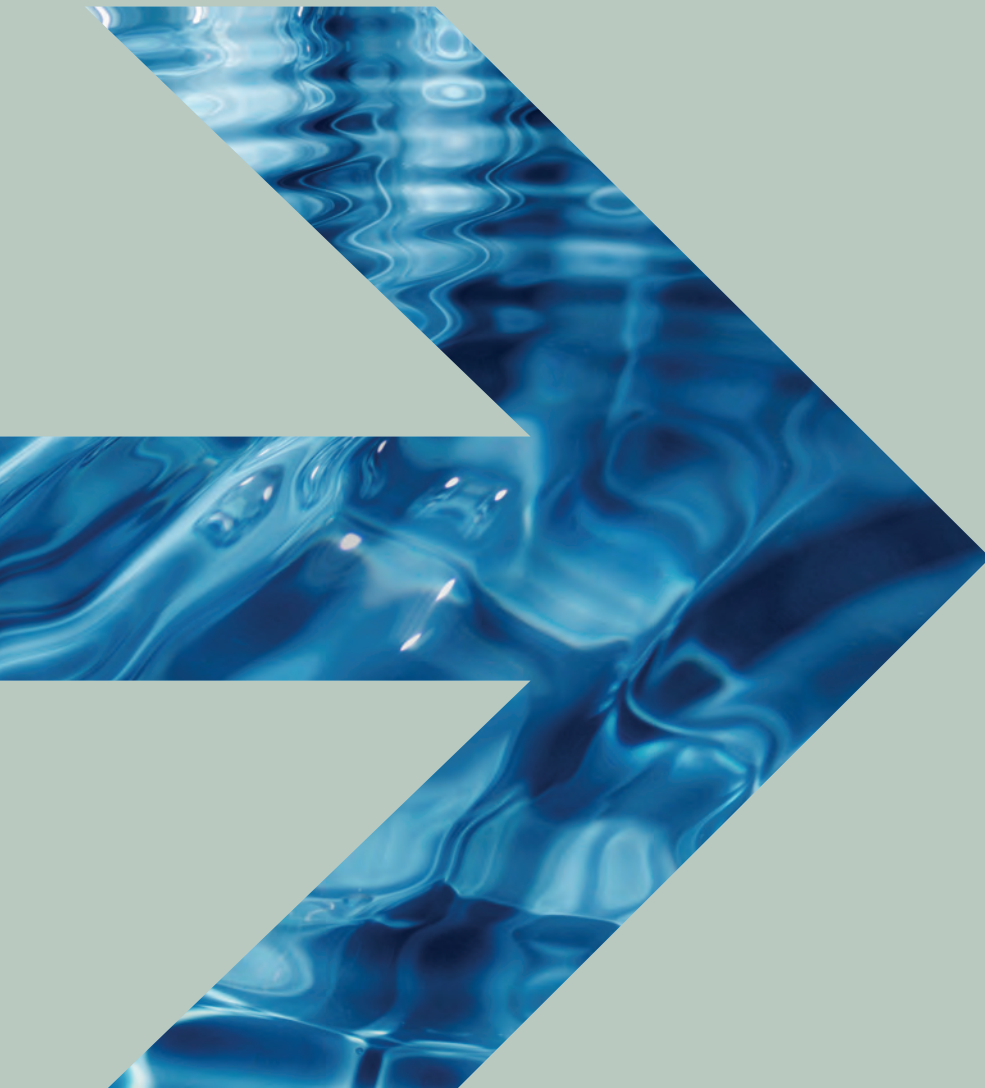
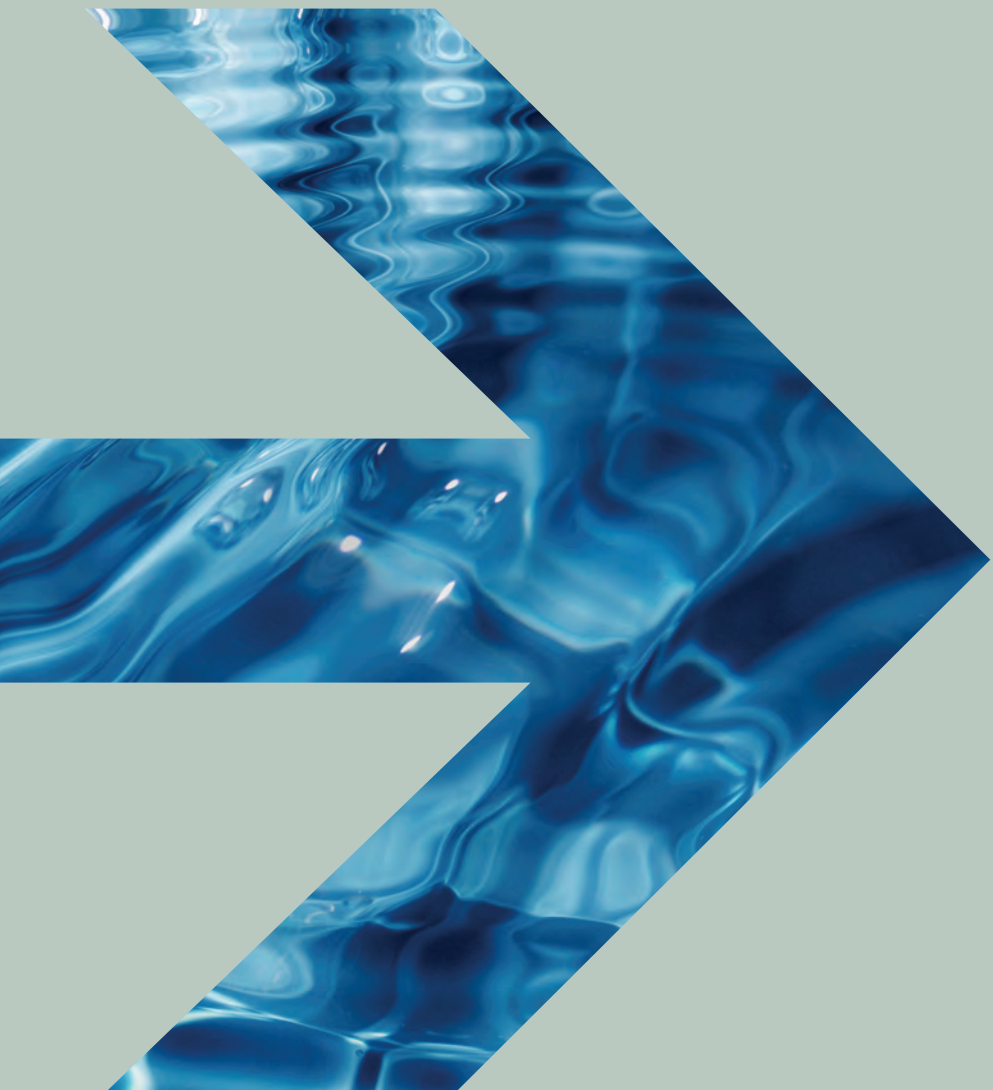


