

January 2019

Trust in water

PR19 initial assessment of plans: Glossary

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Company acronyms

| | |
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| AFW | Affinity Water Limited |
| ANH | Anglian Water Services Limited |
| BRL | Bristol Water plc |
| HDD | Hafren Dyfrdwy Limited (NAV comprising former parts of Dee Valley Water and Severn Trent Water in Wales) |
| NES | Northumbrian Water Limited |
| PRT | Portsmouth Water Limited |
| SES | Sutton & East Surrey Water plc (trading as SES Water) |
| SEW | South East Water Limited |
| SRN | Southern Water Services Limited |
| SVE | Severn Trent Water Limited (England) |
| SWB | South West Water Limited |
| SSC | South Staffordshire Water plc (South Staffs Water) |
| TMS | Thames Water Utilities Limited |
| UUW | United Utilities Water Limited |
| WSH | Dŵr Cymru Cyfyngedig |
| WSX | Wessex Water Services Limited |
| YKY | Yorkshire Water Services Limited |

Test areas

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|------------|--|
| EC | Engaging customers |
| AV | Addressing affordability and vulnerability |
| OC | Delivering outcomes for customers |
| LR | Securing long-term resilience |
| CMI | Targeted controls, markets and innovation |
| CE | Securing cost efficiency |
| RR | Aligning risk and return |
| PD | Accounting for past delivery |
| CA | Securing confidence and assurance |

Acronyms and terms

| Term | Acronym | Definition |
|---|----------------|--|
| Adjusted cash interest cover ratio | AICR | The adjusted cash interest cover ratio (AICR) is similar to interest cover, but measures the scope to make interest payments after meeting costs that have been expensed and RCV run-off. AICR is a more conservative measure than the unadjusted interest cover and provides an indication of coverage assuming companies could not reduce RCV run-off. This is a key financial ratio for the assessment of financeability. |
| Bioresources | | Bioresources refers to wastewater sludge transport, treatment, recycling and disposal. |
| Basis point | bp | A basis point is one hundredth of a percentage point. It is commonly used as a unit to describe differences in the yield of financial instruments. |
| Caps and collars | | Caps and collars are the limits on outperformance and underperformance payments for an ODI, respectively. |
| Common performance commitment | | Common performance commitments are performance commitments that all companies must have, to allow us to make direct comparisons across the sector (see performance commitment). |
| The Consumer Council for Water | CCWater | The Consumer Council for Water is the independent representative of household and business water consumers in England and Wales. |
| Cost of capital | | The allowed cost of capital is an important component of overall allowed revenue and the customer bill. It is necessary to provide debt and equity investors with a return that is commensurate with the level of risk that underpins their investment. We set the cost of |

| Term | Acronym | Definition |
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| | | capital with respect to the notional capital structure. |
| | | Our 'early view' of the cost of capital is 3.4% on a real CPIH basis or 2.4% in RPI terms. |
| Customer challenge group | CCG | CCGs are groups of stakeholders that challenge companies on the quality of their customer engagement, and how well the company's proposed outcomes, associated commitments and outcome delivery incentives reflect their customer engagement and wider consumers' views and priorities. |
| Deadband | | Deadbands are a specified range of performance levels where the ODI underperformance or outperformance payment is zero. |
| Direct procurement for customers | DPC | Direct procurement for customers is an alternative approach, through competitive tendering, for water companies to deliver large scale, discrete programmes of work by means of a third party, which potentially may include the design, construction, financing, ownership, operation and maintenance of an asset. |
| Financeability | | Financeability is the ability of appointed water companies to finance their functions through debt, equity or retained earnings. |
| Funds from Operations | FFO | Funds from operations measures companies' debt burden in relation to operational income. This is a key financial ratio for the assessment of financeability. It is also a key ratio for rating agencies, although each rating agency may make specific adjustments to FFO and/or net debt for its calculations. |
| Gearing | | Gearing measures the capital structure of companies and is therefore critical to the assessment of financeability. This is also a key |

