

July 2019

Trust in water

PR19 draft determinations

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

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

Table 1 – South Staffs 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	SSC.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 Staffs 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 Staffs Water - Delivering outcomes for customers actions and interventions' tables, in particular those related to mains repairs, unplanned outage and to its bespoke performance commitment ('Water treatment works delivery programme').	Refer to interventions described in the 'South Staffs Water - Delivering outcomes for customers actions and interventions' tables regarding mains repairs, unplanned outage and its bespoke performance commitment ('Water treatment works delivery programme').

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	SSC.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 Staffs 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
	SSC.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	South Staffs Water has confirmed this commitment.	No intervention required. The company has complied with the required action.	N/A
	SSC.LR.A4	Required	The company has not presented the results of any financial resilience stress testing in its business plan. The company should demonstrate how the Board has assured itself that it will remain financially resilient in the long term, with specific reference to the results of financial stress tests, including impacts on key financial metrics, declining financial ratios (in the context of the company's proposals for flat nominal billing), and targeted credit ratings for the period from 2020 to 2025.	1 April 2019	<p>South Staffs Water included detailed results of financial stress testing in its updated PR19 business plan. It set out the impact of prescribed/combined scenarios on its key financial metrics.</p> <p>The company confirmed, in response to the IAP, that it carefully considered the specific challenges around its financeability and reached a view that a target credit rating of Baa1 under the notional structure provides enough headroom to absorb any possible shocks. It considers that its metrics will stabilise in the longer term post-2025.</p>	<p>No intervention, but further action required.</p> <p>The company sets out that it targets a credit rating of Baa1. However the company's financial ratios decline through 2020-25. The company expects its financial ratios to improve in 2025-30 based on its assumption of the 'early view' cost of capital through 2025-30; though it notes a risk that the cost of capital could be lower in 2025-30.</p>	<p>While the company proposes a small reduction in gearing through 2020-25, it shows limited headroom in its financial ratios through 2020-25, which provide the company with limited headroom against any cost shocks. We seek further Board assurance from the company that the targeted gearing level and credit rating for its actual financial structure are consistent with maintaining financial resilience in the long term, with reference also to action SSC.LR.C1.</p> <p>In its future reporting, we expect South Staffs Water to apply suitably</p>

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
							robust stress tests in its long term viability statements in 2020-25.
	SSC.LR.A5	Required	The company should carry out an assessment of its financial resilience for the period beyond 2025, highlighting the key challenges that the company might face and how it intends to manage and mitigate these.	1 April 2019	<p>South Staffs Water says that it has assessed its financial resilience taking into consideration its:</p> <ul style="list-style-type: none"> • stress test results; • financial resilience beyond 2025; • target credit rating; • key rating and covenant metrics; • cash generation; • credit facilities headroom; and • key credit rating and covenant metrics. <p>The company also says that it expects to maintain its gearing level below 70% (based on the definition of gearing in its covenants).</p> <p>South Staffs Water outlines the following financial risk management/mitigation approaches available to it:</p> <ul style="list-style-type: none"> • re-prioritising capex; • deferring dividends; • reference to regulatory mechanisms; • ‘making use of the safety valve’ on its flat nominal billing approach; <p>The company says it has risk management systems that are reviewed on a six-monthly basis, subject to bottom-up and top-down challenges, and aligned with key performance indicators.</p>	No intervention required, but further action required as per action SSC.LR.A4.	See actions SSC.LR.A4 and SSC.LR.C1.

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	SSC.LR.A6	Required	The company has not demonstrated that it has assessed financial resilience beyond 2025 in its plan. 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	The company has committed to demonstrating that its assessment of financial resilience will extend beyond 2025 in its next Long Term Viability Statement.	No intervention required.	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
SSC.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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