# Focus on water

Strategic Direction Statement  
2010 → 2035

December 2007





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# Executive Summary

## Our Key Strategic Intentions over the next 25 years are:

1. Providing a continuous supply of quality water
2. Dealing effectively with waste water
3. Responding to customers' needs
4. Minimising our carbon footprint
5. Having the lowest possible charges
6. Having the right skills to deliver
7. Maintaining investor confidence
8. Promoting an effective regulatory regime

Our proposals are based on making improvements which customers support and ensuring that we have a sustainable impact on the environment



**Tony Wray**  
Chief Executive  
Severn Trent Plc

### Severn Trent's Vision

The demands of our modern lifestyles, the impact of climate change and the need to protect our environment and natural resources for future generations will create a complex and demanding set of challenges for the water industry over the next 25 years and beyond. This summer, we have already seen the impact of climate change in the unprecedented flooding in the Midlands and Gloucestershire which has highlighted the importance of some of our proposals.

At Severn Trent we believe that through continuous improvement and innovation we can meet these challenges and deliver our aim of being the best water and waste services company. We will achieve the highest customer service and environmental standards while at the same time offering our customers the lowest possible prices.

We will deliver these aims with an inspired and motivated work force equipped with the right skills, tools and strong quality controls. We aim to have the best health and safety performance in the industry so that no-one within our organisation, or in our community, gets hurt or made unwell by what we do.

### Key Strategic Intentions

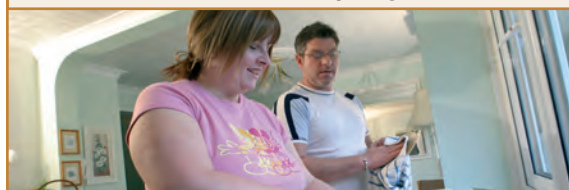
Our strategic direction is based upon eight key strategic intentions (KSIs) which we will deliver over the next 25 years, while ensuring we have a sustainable impact on the environment and playing a critical role in the communities we serve. These KSIs reflect what our customers tell us they consider important and the views of the wider stakeholder groups we have consulted during the preparation of this statement.

### KSI 1 – Providing a continuous supply of quality water

Our research shows that ensuring a reliable, safe water supply is the top priority for our customers. It also shows that customers are willing to pay for improvements in drinking water such as taste, odour and hardness. To achieve this we will:

- Ensure that we meet water quality standards and improve the acceptability of drinking water.
- Improve our networks and treatment works to increase reliability of supply.
- Reduce leakage through improving the distribution network, improving detection methods and speeding up response rates.
- Reduce demand through:
  - Accelerating the installation of customer meters, coupled with appropriate tariffs.
  - Promoting water efficiency programmes for businesses and consumers.
  - Using an education programme to promote water efficiency from an early age.
- Develop new sources of supply by identifying the most sustainable abstraction or storage solutions, and using supplies from other producers where sustainable and economic.
- Adopt customer supply pipes to reduce leakage and improve water quality.

### Ensure no failures in water quality



*“we will achieve the highest customer service and environmental standards”*

### Ensuring the supply of water for future generations



### KSI 2 – Dealing effectively with waste water

Our customers should have confidence that we will take away their waste and treat it to the highest environmental standards before returning it to our region's rivers.

