Affinity Water: Test area assessment

All company test area grades								
Engaging customers	Addressing affordability and vulnerability	Delivering outcomes for customers	Securing long-term resilience	Targeted controls markets and innovation	Securing cost efficiency	Aligning risk and return	Accounting for past delivery	Securing confidence and assurance
C	C	C	D	C	C	D	C	C

Affinity Water - test area results

Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
Engaging customers	C	Overall Affinity Water's business plan falls short of high quality with insufficient evidence in a number of areas. The plan demonstrates aspects of high quality in the following ways: • Customer engagement delivered via a multi-phase approach and used a wide range of methods. • Evidence of involving customers in strategic planning and service design and promoting behaviour change via education programmes. • Evidence of the company using the results of its research to narrow down the long list of investment priorities to be reflected in the business plan. The business plan falls short of high-quality in the following areas: • Customers' preferences on service levels are not fully reflected in the business plan due to a lack of primary willingness to pay research. • While there is evidence of the company having analysed customer contacts and social media data it has provided insufficient detail on the insights obtained from this analysis and how these have been incorporated into its business plan. • Insufficient evidence in the plan and supporting documents to demonstrate the company's efforts to fully adopt or start taking into account the four themes of customer participation, as expressed in the Tapped In report. • Limited engagement with future customers and those that have experienced resilience issues . • The company provides insufficient evidence to demonstrate customer support for the acceptability and affordability of its business plan due to testing being carried out using different bill impacts to those associated with the final version of the business plan.	EC1	C
Addressing affordability and vulnerability	C	Overall Affinity Water's business plan falls short of high quality with insufficient evidence of its approach to affordability and vulnerability. The plan demonstrates some aspects of high quality as the company proposes: • An ambitious approach on addressing vulnerability, in particular on adding customers to its Priority Services Register. It also has a high quality approach to using data to help customers in situations of vulnerability. • A high quality approach to helping customers who cannot afford to pay their bills. In particular, The company has a range of schemes available for different customer needs. The business plan falls short of high quality in two areas because: • The company proposes a real bill increase of 3% in the 2020 to 2025 period, the second largest percentage increase in the sector. In addition, the company's bill profile is higher than the bill profile it tested with its customers, which reduces confidence in the affordability of the bill. • The company proposes a bill increase of 3% in the 2025 to 2030 period and there is no evidence that the company had engaged with its customers about this bill increase.	AV1 AV2 AV3 AV4	D D B B

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<tr><td rowspan="3">Delivering outcomes for customers</td><td rowspan="3">C</td><td rowspan="3">Overall, across the outcomes test area the plan Affinity Water proposes falls short of high quality and the evidence it provides to support its performance indicators (PC) and outcome delivery incentives (ODI) is insufficient or unconvincing in some areas.

The plan demonstrates some aspects of high quality. The company has proposed stretching performance targets for water supply interruptions, which entail significant improvement on past performance and achievement of the industry upper quartile level. The company has forecast the largest percentage reduction in per capita consumption across the industry.

