PR24 DRAFT DETERMINATION RESPONSE
RISK AND RETURN

CONTENTS

SECTION 1

OVERVIEW OF OUR REPRESENTATIONS ON RISK AND REWARD

1. OVERVIEW OF OUR REPRESENTATIONS ON OUTCOMES

A. Allowed return

Allowed return:

The WACC proposed at the Draft Determination is aligned to the PR24 methodology 'early view'; we welcome the acceptance of a small company premium for debt and recognise Ofwat has moved its position since the final methodology was issued to address concerns on investibility.

However, the Ofwat Draft Determination cost of equity of 4.8%, despite the 27-bps aiming up assumption, is lower than the midpoint guidance recently issued by Ofgem for its RIIO-3 control. The Oxera report on investibility indicate allowed return on of equity need to be 50 bps (30-70 bps range) higher to adequately compensate equity and attract investment (see our representation on Havant Thicket for more detail).

The significant downside risk to allowed returns proposed in the overall Draft Determination package results in a package of risk and reward where we currently cannot achieve the allowed return. We believe this needs to be addressed by reviewing the cost of equity and addressing the balance of risk.

B. RoRE downside risk

We have reviewed Ofwat's Draft Determination, and we consider that the proposed determination does not meet the aims of the PR24 methodology in a number of areas. The current Draft Determination would result in significant reduction in RoRE and would significantly undermine our ability to deliver the customer and environmental commitments in our plan and undermine the financial resilience of Portsmouth Water, while we are trying to construct the first reservoir in the UK for a generation.

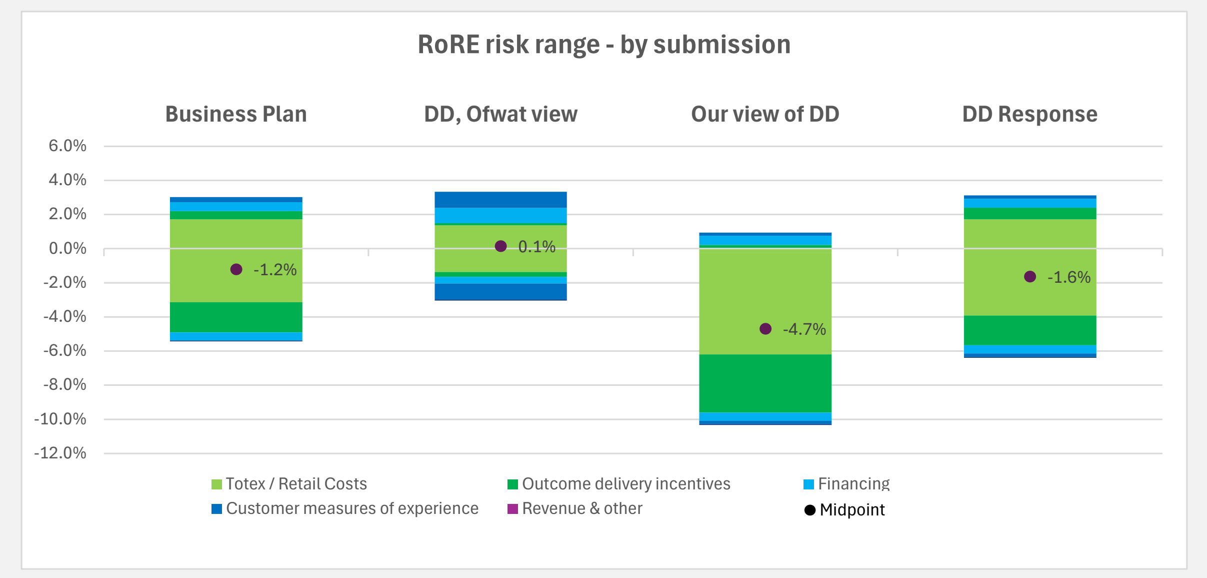
The Draft Determination assumes that the RoRE range would remain the same as we submitted with our Business Plan. We strongly disagree with assumption the Draft Determination has a neutral impact on RoRE given as the Draft Determination significantly altered:

- Wholesale Totex allowances, particularly enhancement expenditure.
- ODI performance targets and penalty rates.
- The Price Control Deliverable (PCD) relating to metering, that had a significant operational performance penalty.