To achieve this we will:

- Meet higher standards for waste treatment resulting from new legislation such as the Water Framework Directive and other legislation.
- Improve our sewerage network to ensure we have no serious pollution incidents, nor any pollution incidents caused by our assets or actions.
- Ensure that no customer community is subjected to internal sewer flooding.
- Improve the capacity of our network to cope with all but the most extreme forms of weather.

### Meet higher standards for waste water treatment



- Progressively separate foul and surface water drainage.
- Promote the installation of Sustainable Urban Drainage Systems (SUDS).
- Support the transfer of privately owned sewers to Severn Trent Water.

*“our customers expect to see higher standards of services”*

### KSI 3 – Responding to customers' needs

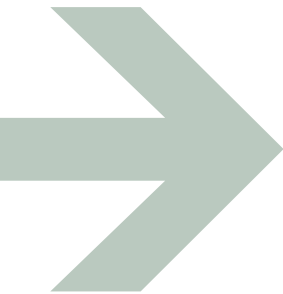
Our customers tell us that, in addition to providing the highest levels of water and waste services, they expect to see higher standards of customer service.

To deliver this, we will:

- Provide an excellent operational service, thereby reducing the need for customers to contact us about these issues.
- Make it easy for customers to contact us by using new technology to provide new and multiple communication channels.
- Provide a speedy and efficient response to customers by dealing with issues at the first point of contact wherever possible.

### Using new technology





**KSI 4 – Minimising our carbon footprint**

We believe we can deliver a leading position in sustainable operations thereby minimising our carbon footprint, provided it does not compromise standards or increase bills beyond levels which customers are willing to pay.

To achieve this we will:

- Expand our renewable energy operations to convert all sewage sludge to fuel.
- Work towards being carbon neutral in our operations.
- Achieve the Government’s carbon reduction targets.

**Develop other energy sources**



- Streamline processes to reduce energy use.
- Develop other energy sources such as wind energy.

**KSI 5 – Having the lowest possible charges**

Bills for water and sewerage services have seen large increases since the industry was privatised in 1989. This has funded a large investment programme which has resulted in huge improvements to drinking water quality, river quality and the robustness of our assets. At Severn Trent, our bills have been amongst the lowest in the industry since privatisation and our aim is to maintain this position over the next 25 years.

To do this we will:

- Ensure we improve our efficiency, to keep costs and bills no higher than they need to be.
- Invest as required to meet statutory obligations, but do this at the lowest possible cost to customers.
- Ensure that other investment is supported by customers by continuing to research their willingness to pay for discretionary improvements.
- Innovate across our business and adopt best practice from wherever we find it.

We will accelerate the installation of meters as the fairest method of charging for our services. We recognise that there might be affordability consequences of extending metering. We will

develop tariffs which encourage water efficiency savings and avoid high charges for essential use.

We will move to a predominantly metered charging basis and develop more sophisticated tariffs to enable management of water usage and demand. We will move to assessed property charges (based on property type) for those who are not metered as a simple and understandable means of charging for a non-measured service.

We believe it is the role of Government to ensure those in most need are protected through the welfare system. We know that some customers have difficulty paying their water bills and we will develop payment options and continue to support our charitable trust which provides help to those in debt – to help the most needy and least able to pay. We will also make sure that those who can pay but won’t are pursued effectively.

**Our bills have been amongst the lowest**



*“our bills have been amongst the lowest in the industry”*

**KSI 6 – Having the right skills to deliver**

To deliver our aims, we will ensure we have the right skills, both in Severn Trent and in our supply chain. This will mean playing a leading role in education, training and development in the communities we operate in.

To achieve this we will:

- Continue to invest in learning and development and offer our employees the right environment in which to develop their careers.
- Develop productive relationships with our suppliers and use experts from outside the organisation where necessary.

**Investing in employees**



- Continue to invest in delivering water education services to the wider community, including schools and visitors to our public access sites.

## KSI 7 – Maintaining investor confidence

We believe that the current ownership model, with finance from shareholders and borrowing, has served the industry well since privatisation and should continue.

The ongoing cost of our programme of investment in quality, capacity and asset maintenance amounts to far more than the money collected from customers through their bills. This has been provided through private finance (from both debt and equity) and is expected to continue into the future.

To ensure we can continue to finance our activities and investment programme by raising money in the markets it is essential that the financial markets have confidence in the business model.

To achieve this we will:

- Provide investors with an adequate return on the monies they invest.
- Seek to avoid rapid increases in spending and borrowing.

### Programme of investment



- Communicate regularly with investors in order to avoid surprises and keep them informed of our plans and priorities.
- Plan sensibly to avoid cost and credit shocks.
- Maintain a broad range of funding options – equity and a broad debt portfolio.
- Avoid bunching debt maturity dates to promote a stable and balanced financial environment.

## KSI 8 – Promoting an effective regulatory regime

It seems likely that water and waste will, to some extent, remain monopoly services for a number of years to come and will therefore continue to be subject to regulation, both economic and environmental.