However, there are several key areas of concern where the business plan falls short of high quality, as described below:
The company is not proposing a well-rounded package of PCs. The number of bespoke PCs is small, and those that are proposed are lacking in ambition. It is not proposing a bespoke resilience performance commitment despite the water resource challenges that the company faces.
The company proposes an insufficiently stretching leakage reduction target, and it proposes asset health measured by the level of mains repairs to deteriorate due to action to reduce leakage, which we do not consider to be sufficiently evidenced or justified.
The company has selected evidence to support its chosen ODI rates from secondary evidence without adequate explanation of how this evidence was selected impartially and without bias, and there are material concerns about the triangulation approach used to inform these rates. Additionally, the company provides insufficient evidence to support outperformance payments. There is insufficient evidence of customer engagement on the use of outperformance payments, and there is insufficient evidence that outperformance will deliver genuine benefits to customers for a number of PCs.</td><td>OC1</td><td>C</td></tr>
<tr><td>OC2</td><td>D</td></tr>
<tr><td>OC3</td><td>C</td></tr>
<tr><td rowspan="2">Securing long-term resilience</td><td rowspan="2">D</td><td rowspan="2">Overall, Affinity Water’s plan falls significantly short of high quality and, in some areas, there is little or no evidence that convincingly demonstrates a commitment to resilience in the round. In particular, we have significant concerns with the quality of evidence presented linking the options proposed to the identified risks to resilience. We also consider that there is little or no convincing evidence linking the identified resilience challenges faced by the company with the outcomes package proposed.
The plan provides sufficient evidence of a baseline resilience maturity assessment and there is also sufficient evidence that risks have been assessed before and after mitigation with future projections up to 2035. The company also provides some third party evidence on asset management and asset health.
The plan provides sufficient evidence for some aspects of financial resilience assessment and risk management. However, we consider that the plan does not provide sufficient and convincing evidence of a commitment to resilience in the round in the following areas:While the company presents the results of the prescribed financial stress scenarios in terms of key financial ratios, it does not present the results of its company specific scenarios. The company is highly geared and although its sets out an intention to reduce gearing to around 70%, there is no evidence to demonstrate how or when this will be achieved. The company has not considered possible impacts of the mechanism for sharing financing outperformance for companies with actual gearing levels of 70% and above.
There is insufficient evidence of an integrated and systems-based approach to resilience, where interdependencies or cascading impacts of one system to another should be considered.
There are significant concerns regarding the company’s customer engagement on resilience. The evidence in the plan lacks the depth and scope necessary for the proposed level of investment and identified options. The company provides limited evidence that customers have been consulted appropriately about options to improve resilience.
The plan relies on infrastructure reliability options and demand management, with less emphasis on response and recovery measures. The plan also lacks efficient options that account for multiple risks or future uncertainty. In this sense, the approach used by the company to develop options is limited in its treatment of uncertainty, given the challenges faced now and in the future.
There are significant concerns with the outcomes package proposed as no direct bespoke resilience metrics have been included.
We also consider that the plan lacks a robust water resources management plan that supports the company’s long term resilience strategy, especially when the company has identified that a number of customers are exposed to the risk of severe water restrictions.</td><td>LR1</td><td>C</td></tr>
<tr><td>LR2</td><td>D</td></tr>
<tr><td rowspan="2">Targeted controls, markets and Innovation</td><td rowspan="2">C</td><td rowspan="2">Overall, despite some areas of high quality, Affinity Water's plan falls short of high quality across the Targeted Controls, Markets and Innovation test area and evidence is insufficient and/or unconvincing in some areas.

The company provides sufficient evidence it had addressed Ofwat feedback on the RCV allocations, provides a comprehensive Bid Assessment Framework (that would nonetheless benefit from greater detail on how appeals or communication with bidders will work) and outlines some innovative approaches to abstraction optimisation.</td><td>CMI1</td><td>D</td></tr>
<tr><td>CMI2</td><td>D</td></tr>
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<tr><td rowspan="5"></td><td rowspan="5"></td><td rowspan="5">The company does not provide sufficient information to demonstrate a high quality plan in relation to its approach to enabling innovation more generally, management of 'gaps', engagement with 3rd parties for water resources, its strategy for bilateral markets and consideration of DPC in the creation of its business plan. The company signalled its intention to launch an innovation strategy in 2020 that would include rolling out an innovation portal. However, the company does not provide details of what it was already doing in this space, beyond convening 'Big Conversations' on key issues. There is limited evidence that the company was already - or planned to - focus innovation on key goals, has leadership commitment to innovation, enables company-wide involvement, provides resources, and considers broader supply chain collaboration on innovation. Whilst the company explains its approach to managing residential voids, evidence on residential and business gaps and business voids and retail market learnings is insufficient. Despite forecasting a water deficit in the short term and having a high residual risk, the evidence in the business plan pointed to limited engagement with third party providers for supply and demand solutions. The business plan does not include a strategy for bilateral markets, and the company's data table on Water Resources (WR6) is incorrect. The company does not evidence it has considered DPC in its own business plan. It does not describe its approach to considering the relevance of DPC in sufficient detail and provided no evidence it had looked at the threshold assessment for its own investment plans. The company's evidence referred to the Abingdon scheme - however this is excluded from the assessment as this scheme is led by Thames Water.</td><td>CM3</td><td>D</td></tr>
<tr><td>CMI4</td><td>N/A</td></tr>
<tr><td>CMI5</td><td>B</td></tr>
<tr><td>CMI6</td><td>B</td></tr>
<tr><td>CMI7</td><td>D</td></tr>
<tr><td rowspan="4">Securing cost efficiency</td><td rowspan="4">C</td><td rowspan="4">Overall, we do not consider Affinity Water’s costs to be efficient. At the company level its costs are around 12% above our view of efficient costs, with its retail costs being considerably less efficient than its water costs.