We have calculated that the Draft Determination is highly skewed with a RoRE range of +0.7%/-10.4% which has been created by the introduction of significant adverse risk. These changes have resulted in our RoRE range being significantly outside of the PR24 guidance of +4.8% / -4.9%.

Our Board are unable to accept the current balance of risk and reward balance if issues are not addressed for the Final Determination.

Figure 1: RoRE range from business plan to DD response



Source: Data obtained from data table RR30, Ofwat DD and proposed figures for DD response.

We have outlined the six interventions that Ofwat need to address in their Final Determination to provide a balanced risk range for our company, which would constitute a fair bet for investors. Failure to address these issues will significantly undermine our ability to meet our commitments to customers and deliver the additional scope on the Havant Thicket reservoir.

Wholesale Totex Risk

Our allowances at Draft Determination were impacted by significant changes to our base and enhancement expenditure. We estimate this results in a Totex risk of -0.6%/-5.6% RoRE(high case/low case).

We have considered the Draft Determination and believe that enhancement totex needs to be increased by £41m. This would recalibrate our RoRE assessment a more balance range of +1.3%/-3.7% although this is still skewed to downside risk.

Table 1: Proposed Totex allowance for Final Determination

£m (22/23 prices)	Base	Enhancement	Havant Thicket	Total
Total Totex	256	132	85	473

Note: Pre-frontier shift and RPE

Discharge Permit Compliance

The ODI for Discharge Permit Compliance introduced a very high penalty for us of £3.8m compared to £1.6m for the average WaSC. We believe this is an error in Ofwat's methodology and we propose that the ODI rate is reduced from £0.228m to £0.007m per 1% of compliance, to align the RoRE risk to that of a WaSC of 0.1% per failure.

Per Capita Consumption

In the Draft Determination Ofwat started our performance at a low level that did not reflect our current performance or circumstances. We propose adjusting our first-year target to 149.6 l/p/d with a final year target of 142.8 l/p/d (three-year average). This would move the balance of risk for this ODI towards +0.01%/-0.13%%.

PCD Timing

Ofwat introduced a set of PCDs on timing for our mains renewal and our metering programs. This PCD aimed to incentivise on-time delivery of these programs with a balanced risk of +/-0.16% RoRE. On closer inspection we found that specific timing PCDs introduced a skewed risk range of -0.06%/-0.24% due to the construction of the PCD and specifically on the metering PCD that introduced a very high operability threshold for installed meters.

We propose the recalibration of these timing PCDs to bring the risk back to the intended +/-0.16% RoRE by:

- Adjusting the rates to give a better balance between risk and reward.
- Removing the 95% operability threshold for acceptance on installation and introducing bespoke performance commitments on operability.

Metering PCD 95% Read Threshold

The PCD for metering, introduced at the Draft Determination, recovered totex for customers for meters that were not delivered. The criteria for the non-delivery included smart meters that would not be installed and meters that would be installed but that did not meet a data communication threshold of 95% of reads received. We believe that this 95% threshold is unachievable and could lead to behaviours that do not further the installation of meters. We propose that the PCD is retained with the following amendment:

- Removal of the 95% data threshold for recognition of the install.

We also recognise that having smart meters in the ground that are non-communicating with the data centres is poor performance and we are proposing a performance commitment for data reads that creates a balanced risk and reward for under/over performance of reads against a realistic target for companies as they move towards a mature network.

Risk Bias

We remain concern that a high performing company like Portsmouth Water will continue to struggle to earn the allowed base return. The performance commitments stated that the overall balance of risk for a median company was +/-4.5% of RoRE and the range for our company was +3.3/-3.1% (+7.9/-7.2% if you exclude the Havant Thicket control). We have reviewed the Draft Determination and consider that in the analysis Ofwat have applied companies' view of risk on their submitted plans and then overlayed these onto the stretching upper quartile performance and efficient enhancement allowances in the Draft Determination. The Draft Determination includes two levels of risk bias:

- An ODI negative bias to water only companies (WoCs), that has trended through 2015 to 2025 and continues into PR24.
- A risk range that has a starting point significantly below our allowed RoRE.
- Companies are subject to a mixture of risks that are sector wide or very specific to their circumstances, including ODIs, PCDs and efficiency targets. We propose that Ofwat reviews the level of risk for each company in the Final Determination and adjusts the risk range to better align with the final methodology and, in extremis, adjusts the return on equity to reflect material skews in risk.

