

July 2019

Trust in water

PR19 draft determinations

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

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PR19 Draft Determinations: Portsmouth 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 'PRT' denotes the company Portsmouth 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 'PRT' denotes the company Portsmouth 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 Portsmouth Water draft determination, please see the [draft determinations webpage](#).

Table 1 – Portsmouth 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	PRT.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	Portsmouth Water has not implemented all relevant outcome actions associated with operational resilience, in particular those related to asset health performance commitments.	Intervention required. The company should address any outstanding actions associated with operational resilience from the 'Portsmouth Water - Delivering outcomes for customers actions and interventions' tables, in particular those related to mains repairs and unplanned outage.	Refer to interventions described in the 'Portsmouth Water - Delivering outcomes for customers actions and interventions' tables regarding mains repairs and unplanned outage.

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	PRT.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	Portsmouth 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
	PRT.LR.A3	Required	The company should 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	Portsmouth Water has confirmed this commitment.	No intervention required. The company has complied with the required action.	N/A
	PRT.LR.A4	Required	Please explain the steps the company is taking to ensure it will be able to maintain long term financial resilience in the event that its requested adjustment to the cost of capital is not allowed at a future (subsequent to PR19) price control and set out the risk management/mitigation approaches that have been identified.	1 April 2019	Portsmouth Water says it has performed sensitivity analysis using two scenarios to assess the impact of loss of the company specific premium. It concludes that, although it could have a more detrimental effect on financeability from 2025, in the round the company is likely to be able to use mitigating actions to retain financial resilience over the longer term.	No intervention but further action required. The company has provided the required explanation.	We expect the company to continue to consider and plan for appropriate scenarios in its ongoing assessment of financial resilience in its long term viability assessment in its annual performance reports.
	PRT.LR.A5	Required	Please explain how the company has taken account of the risks associated with its targeted credit rating, and outline associated risk management/mitigation approaches identified by the company to provide assurance on long term financial resilience.	1 April 2019	Portsmouth Water says that its Board has concluded that it understands the risks associated with its targeted credit rating and that these can be effectively managed/mitigated. It says its Board has considered: <ul style="list-style-type: none"> the company's ability to respond to financial shocks; the company's ability to raise debt at the targeted credit rating; risks relating to the Havant Thicket winter storage reservoir investment programme; the license condition requiring the company to retain an investment grade rating; 	Intervention required. Portsmouth Water considers its targeted credit rating of Baa2/BBB is consistent with ongoing financial resilience. We note that this is one notch lower than the current credit rating. It is also one notch lower than the credit rating for the notional structure that the company has targeted and based its Board assurance statement for the notional company structure upon.	In its response to our draft determination Portsmouth Water should provide further detail and Board assurance about its plans to maintain its long term financial resilience in the context of targeting a Baa2 credit rating (that is only one notch above the lowest investment grade rating and lower than the target credit rating the

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
					<ul style="list-style-type: none"> further tightening of rating agencies' metrics; downward pressure on the company's allowed cost of capital; and available mitigations and regulatory remedies. <p>The company sets out that it has performed further sensitivity analysis on a range of financial down-side scenarios, to assess its ability to respond to financial shocks whilst remaining financeable.</p>		<p>company states it targets on a notional basis), and our draft determination as referenced in PRT.LR.C1.</p> <p>In its future reporting Portsmouth Water should undertake suitably robust stress tests to support its long term viability statements.</p>
	PRT.LR.A6	Required	<p>With respect to development of the Havant Thicket Winter Storage Reservoir:</p> <p>Demonstrate how the company has considered the risks to its long term financial resilience if the project is significantly delayed or does not proceed.</p> <p>Explain how the company will ensure the development and financing of the project will not result in any detrimental impact to the service provided to Portsmouth Water customers.</p>		<p>Portsmouth Water has set out the protective commercial arrangements that it expects will be included in a bulk supply arrangement with Southern Water.</p> <p>The company states that even if the project were cancelled, its cashflow position would be adequate and its gearing would remain within acceptable ranges in the context of support from its owners.</p> <p>Portsmouth Water provides assurance that there would be no detrimental impact on operational service to its customers as a result of the Havant Thicket reservoir development.</p>	<p>No intervention required.</p> <p>The company has provided the required information.</p>	N/A.
	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
PRT.LR.C1	<p>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.</p>	<p>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'.</p>

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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