

July 2019

Trust in water

PR19 draft determinations

**South East Water – Securing long-term
resilience actions and interventions**

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PR19 Draft Determinations: South East 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 'SEW' denotes the company South East 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 'SEW' denotes the company South East 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 South East Water draft determination, please see the [draft determinations webpage](#)

Table 1 – South East 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	SEW.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	South East 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 'South East 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 'South East 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
	SEW.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	South East 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
	SEW.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	South East Water has confirmed this commitment.	No intervention required. The company has complied with the required action.	N/A
	SEW.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	South East Water has committed to demonstrating that its assessment of financial resilience extends beyond 2025 in its next Long Term Viability Statement.	No intervention required. The company has complied with the required action.	N/A
	SEW.LR.A5	Required	Please explain how the company has taken account of the risks associated with: <ul style="list-style-type: none"> its plan to reduce gearing to around 75%, including the certainty that the proposed £55 million equity investment will be made; any application of the gearing outperformance mechanism for PR19; and outline associated risk management/mitigation approaches identified by the company to provide assurance on long term financial resilience. 	1 April 2019	<p>South East Water says that its shareholders have committed to introducing funds to achieve its proposed reduction in gearing to 75%. The company sets out that this will provide significant headroom to its covenant limits.</p> <p>The company says that its financial risk mitigation approach includes a flexible dividend policy and the maintenance of reserve bank facilities. It also notes that its business has a relatively straightforward financial structure.</p> <p>South East Water did not directly address risks associated with applicability of the gearing outperformance mechanism for PR19 in its response to our initial assessment of plans.</p>	Intervention required. South East 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 South East Water should provide further Board assurance about how its relatively high ongoing gearing level, and targeting of a Baa2/BBB credit (that is only one notch above the lowest investment grade rating and lower than the target credit rating the company says it targets on a notional basis) is consistent with long term financial resilience. In doing so it should take account of the issues referenced in action SEW.LR.C1. In its future reporting South East Water should undertake suitably robust stress tests to support its

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
							long term viability statements
	SEW.LR.A6	Required	Please outline the risks and risk management/mitigation approaches the company has identified in the context of the requirement to refinance a significant amount of debt prior to 2020, referred to in Appendix 14 of the company's business plan.	1 April 2019	<p>South East Water says that it has secured the financing needed to refinance debt maturing in September 2019 amounting to £311.5m through several loan agreements.</p> <p>South East Water says that it is not expecting to raise a material amount of debt during 2020 to 2025, with requirements being met before the start of the period. The company also says that it has improved its debt maturity profiles.</p>	No intervention required. The company has complied with the action.	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
SEW.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'.

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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