Regulation of the water industry has clearly helped to deliver significant improvements since privatisation and has given confidence to investors to continue to invest in the industry. Nevertheless we believe the regulatory regime needs to develop to reflect the challenges of the 21st century and we will seek to positively influence the regime in the following ways:

- A move away from the five-year price-setting framework, to a system which encourages innovation, better planning and development of long-term, sustainable solutions.
- Setting river water quality standards at an appropriate level and ensuring these are delivered in the most cost-effective way.
- Increasing competition where this benefits customers.

### Setting river quality standards



- Establishing better approaches to measuring performance and target-setting, which encourages companies to meet customers' needs.
- Maintaining a long term return on capital that ensures water remains attractive to investors in order to secure sufficient financing for our significant planned investment programme.
- Improving communication and co-operation between regulators and between companies and regulators.

*“the regulatory regime needs to develop to reflect the challenges of the 21st century”*

## Next steps

This statement sets out our specific aims in the eight key strategic areas, the challenges we believe we face and the assumptions we have made about what the world might look like in 25 years time. We have consulted our stakeholders in order to develop these positions and published a draft statement in October 2007. In this revised statement we have taken into account the extensive comments which we have received.

The business plan we submit to Ofwat in 2008 for the next 5 years will build on and reflect the priorities in this statement. Although we have set out our proposed direction of travel for the next 25 years, we recognise that it cannot be set in stone. We will update this document as new challenges present themselves, or as our statutory obligations, the regulatory regime or customers' expectations change.



# About us

Severn Trent Water provides water to 7.4 million people, and sewerage services to 8.5 million people in an area covering 21,000 square kilometres in the Midlands and mid-Wales. We are one of the largest water companies in England and Wales, supplying around 1,900 million litres of water per day, and treating around 2,500 million litres of waste water per day.

We have a significant impact on our communities and regional economy, through the services we deliver, as a major employer and as a purchaser of goods and services. We also have a significant impact on the local environment through abstraction of water and discharge of waste water, and through our management of our public access recreational sites. We recognise our responsibility to take full account of our impact on the local community and environment in everything we do.

## Our physical assets include:

- 46,000 kilometres of water mains
- 181 ground water treatment works
- 54,000 kilometres of sewers
- 1,017 sewage treatment works

## Operational facts and figures 2006-07:

- 250,000 water quality tests
- drinking water quality compliance – 99.9%
- more than 4 million visits to our recreational sites
- nearly 25,000 children visited our education centres
- 2.4 million customer contacts
- average cost of water and sewerage service – 78p per day
- 40% of our water comes from river abstraction
- 30% comes from groundwater (such as boreholes)
- 30% comes from reservoirs

*“we have invested over £10 billion since 1990”*

The water industry has come a long way in the eighteen years since privatisation, but there is still more to do. At Severn Trent we alone have invested over £10 billion since 1990, and made major improvements to both water and sewerage services, which have included:

- Improved sewage treatment, which has contributed to 59% of rivers being assessed as being in a good state in 2006, compared with only 37% in 1990.
- Improved water pressure, which has reduced the number of properties as being at risk of receiving low pressure from over 23,000 fifteen years ago to just over 300.
- Meeting higher drinking water standards, and at the same time improving our performance against those higher standards. The number of drinking water tests failing to meet required standards has fallen (by 93% over the last fifteen years), with only about one in 5,000 tests failing.
- Reducing the number of serious pollution incidents from 238 in 1994 to only 10 last year.

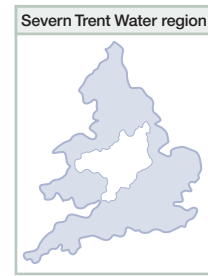
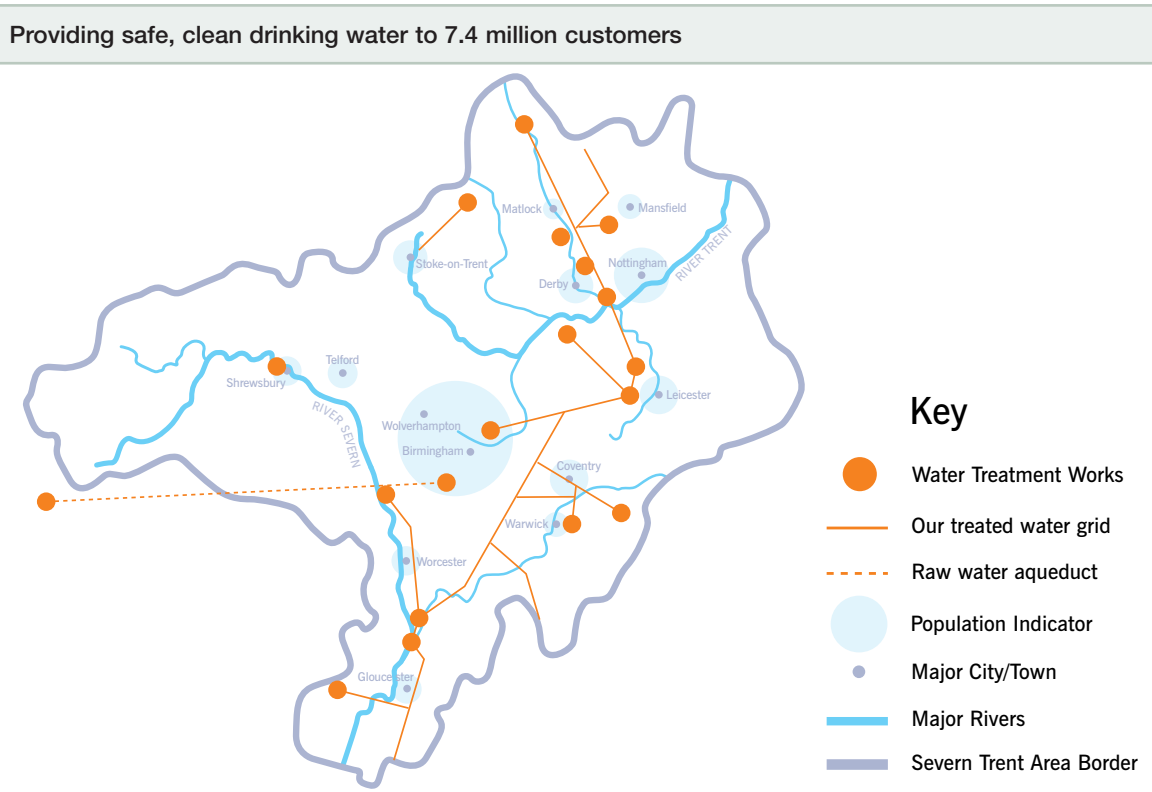
The need to finance improvements was a primary reason for the industry being privatised in 1989. Privatisation and the regulatory regime within which we operate has provided a stimulus for increased efficiency, which has limited the need for increases in bills to pay for improvements.