In wholesale water, the company’s costs are around 11% above our view of efficient costs. Its base costs are around 8% above our view of efficient costs with the largest difference between the company view and our view of its enhancement plans. We are not allowing for all water supply demand reduction enhancement proposals due to a lack of evidence provided to justify the long term benefits proposed. We do not make an additional allowance for leakage reduction because the company does not propose to reduce leakage by more than 15% or to upper quartile industry performance. The company’s retail costs are around 22% above our view of efficient costs.

The company proposes four cost adjustment claims. Three of these are not of high quality and only one of them is of sufficient quality. This gives the company a score of D for its cost claims.</td><td>CE1</td><td>C</td></tr>
<tr><td>CE2</td><td>N/A</td></tr>
<tr><td>CE3</td><td>D</td></tr>
<tr><td>CE4</td><td>D</td></tr>
<tr><td rowspan="4">Aligning risk and return</td><td rowspan="4">D</td><td rowspan="4">Overall, the company’s plan falls short or significantly short of high quality in all areas of our assessment, with little to no convincing evidence supporting some of the most material aspects of aligning risk and return.

There are five areas of major concern where the plan falls significantly short of high quality. The plan provides insufficient evidence:
• that the financial metrics used to support the Board’s assessment of financeability are valid. They were substantially different from metrics forecast in the PR19 Financial Model and there is insufficient evidence that the company has reconciled the differences.
• that the company's choice of PAYG and RCV run-off rates are appropriate, with insufficient evidence they are supported by the operational and capital costs faced by the company.
• that the final bill profile is supported by customer preferences. The plan’s final bill profile is different to that which was used in customer acceptability testing, and the CCG stated it did not have sufficient time to review and challenge the revised profile before it was submitted.
• in respect of risk and risk mitigation measures in the RoRE assessment for the notional company. We have concerns about the assumptions of exposure to revenue risk and with the company's presentation of likely totex outcomes which is weighted towards underperformance on a notional basis.
• there is insufficient evidence that the proposed uncertainty mechanism for the sustainability reduction item is required. However, further evidence is required to allow us to determine whether the mechanism for uncertainty related to metaldehyde treatment costs is necessary and will remain uncertain at the time of the draft and final determination.

The plan also provides unconvincing evidence for its alternative long-term RPI assumption, which is lower than our ‘early view’ and results in a higher RPI-stripped cost of capital in the business plan.</td><td>RR1</td><td>C</td></tr>
<tr><td>RR2</td><td>D</td></tr>
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<tr><td rowspan="2">Accounting for past delivery</td><td rowspan="2">C</td><td rowspan="2">Overall, Affinity Water's business plan falls short of high quality in accounting for past delivery.

In the round we have some concerns with the evidence for deliverability for the 2020-25 plan, in particular in relation to outcomes and customer complaints handling.

The plan provides sufficient evidence of deliverability in the following areas.
• The company forecasts that it will overspend its PR14 allowance and does not provide sufficient evidence that it understands the drivers of its performance. However, as we calculate that the plan includes a relatively low efficiency challenge we do not have concerns with the evidence for deliverability of the planned costs.
• We do not have concerns with the evidence for deliverability of performance in relation to major incidents.

