

July 2019

Trust in water

# PR19 draft determinations

**Affinity Water – Securing long-term resilience  
actions and interventions**

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## PR19 Draft Determinations: Affinity Water – Securing long-term resilience actions and interventions

Following our initial assessment of plans, we categorised two types of actions for slow-track and significant scrutiny companies:

- required actions for companies which in general were required for draft determinations (or final determinations for some aspects of past delivery); and
- advised actions for companies to do by a specific date but that are not required for our draft determinations.

Table 1 below sets out the required and advised actions, a summary of the company's response to the action, our assessment of the company's response, and any further interventions we are making as part of the draft determination.

Each action has a unique reference. The prefix 'AFW' denotes the company Affinity Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key to these acronyms. Actions whose numbers are preceded with an 'A' denote required actions and actions whose numbers are preceded with a 'B' denote advised actions.

Table 2 below sets out any further interventions that are not resulting from an action which we are making as part of the draft determination.

Each further intervention that is not resulting from an action has a unique reference. The prefix 'AFW' denotes the company Affinity Water. The central acronym references the test area where the action has been identified, please see the 'PR19 draft determinations: Glossary' for a key to these acronyms. Intervention numbers are preceded with a 'C'.

For all other documents related to the Affinity Water draft determination, please see the [draft determinations webpage](#).

**Table 1 – Affinity Water's response to required actions and interventions for draft determinations**

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
Securing long-term resilience	AFW.LR.A1	Required	The company should ensure that its common and bespoke performance commitments associated with operational resilience are clearly defined, sufficiently demanding for the 2020 to 2025 period and the long term, and supported by the right incentives. We expect the company to satisfy the relevant actions set out in relation in the outcomes areas ensuring a line of sight between risks to resilience and package of outcomes.	1 April 2019	Affinity Water has not implemented all relevant outcome actions associated with operational resilience, in particular those related to asset health and bespoke resilience performance commitments.	Intervention required.  The company should address any outstanding actions associated with operational resilience from the 'Affinity Water - Delivering outcomes for customers actions and interventions' tables, in particular those related to mains repairs and to its bespoke resilience performance commitments ('Unplanned interruptions to supply over 12 hours' and 'Cyber security and resilience').	Refer to interventions described in the 'Affinity Water - Delivering outcomes for customers actions and interventions' tables regarding mains repairs and its bespoke resilience performance commitments ('Unplanned interruptions to supply over 12 hours' and 'Cyber security and resilience').

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	AFW.LR.A2	Required	The company should provide a commitment that it will, by 22 August 2019, prepare and provide to us an action plan to develop and implement a systems based approach to resilience in the round and ensure that the company can demonstrate in the future an integrated resilience framework that underpins the company's operations and future plans showing a line of sight between risks to resilience, planned mitigations, package of outcomes and corporate governance framework.	1 April 2019	Affinity Water has confirmed its commitment to complete the action by 22 August 2019.	No intervention required.  The company has complied with the required action.	N/A
	AFW.LR.A3	Required	The company should also provide a commitment to work with the sector to develop robust forward looking asset health metrics and provide greater transparency of how its asset health indicators influence its operational decision making.	1 April 2019	Affinity Water has confirmed this commitment.	No intervention required.  The company has complied with the required action.	N/A
	AFW.LR.A4	Required	The company's assessment of financial stress scenarios extends only to 2025. The company should commit to demonstrating that its assessment of financial resilience extends beyond 2025 in its next Long Term Viability Statement.	1 April 2019	Affinity Water has committed to demonstrate financial resilience beyond 2025 in its next long term viability statement.	No intervention required.  The company has complied with the required action.	N/A
	AFW.LR.A5	Required	<p>Please explain:</p> <ul style="list-style-type: none"> <li>• how the company will achieve the planned reduction of gearing to 70% referred to in the plan;</li> <li>• how the company will maintain Baa1/BBB+ credit ratings if its planned gearing reduction does not proceed as planned; and</li> <li>• the company's assessment of the impact of the gearing outperformance mechanism for PR19 on its financial metrics in case the planned gearing reduction is not achieved.</li> </ul>	1 April 2019	<p>In its revised business plan Affinity Water says that it expects its gearing to be brought to 75% (from 78.6% at 31 March 2018) or below before or during 2020-25 with additional equity in the appointee being facilitated by group restructuring, and an ambition to reduce gearing to 70%.</p> <p>The company says it will meet the ratios expected to be required to maintain its current credit rating. It says that it has also assessed the other elements of the current credit rating assessment and is confident that these will be fulfilled. As well as being able to maintain its Baa1/BBB+ corporate credit ratings, Affinity Water considers that it will be able to maintain an A3/A- rating for its Class A debt.</p> <p>Notwithstanding its plan to reduce gearing, Affinity Water says its financial modelling for 2020 to 2025 assumes that gearing of 80% with commensurate application of the gearing outperformance mechanism. Affinity Water says it</p>	<p>Intervention required.</p> <p>Affinity Water is responsible for maintaining its long term financial resilience. The company has set out a plan to reduce its gearing level to 70%. However, further assurance is required about how the gearing reduction will be achieved, in the context of the draft determination which includes, for example, an updated view of the cost of capital, our assessment of efficient costs and our assessment of outcome delivery incentives.</p>	<p>In its response to our draft determination Affinity Water should provide further assurance about how it will maintain its long term financial resilience and, in particular, how its planned gearing reduction will be achieved taking account also of action AFW.LR.C1.</p> <p>In its future reporting Affinity Water should undertake suitably robust stress tests to support its long term viability statements.</p>

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
					has accounted for expected gearing outperformance payments in its business plan.		
	Advised actions	Advised	No advised actions.	N/A	N/A	N/A	N/A

**Table 2 – Further interventions for draft determinations**

Intervention reference	Our assessment and rationale	Interventions
AFW.LR.C1	The Board assurance on actual and notional financeability and financial resilience in the revised business plan was provided on the basis of the assumptions made in the business plan, prior to any interventions we have made in the draft determination and our updated view of the cost of capital. There is evidence of further downward pressure on the cost of capital in very recent market data which will be considered for our final determination.	We expect companies to provide further Board assurance, in their responses to the draft determination, that they will remain financeable on a notional and actual basis, and that they can maintain the financial resilience of their actual structure, taking account of the reasonably foreseeable range of plausible outcomes of their final determination, including evidence of further downward pressure on the cost of capital in very recent market data as we discuss in the ‘Cost of capital technical appendix’ and the specific issues we have set out related to the financial resilience of the actual financial structure.

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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