We are committed to continuing private ownership, with a balance between finance from shareholders and borrowings, as the best way to deliver future improvements effectively.

## Our Strategic Direction Statement

This Strategic Direction Statement sets out our aims, and how we intend to achieve them, over the next 25 years. We invest in assets which have a very long life – water mains and sewers may be in the ground for over 100 years. In order to make the right decisions we need to look ahead to what the needs of customers and other stakeholders will be over the





long term. The water industry is vital to people's health, to the environment, and to the economy, and it is essential that we have long-term plans in place to meet society's needs in the future.

We have listened to the views of our stakeholders. The draft document was sent to:

- the Environment Agency (EA).
- the Drinking Water Inspectorate (DWI).
- Department for Environment, Food and Rural Affairs (Defra).
- Ofwat.
- the Consumer Council for Water (CCWater).
- the Countryside Commission for Wales.
- Natural England.

Investors, local councils, MPs in our region and employees were also consulted. We have also taken into account the objectives for the water industry set out in the EA's Water Sector Plan.

Customer views were taken into account through market research which we have carried out with our domestic and business customers including a major willingness to pay survey carried out earlier this year. This involved interviews with 1,000 domestic customers and nearly 500 business customers, to establish customers' priorities and their willingness to pay for improvements in the different areas of service provision.

We have indicated in this statement the level of customer support for the improvements we are

proposing. For each of the proposed improvements we have shown whether customer willingness to pay was:

- Generally greater than the costs of improvements.
- Marginal relative to costs.
- Generally less than the costs of improvements.

We published this statement on our website to give everyone the opportunity to comment on our strategic intentions. We also put it on our internal website to give our employees the chance to contribute. The statement was broadly supported. We are grateful for all the contributions and have revised the statement to reflect comments received.

We continue to welcome feedback on this document and consider our Strategic Direction Statement to be a living document. Its content will need to be reviewed as new information becomes available. For example, Defra will publish their Strategic Intentions for the next 5 years in 2008 and our Statement will be reviewed in light of this.

We will continue to involve stakeholders as we develop our draft Business Plan for the 2009 price review, to be submitted to Ofwat in August 2008. We welcome any further comments on our strategy.

Comments can be sent to:

Jo Dempster-Fowle  
 Severn Trent Water  
 2297 Coventry Road  
 Birmingham B26 3PU  
 Email: Jo.Dempster-Fowle@severntrent.co.uk

*"it is essential we have long-term plans in place to meet society's future needs"*



# Our vision

Our vision is that we will be the water and waste services company which achieves the highest quality and customer service standards while offering our customers the lowest prices, with great people delivering the service.

We believe we can raise standards while reducing costs through the implementation of better processes and innovation. We are currently very close to having the lowest bills in the UK.

We believe our customers want us to make significant improvements in services. In order to achieve this we will have to increase our spending to ensure that assets are in the right condition and to maintain the advances in service performance already made. In addition, we intend to meet all the future requirements for improvements while keeping our bills as low as possible. Increases in bills in recent years have raised concerns about the ability of low-income customers to pay their water bills.

We will achieve objectives on services and bills by:

- Making sure we increase efficiency, to keep costs and bills no higher than they need to be. Getting things right first time will both improve service to customers and reduce costs. We have reorganised around key processes (Water, Waste Water, and Customer Service) to increase our effectiveness.
- Ensuring that we have the right recruitment processes and training so that we have employees who understand customer needs and can deliver the right services effectively.
- Basing the scope and pace of improvements on customer priorities – we will weigh up potential improvements in terms of whether their benefits to customers and the environment exceed the costs. This is an approach supported by both Ofwat and CCWater.
- Providing stable returns for investors, and limiting the extent of the future capital programme to that which can be financed without excessive increases in the cost of raising finance.