C. Other downside risks

There are a number of other policy positions taken in the Draft Determination that increase the downside risk in AMP8. The major issue is that the current Draft Determination reflects a layering of risk and additional complexity, and the following areas further increase the asymmetry of risk and reward and create significant liquidity risk for companies. This will result in challenges raising the new equity that is essential to delivering our Business Plan commitments to customers and the environment.

RPE Mechanism on Energy Costs

We support the Ofwat policy intention on energy costs, but the current approach is flawed and results in a further shortfall on totex allowances that has not been appropriately considered in the balance of risk and reward. We recommend Ofwat, when calculating the RPE factor, replace the Ofgem day ahead electricity baseload energy price for the base forecast year with DESNZ extra-large users price data (that includes hedging activity). We also propose that same DESNZ data is used to calculate the uplift to modelled base costs. Finally, we recommend that the base year takes account of most recently available data of prices and is moved forward to FY24 (from FY23).

Cost Sharing on Business Rates

We have taken advice from a business rates consultant, who has confirmed that, subject to any unanticipated changes in methodology, the business rates payable by all water companies are certain to increase as a result of the 2026 revaluation. Ofwat's proposed approach in the Draft Determination creates two issues.

(i) With no adjustment until PR29, companies will bear the cashflow risk on a material item of expenditure for a significant proportion of the AMP8 period, eroding financial resilience.
(ii) Allowing only 90% of a cost that is certain to increase, amounts to an unjustified additional efficiency challenge on companies.

We propose that:

(i) Ofwat allows for full recognition of business rates increases (i.e. a 100% sharing rate), subject to companies being able to demonstrate that they have appropriately challenged the revaluation.
(ii) Ofwat specify business rates as a Notified Item for PR24, so that if any increases are of a sufficient magnitude, either alone or in combination with other relevant changes of circumstance, they can be adjusted for via an Interim Determination of K.

Run Off Rates

Portsmouth Water run off rates have been set to align with capital maintenance costs or aligned to recovery over the life of the assets in use, to ensure costs are recovered. We support industry concerns on Ofwat adjustments to run off rates to address affordability concerns. By reducing RCV run-off Ofwat is expecting companies to raise equity to subsidise bills in AMP8 at a cost to future customers and compounds liquidity challenges of underfunding of totex and downside risk on performance commitments. We do not believe Ofwat has adequately supported its case to adjust run off rates. We have submitted our Draft Determination representation run off rates in line with our PR24 submission and not adopted Ofwat Draft Determination policies.

Gated review with deferred RCV recognition

Ofwat have introduced a number of additional mechanisms to deal with uncertainties. One mechanism is approval of additional totex through a gated review process where totex is recognised in the RCV and allowed revenue at PR29. This form of gated review creates further challenges to investibility of the sector. In the specific case of Havant Thicket, a similar approach on CAM2 could result challenges maintaining Baa2 rating. We have recommended inclusion of notified items for the increases in scope on the Havant Thicket programme rather than a gated review mechanism.

