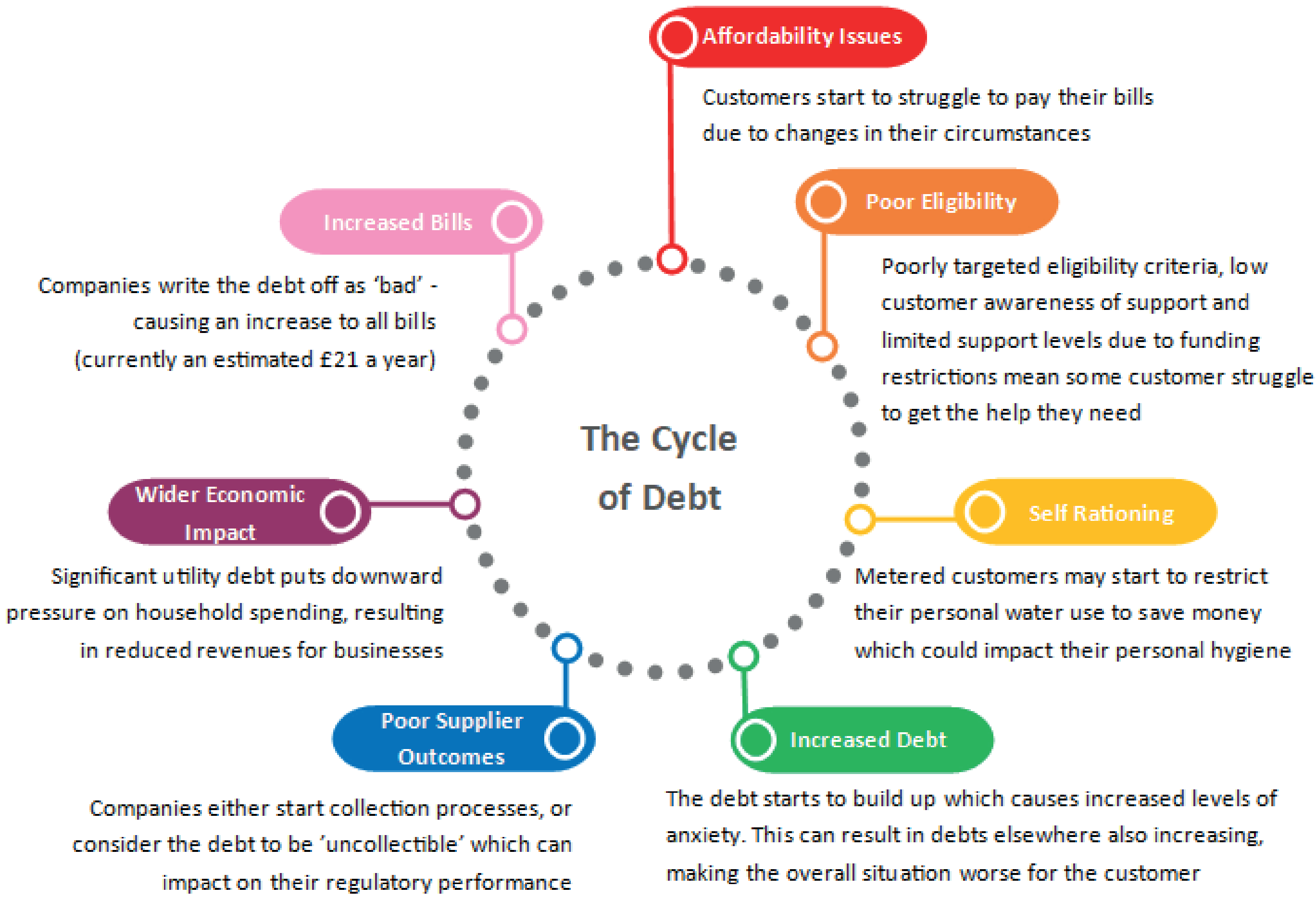
The issues outlined in this section are quite extensive and have illustrated the mixed outcome for customers. As more customers struggle with their bills and cannot access support, there is a risk these disparities will continue to increase and could result in more customers defaulting on their bills. Defaults turn into increasing arrears; as well as the physical and mental impacts that the resulting water rationing can prompt, the increasing depth of customer indebtedness can also result in bad debt, with the outstanding balance deemed to be uncollectable by the water company. This bad debt is then passed back to the customers of each water company via a bad debt charge – this adds approximately £21 annual to each customer's bill (Ofwat, 2020a), potentially making their financial struggle even harder to manage.