Planning on a long-term basis will assist in delivering improvements cost-effectively. We have a large capital expenditure programme (over £2 billion for the current five-year period) investing in very long-life assets. A long-term strategy will assist in developing

sustainable solutions and enable investment decisions to be based on the lowest whole-life cost.

All improvements will need to be sustainable in terms of their impact on the local environment and on climate change. We are an industry leader in terms of avoiding serious pollution incidents, meeting environmental standards for discharges to rivers, and minimising our “carbon footprint” by generating renewable electricity, and we intend to maintain that position.

## Key strategic intentions

Our strategy is based on eight key strategic intentions and our plans for improvements in each of these areas are set out in this statement:

1. Providing a continuous supply of quality water.
2. Dealing effectively with waste water.
3. Responding to customers’ needs.
4. Minimising our carbon footprint.
5. Having the lowest possible charges.
6. Having the right skills to deliver.
7. Maintaining investor confidence.
8. Promoting an effective regulatory regime.

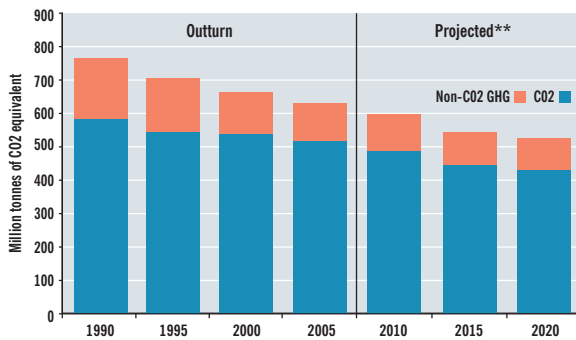
## The challenges we face

There will be a wide range of changes over the next 25 years which we will need to address:

- Customers will expect better standards of service. Some aspects of service fall short of what customers believe that they are already paying for and have every right to receive.
- There is a need to adapt to and help mitigate the effects of climate change. Climate change is bringing more variability in weather patterns. We will need to increase the resilience of our assets to cope with greater extremes, for example by providing additional sewer capacity.

*“we are investing £2 billion from 2006 to 2010”*

**Government projections of carbon reduction**

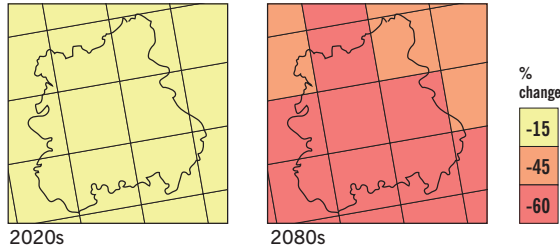


Source: 2006 Climate Change Programme Review, Defra News Release – 'Greenhouse gas statistics' – January 2007, DTI Updated Emission Projections, July 2006 (UEP26)<sup>23</sup>

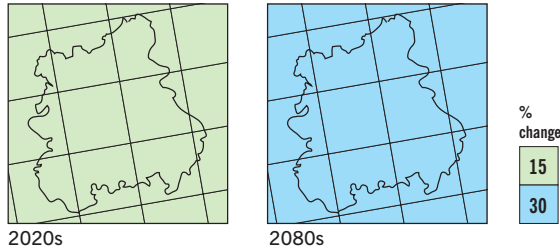
- The population is growing, with smaller households, and shifts in population. This will require us to plan changes in our networks and treatment works capacity for both water and sewerage. There is currently a drive from national government to dramatically increase the supply of new housing. Many towns and cities in the Midlands have been identified as growth points. To meet this additional demand we will need to ensure that treatment works capacity for both water and sewerage can be planned and timed to provide services for new residents.
- Legal requirements will result in further new investment increasing our costs, in particular the Water Framework Directive requirements to achieve good river quality and the adoption of private sewers.

**Example climate change scenarios for the West Midlands**

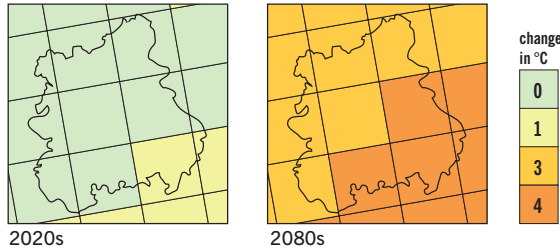
Percent change in Summer precipitation (High Emissions scenario)



Percent change in Winter precipitation (High Emissions scenario)



