

July 2019

Trust in water

PR19 draft determinations

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

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

Table 1 – Thames 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	TMS.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	Thames 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 'Thames Water - Delivering outcomes for customers actions and interventions' tables, in particular those related to mains repairs, unplanned outage and to its bespoke resilience performance commitments ('Improving system resilience of North East London water supply' and 'Power resilience').	Refer to interventions described in the 'Thames Water - Delivering outcomes for customers actions and interventions' tables regarding mains repairs, unplanned outage and its bespoke resilience performance commitments ('Improving system resilience of North East London water supply' and 'Power resilience').

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
	TMS.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	Thames 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
	TMS.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	Thames Water has confirmed this commitment.	No intervention required. The company has complied with the required action.	N/A
	TMS.LR.A4	Required	The company should explain how it has taken account of the risks to its financial resilience associated with: <ul style="list-style-type: none"> its plan to maintain a Baa1 credit rating; the introduction of the gearing outperformance sharing mechanism; its current and planned gearing levels; requirements to refinance subordinated debt; and capital for the business raised as debt elsewhere in the corporate group, outlining associated risk management/mitigation approaches identified by the company to provide assurance on long term financial resilience. 	1 April 2019	<p>Thames Water refers to an independent view that its business plan is financeable, with an estimated credit rating of BBB+/Baa1 or above. It considers that the key ratios presented in its plan are consistent with maintaining its Moody's corporate family rating of Baa1.</p> <p>Thames Water sets out that during 2020 to 2025 it expects to continue to issue senior (Class A), subordinated (Class B) and Holdco debt (i.e. debt issued by entities outside the regulatory ring-fence) in the public and private Sterling markets. It considers the risk of market disruption or unfavourable market conditions is mitigated by an even maturity profile (with the largest maturity in the period being only £300m), a smooth cash flow profile, and the fact that a significant proportion of its financing needs relate to refinancing.</p> <p>The company says that its ability to access markets is further supported by the</p>	<p>Intervention required.</p> <p>The company has provided a Board assurance statement that its business plan achieves the credit metrics for a Baa1/BBB+ credit rating under the actual capital structure based on our early view cost of capital. However the company expects to be highly geared (remaining above 77% by the end of 2025).</p> <p>The company is responsible for maintaining its long term financial resilience. Further assurance is required about how the company will maintain its financial resilience in the context of our draft determination, which includes, for example, an updated view of the cost of capital, our assessment of efficient costs, our assessment of outcome delivery incentives and the requirement to include our default gearing outperformance mechanism.</p>	<p>The company should provide further detail and Board assurance about its plans to maintain its long term financial resilience in the context of our draft determination, as referenced in action TMS.LR.C1.</p> <p>In its future reporting, we expect Thames Water to apply suitably robust stress tests in its long term viability statements in 2020-25.</p>

Test area	Action reference	Action type	Action	Date required	Summary of company response to action	Our assessment and rationale	Required interventions
					<p>substantial liquidity facilities it maintains with creditworthy counterparties, the support of its relationship bank group, and the support of shareholders. The company has provided evidence of support that it will be able to raise debt as required from its bank group.</p> <p>The company expects to reduce gearing by the end of AMP7 through the investment of additional capital of around £900m.</p> <p>The company concludes that it would be financially resilient over a ten year assessment period, even if financial downside risks crystallise.</p>		
	TMS. LR.A5	Required	The company should explain the steps it has taken/will take in response to its consultant's view that it should undertake additional scenario analysis and planning to deal with financial and operational shocks.	1 April 2019	Thames Water says that, as part of its long term viability assessment, it has analysed extreme downside scenarios that could be severe enough to lead to a covenant default event as recommended by its consultant.	No intervention required at this stage, but we expect that in its future reporting, we expect Thames Water to apply suitably robust stress tests in its long term viability statements in 2020-25, taking account of advice provided to it in consultancy reports.	N/A
	Advised actions	Advised	There are no advised actions.	N/A	N/A	N/A	M/A

Table 2 – Further interventions for draft determinations

Intervention reference	Our assessment and rationale	Interventions
TMS.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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