The current landscape of water poverty

In our first discussion paper, 'Water Poverty: A Common Measurement' (NEA, 2019), we highlighted the current landscape of water poverty in England and Wales. Based on 2017/18 data, an estimated 21.9% of households are currently in water poverty at the 3% threshold, with 10% paying more than 5% of their household disposable income on their combined water bill. The mean water poverty gap (the amount incomes need to increase, or bills decrease, by to take households out of water poverty) is currently at £4.75 or £6.48 a week at the 3% and 5% thresholds respectively.

Our analysis shows a significant increase in the water poverty gap when compared to 2013 research using the same methodology, yet a decrease in the number of households under each definition. This means that the depth of the issue is worsening, as households in water poverty would require significantly more support in order to not be water poor. Although not the only option for supporting these households, social tariffs play an extremely important role in addressing the financial issues these customers face. This has also been recognised by Water UK in their Public Interest Commitments (2019), who at a minimum are working to make bills affordable for all households spending 5% or more of their disposable income on their water bills.

The final section of this paper focuses on three key recommendations to improve social tariffs across England and Wales, with the aim of addressing the lack of consistency across the sector.



Recommendations

The will of the water companies to support customers struggling to afford their bills is clear; the social tariffs they have designed already support over 500,000 customers across England and Wales. These households no longer face the worry of whether or not they can afford their water bill, and they have trust that their water company has their best interests at heart.

But the differences across social tariff schemes, and bill levels, has resulted in the development of a postcode lottery, and many find it unfair that two customers in the same financial situation may not both be able to access support due to the differences in company schemes and available funding.

NEA believes the postcode lottery should not exist, and that Government should review their social tariff guidance to ensure the support is fairer for all.

Recommendation 1

Government should conduct a thorough review of social tariff guidance in consultation with water companies and stakeholders to make the support across England and Wales fairer for all.

A number of the highlighted issues stem back to the variances across the willingness-to-pay research, in how it is conducted and how the resultant cross-subsidy levels are determined and applied to company schemes. As part of the review into social tariffs, NEA recommends assessing the impact of the current overreliance on willingness-to-pay being used as the determinant for customer cross-subsidy and the resulting impact this has on company support levels and eligibility criteria.
There are several alternative approaches that could be taken to fund social tariffs. The following table outlines some which NEA has considered alongside their strengths and weaknesses, but it should be noted that this is not an exhaustive list.

Recommendation 2 - table

Option	Explanation	Strengths	Weakness
Willingness-to-pay research should no longer be used to determine cross-subsidy levels, and instead social tariffs should be centrally funded.	As a number of the issues with social tariffs stem back to the cross--subsidy levels agreed through willingness-to-pay research, it could be argued that this process is not fitforpurpose. Instead, willingness-to-pay could be abandoned, and social tariffs could be funded centrally through Treasury.	Many argue that social policy is for government to decide and not for companies, and so this could address this point. Customers would not be expected to pay to support low-income households through their water bills. The funding would be prescribed, and therefore would be steadier than willingness-to-pay which can change year-by-year.	This does not account for regional differences across water company licence areas. This does not have the broad acceptability of customers in each water area.
Willingness-to-pay research should be conducted on a national basis (two sub-options).	Willingness-to-pay research is conducted centrally as a financial exercise, talking to different customer groups across England and Wales.	This removes lack of consistency as all companies will be allocagted the same amount of funding per customer bill for their social tariff schemes. This reduces the costs associated with conducting the willingness-to-pay research for cross-subsidy, as all companies would contribute a smaller amount to conducting one piece of research each year. This has broad acceptability of all engaged customers across various licence areas.	This does not account for regional differences across water company licence areas.
	The level of cross-subsidy is 'deemed' by Defra in a similar way to the Warm Home Discount (currently an estimated £12.86 on a dual fuel bill).	This removes the lack of consistency as all companies will be allocagted the same amount funding per customer bill for their social tariff schemes. This removes all costs associated with conducting the willingness-to-pay research for cross-subsidy.	This does not account for regional differences across water company licence areas. This does not have the broad acceptability of customers in each water area. This would be subject to Treasury 'tax and spend' rules.
There should be a national minimum standard for crosssubsidy, which can be 'topped up' by companies.	A minimum level of cross-subsidy is deemed by Defra, but companies are able to conduct additional research with their customer base to 'top-up' their cross-subsidy with broad acceptability.	This ensures a minimum level of funding for each water company. This allows companies to address the regional differences in each of their operating areas, with broad acceptability of engaged customers. This closes the gap between the highest and lowest cross-subsidy levels that currently exist. This brings social tariffs more in line with current guidance which states "the government views that a charge of up to 1.5% of the average annual household bill would be a reasonable amount of cross-subsity."	This could see a cross-subsidy levels for some companies reducing if they cannot secure the top-up funding through their own engagement. This could see some customers paying more than they currently pay for cross-subsidy, resulting in (small) bill increases. This would be subjec to Treasury 'tax and spend' rules.