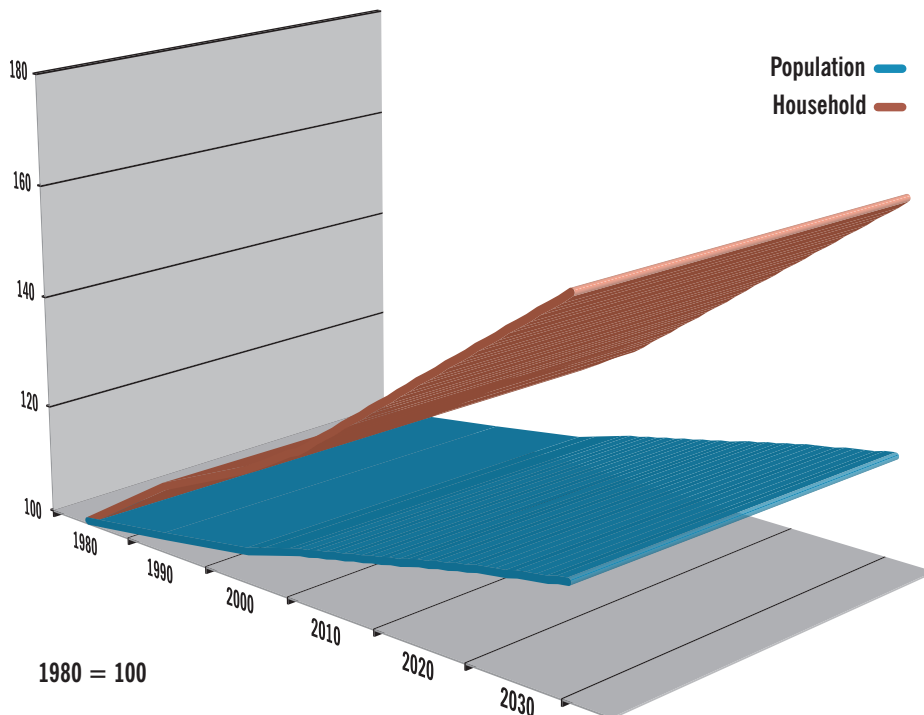
Change in Annual average daily temperatures (High Emissions scenario)



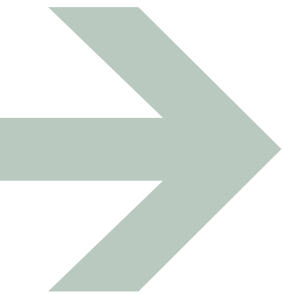
Source: UKCIP02 Climate Change Scenarios (funded by Defra, produced by Tyndall and Hadley Centres for UKCIP)

- We will need to ensure that we can continue to access finance for the requirements of our operations and investment programme.

**A growing population**



*“Many towns and cities in the Midlands have been identified as growth points.”*



### Responding to the challenges

We will respond to these challenges:

- We will make significant improvements in services, with the programme determined by the views of customers and other stakeholders. In particular, homes being flooded by sewers overflowing is not acceptable, and we will need to reduce the risk of customers' water supply being interrupted.
- We will adapt our operations and assets to respond to climate change, and we will set a target to reduce our carbon footprint.
- We will adopt a range of measures to balance supply and demand – including increased metering, leakage control and water efficiency to manage peak demand.
- We will support more sustainable solutions to surface water drainage – including Sustainable Urban Drainage Systems and surface and foul water separation.
- We will encourage addressing pollution at source to improve river quality and will support sewage treatment improvements when the benefits justify the costs.
- We support the adoption of private sewers, which will lift a significant burden from some of our customers.

#### Increased leakage control



*“it is essential we have long-term plans in place to meet society’s future needs”*

### Innovation

We will innovate to make our activities more efficient and sustainable, including:

- Water and Waste Water Treatment
  - Developing treatment processes which are more energy-efficient and use less chemicals.
  - New developments in catchment management to improve the quality of water and waste water entering treatment works, so reducing the cost of treatment.
- Climate Change Adaptation and Mitigation
  - Introducing new approaches to generating renewable electricity from sewage sludge.
  - Reducing our carbon footprint through increasing use of video-conferencing and ensuring that our new headquarters uses appropriate technology to be energy and water efficient.
  - Developing more sustainable drainage systems to cope with increased volumes of rainwater.
- Water and Sewerage Networks
  - Improving methods for finding and fixing leaks.
  - Improving methods of laying water mains to ensure that they are laid without leaks.
  - Introducing new methods of monitoring the water and sewerage networks to enable faults to be identified more quickly.
- Water Use
  - Encouraging introduction of new water-using appliances which use water more efficiently.
  - Development of more sophisticated meters to allow us to manage demand more effectively.
- Customer Service
  - Establishing new ways to communicate with our customers, to improve service and enable us to reduce costs and bills.
- Systems
  - Improve our information systems so that we can manage information more efficiently, enabling us to assess trends in asset and service performance more rapidly and respond more quickly.

### The need to provide water and sewerage services to new housing



### The future is uncertain

We will have to be prepared to adapt our plans over time and the further we look out the more uncertain the world looks. Some of the major influences on our business are highly uncertain and we will need to be flexible in the way that our business operates and in our response to challenges. Some of the most significant uncertainties for the next 25 years are:

- Climate change – the extent of the need to adapt to climate change remains uncertain.
- The costs of private sewer adoption are unknown.
- We may be required to implement a larger environmental programme than we believe will be justified by an assessment of costs and benefits.
- There may be changes in the standards for drinking water quality which would add to the costs of treatment.
- There may be significant changes in input costs, for example:
  - energy prices may increase due to rising world oil prices or taxation changes to include carbon impacts in the price.
  - construction costs may increase with high demand because of other major construction projects, e.g. the Thames Tideway and the Olympics.