The plan falls short of high quality for deliverability in the following areas.
• The company provides insufficient evidence that it understands the drivers of its current outcomes performance and that it includes of appropriate measures to deliver its planned performance. For example, only for supply interruptions does the company present a clear plan for delivering improved performance.
• The company is not yet meeting CCWater's 2020 household customer complaints target of resolving 95% of customer complaints at stage one and, while it has reduced the number of complaints, the plan does not contain sufficient and convincing evidence that this performance will be addressed and so we have some concerns with the evidence for deliverability of customer complaints performance.

There is sufficient and convincing evidence for six out of eight PR14 reconciliation areas and insufficient evidence for land sales and totex. There is only a marginal difference (within 0.05% of 2019-20 revenue) between expected and proposed reconciliations. In the round, the sufficient and convincing evidence for the PR14 reconciliations is not sufficient to raise the accounting for past delivery test area score.</td><td>PD1</td><td>B</td></tr>
<tr><td>PD2</td><td>C</td></tr>
<tr><td rowspan="3">Securing confidence and assurance</td><td rowspan="3">C</td><td rowspan="3">Overall, Affinity Water's business plan falls short of providing sufficient evidence to demonstrate high quality in the securing confidence and assurance test area.

The company's business plan provides some evidence of high quality.

On demonstrating a fair balance between customers and investors:
• The company's proposals on gearing benefits sharing, meet the expectations of the 'Putting the sector in balance' position statement.
• On executive pay, the company demonstrates sufficient evidence of its intention to meet the expectations set out in the 'Putting the sector in balance' position statement, but we require a clear explanation of how targets will be stretching and evidence of how changes will be signalled to customers.
• On dividend policy, there is sufficient evidence of the company's intention to meet the expectations set out in the 'Putting the sector in balance' position statement, but we require the company to confirm/explain the statement in its plan that annual dividends are not to exceed 5%, as our calculations have resulted in yield figures above 5% in some years (noting that on average yield is below 5%).
• The company does not put forward proposals for a bespoke voluntary benefits sharing mechanism but proposes donations to social tariffs and its hardship fund which we assess could have a value of £0.5m per year. In the round, we consider that the company's proposals are high quality in terms of voluntary sharing, when considering its size.
• Although the Board provides a compliant statement of assurance that its plan will enable customers' trust and confidence through engagement on its corporate and financial structure, it provides insufficient evidence of its assurance process.
• The company's business plan provides insufficient evidence of transparency on its corporate and financial structures and how these relate to its financial resilience.</td><td>CA1</td><td>C</td></tr>
<tr><td>CA2</td><td>C</td></tr>
<tr><td>CA3</td><td>B</td></tr>
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Test area	Overall test area grade	Overall test area summary assessment and rationale	TQ#	Test question grade
		The company's Board provides a compliant statement of assurance with sufficient supporting evidence to demonstrate that the business plan will deliver – and that the Board will monitor delivery of – its outcomes. The company's business plan falls short of high quality in the following areas: The company's Board provides the majority of statements requested to demonstrate that all the elements of its business plan add up to a plan that is high quality and deliverable and that it has challenged management to ensure this is the case. However a small minority were non-compliant. This reduces our overall confidence in the assurance of the plan and the Board's ownership. The company's Board provides a compliant statement of assurance to demonstrate that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term. However, the company provides insufficient evidence to support this statement. In our assessment of the company in the 2018 Company Monitoring Framework (not including the elements related to the PR19 business plans) while the company meets expectations in 7 areas, it has minor concerns in 3 areas. The plan falls significantly short of providing sufficient and convincing evidence that overall, its PR19 business plan tables are consistent, accurate and assured. We identify material issues within our assessments of the data tables in the policy areas of cost assessment, risk and return, financial modelling and cross cutting themes (water resources).	CA4	B
			CA5	C
			CA6	D