The final option outlined in the table – "There should be a national minimum standard for cross-subsidy, which can be 'topped up' by companies" – addresses the majority of the concerns and original guidance around social tariffs. This option would allow regional differences to be addressed, whilst still closing the gap which causes the current postcode lottery. To reduce the variation due to regional bills, this could be defined as a percentage of the average household combined bill in England and Wales –£397 in 2020/21 bill prices (Discover Water, 2020). This option is therefore NEA's preferred option, but we recognise that other options may also exist. A consultation to consider these options and any additional options that may exist, alongside a thorough impact assessment of the options outlined would therefore be recommended.

Recommendation 2

Particular consideration should be given to alternative options for funding social tariffs schemes. This should include an impact assessment of the current approach to willingness-to-pay as the basis for funding and the resulting designs of social tariffs, alongside alternatives.

In reviewing the current approach to social tariffs, thought should also be given to the eligibility criteria applied by each water company. There is no current minimum standard with social tariffs, this is only prescribed within the guidance for WaterSure. By setting minimum eligibility criteria, companies would be better placed to utilise the powers of the Digital Economy Act for data-matching and could undertake an auto-enrolment process, reducing complex administration costs and ensuring those most in need of support receive it.

NEA would recommend this minimum criteria is developed, allowing companies to add additional criteria to meet their regional differences if they feel this is required. This could be designed in a similar way to the current structure of Warm Home Discount, whereby there is a core group who receive the discount automatically, and a broader group who need to apply. The Warm Home Discount uses pension credit as their 'passport' for data matching, though as previously addressed, the take-up of pension credit is low. Another option could be exploring the use of Universal Credit as a passport – if only claiming the basic allowance then incomes would always be below any income thresholds currently used by water companies. This could be used alongside Pension Credit to ensure customers of both working age and retirement age are able to access support.

Recommendation 3

Government should prescribe 'core' eligibility criteria allowing companies to continue to take account of regional circumstances whilst removing unacceptable variances in levels of support, and to aid the use of powers under the Digital Economy Act for auto-enrolment to mitigate against the lack of customer awareness of social tariffs.

Next Steps

NEA recognise that there are a number of factors which influence the ability of water companies, the regulator, and Government to make changes in the short-term. We do not expect any of the proposed recommendations could be delivered overnight, and yet, with more people than ever experiencing financial difficulty due to the Covid-19 crisis it is extremely important to make necessary preparations for adjustments before the situation worsens.

With this, and the acknowledgement that companies are at the start of a new price control period, we suggest the following next steps could be taken:

- **During this price control, the eligibility for social tariffs could be reviewed and made more consistent across England and Wales:**

  - This would allow for further data sharing agreements to be made for all companies to have the same access to DWP data under the powers of Digital Economy Act, allowing for more automation of the enrolment process. This in turn would reduce the administration costs of the social tariff schemes, allowing more customers to be supported;

- **As the work begins for the next price review, PR24, companies agree to work towards a degree of standardisation with their social tariff schemes and the cross-subsidies which fund them:**

  - This will remove the postcode lottery, but will be approached as 'floor' rather than a 'ceiling', allowing companies the flexibility to go further to address specific geographical needs; and
  - In the long-term, further consideration will be given to the need for a more centralised scheme, which may, or may not, be funded by cross-subsidy.

NEA believe that the review of social tariffs is a necessary step to ensure the most vulnerable in our society are supported by their water companies. These recommendations and next steps could increase the numbers of customers supported across England and Wales, relieving them of yet another financial pressure, and reducing the complex administration costs which water companies incur. This in turn has the potential to further reduce customer bills, and significantly change the water poverty landscape, removing the questions associated with high bills for an essential service, and confirming the legitimacy of the water companies in England and Wales.

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Water Poverty: The Consistency of Social Tariffs

Action for Warm Homes

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