- costs of chemicals used in water and sewage treatment may rise because of growing world demand.

- Costs resulting from the Traffic Management Act could be higher than expected, either in terms of charges from local authorities for occupation of roads in carrying out repairs, or costs of changing the way we operate.
- The contribution we will need to make to reducing carbon impact, and the extent to which there will be conflicting pressures to increase energy use, remains uncertain.
- The extent of the need to provide for new housing, and the location of new demand, could be significantly different from our expectations. This will be affected by the pressure on water infrastructure caused by the Government's drive to increase the supply of new houses.
- Interest rates have been low by historical standards for some years but instability in financial markets generally, or uncertainty about water industry returns, could cause this to change.

There are likely to be a number of other areas of uncertainty and we will need to be able to respond to an ever changing world.

*“We will have to be prepared to adapt our plans over time.”*



# Next Steps

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## Recycled

Supporting responsible use  
of forest resources

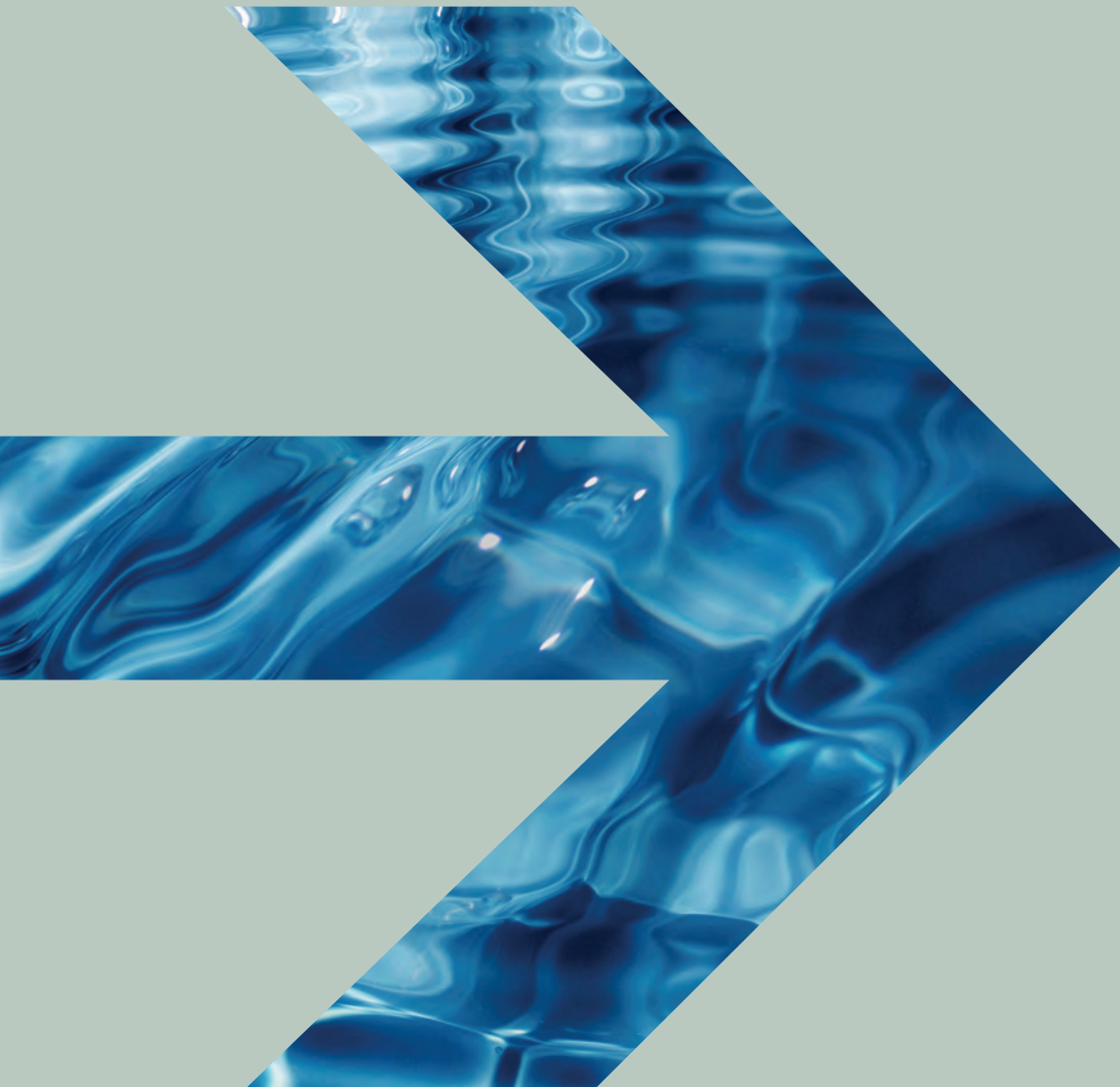
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