| Term | Acronym | Definition |
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| | | financial ratio for rating agencies, although each rating agency may have its own definition of net debt. |
| iBoXX indices | | Bond indices compiled by IHS Markit and commonly used as a regulatory benchmark for the cost of debt. Where not spelt out fully, the reference is to the iBoXX GBP-denominated non-financials index of bonds with maturity 10 years or more, rated A (A+ to A-) or BBB (BBB+ to BBB-). |
| Interest cover | | Interest cover measures the ability to meet interest payments from operational sources of cash generation. |
| Long-term financial viability statement | LTVS | A long-term viability statement (LTVS) sets out a company's Board of directors assessment of whether it has a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of its assessment, taking into account the company's current position and principal risks. The statement should explain the assessment undertaken including an appropriate set of stress tests and over an appropriate forward-looking period. The aim is to provide stakeholders with greater transparency about the steps companies take to ensure long term financial resilience. We require all water and wastewater companies to produce LTVS. |
| Natural capital | | Natural capital can be defined as the world's stocks of natural assets which include geology, soil, air, water and all living things. It is from this natural capital that humans derive a wide range of services which make human life possible. |
| Nominal bills | | Nominal bills are bills unadjusted for inflation. |
| Notional capital structure | | In defining an efficient company, we set a notional capital structure that is consistent for all companies with a proportion of debt to total regulatory capital at 60 per cent for PR19. The |

| Term | Acronym | Definition |
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| | | notional capital structure also incorporates our view of the mix and cost of new and embedded debt raised by an efficient company. The notional company is used to set the allowed cost of capital, and for the financeability and RoRE assessments. |
| Notional regulatory equity | | Regulatory capital value x (1 - notional gearing) |
| Outcome delivery incentive | ODI | Outcome delivery incentives are the financial or reputational incentives for companies to outperform and avoid underperformance against each of the commitments. |
| Pay as you go | PAYG | PAYG is the proportion of total allowed expenditure that is recovered in each year of the price review period. |
| | | Along with RCV run-off, balances the recovery of costs between different generations of customers. |
| | | A company's choice of PAYG and RCV run off rates affects bills for current and future customers. |
| Performance commitment | PC | Performance commitments are the level of performance that companies commit to deliver for customers. They are the means to hold companies to account for their service delivery. |
| Priority services register | PSR | The priority services register is a register of people that require extra help from their water company. Examples of the help are: bills in braille, more warning of supply interruptions and setting a password that a water company employee will use if they visit the customer's home. |
| Real bills | | Real bills are bills adjusted for inflation. |

| Term | Acronym | Definition |
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| Regulatory capital value | RCV | <p>Regulatory capital value (RCV) is a vital component of how price limits are calculated, and represents a measure of the capital base of a company when setting price limits. It reflects the allowed expenditure to be recovered from future customers.</p> <p>Expenditure not recovered in the current period through PAYG is added to RCV and recovered in future periods through RCV run-off. The RCV is inflated each year to maintain the RCV at current prices.</p> |
| RCV run-off | | <p>RCV run-off is a measure of the annual depreciation of the RCV to reflect the long-term nature of the benefit to customers of the previous investment a company has made in its assets.</p> <p>Along with PAYG, the RCV run-off balances the recovery of costs between different generations of customers.</p> <p>A company's choice of PAYG and RCV run-off rates affects bills for current and future customers.</p> |
| Retail margins | | <p>The retail margin is a component of the overall cost of capital allocated to the retail price controls.</p> <p>As there is no RCV associated with the retail price controls, the retail margin gives a return to investors based on the total costs of each retail price control.</p> <p>For our early view, we use a pre-tax retail margin of 1% for residential retail activities and business retail activities in Wales for customers using up to 50 megalitres of water a year and wastewater customers.</p> |

| Term | Acronym | Definition |
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| | | An adjustment is made to the cost of capital for the wholesale controls to take account of the retail margins. |
| Regulatory equity | | Regulatory equity is regulatory capital value less net debt. |
| The return on regulatory equity | RoRE | Return to shareholders as a proportion of the equity component of RCV calculated by reference to the notional capital structure. |
| Total expenditure | Totex | Total expenditure is capital expenditure and operating expenditure. |
| Upper-quartile | | Upper-quartile is a level that 25% of companies have already achieved, or are forecast to achieve. |

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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