SECTION 2

DRAFT DETERMINATION REPRESENTATIONS: RISK AND REWARD

1. ALLOWED RETURNS

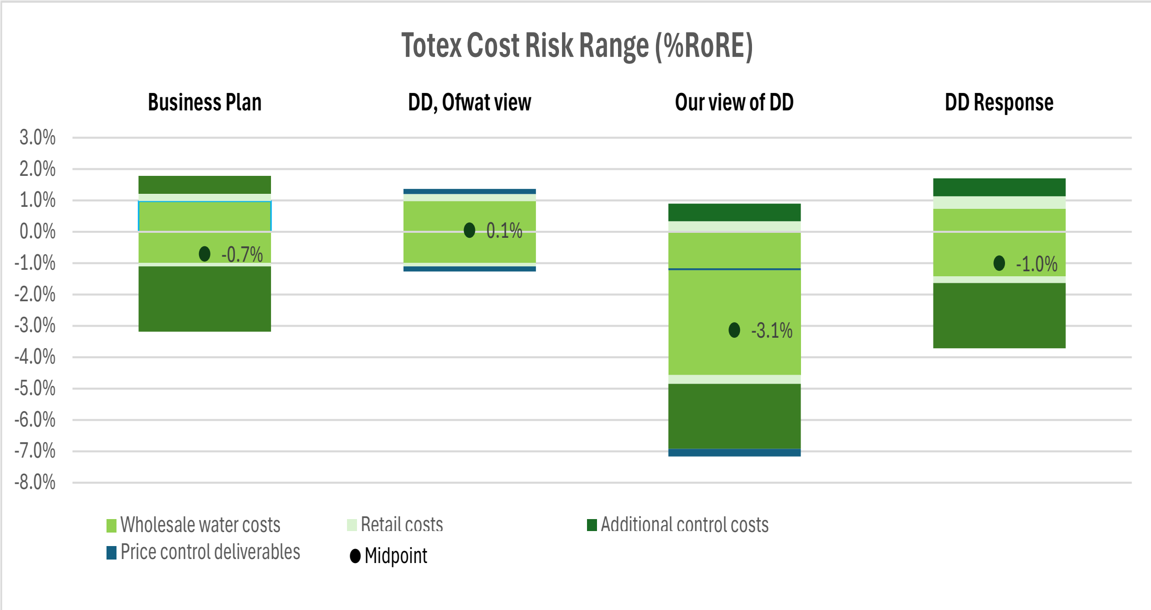
We recognise that Ofwat has taken steps to strengthen investability including a 27bps ‘aiming up’ within its cost of equity range to set a 4.8% CPIH-real return. However, we share industry concerns with the investability approach taken and significant delivery risk, arising from several issues within the current Draft Determination. We believe the current cost of equity and balance and risk and reward does not present an investable proposition for investors at an industry level and specifically for Portsmouth Water. This is not our isolated view, this is supported by industry, analysts, and rating agencies.

We believe that the current cost of equity is underestimated creating a significant barrier to securing required equity to deliver PR24 plans. Based on Oxera analysis, the cost of equity is understated by c.30-70 bps which would **increase the cost equity at PR24 Final Determination to 5.32% (5.10% - 5.53% range)**. This is more comparable to the mid-point guidance on Ofgem RIIO-3 SSMD.

We anticipate we will need to raise up to a further £85m of equity to support the change in scope on Havant Thicket Reservoir. We are seriously concerned the 4.8% cost of equity is not sufficient to attract new equity to support the scope change for the Havant Thicket alignment works. We have provided a more comprehensive representation on cost of equity for the wholesale control and the Havant Thicket controls ***in PRT HT 00 PR24 Response – Havant Thicket***.

2. TOTEX RISK

Figure 1: Totex Risk range by submission



Source: Data obtained from data table RR30, Ofwat DD and proposed figures for DD response.

A. What is the issue?

In the Final Methodology Ofwat provided an indicative risk range of +1%/-1% of RoRE for Totex.

Our Business Plan proposed a totex plan of £424m, with a RoRE risk range of +1.6%/3.1% which was composed of:

- Wholesale risk range +1.0%/-1.0%
- Havant Thicket risk range +0.6%/-2.1%

We had aligned our Totex risk to the final methodology, although the size of Havant Thicket had layered on additional risk.

Totex Reductions

In the Draft Determination our wholesale totex was significantly adjusted with positive base allowances as we were categorised as more efficient than the benchmark, and significant reductions in our enhancement allowances. Ofwat also required us to carry out additional work on mains renewals, greenhouse gas emissions, leakage and climate resilience. These impacts are shown in the table below:

Table 1: Additional Totex Allowances Risk – Base and Enhancement

Totex Allowances	BP (£m)	DD (£m)	Additional (£m)	Risk gap before customer sharing (£m)	Risk gap after customer sharing (£m)
Base allowances	206	225	+15	-4	-2
Enhancement allowances	133	86	-10	37	15
Havant Thicket	85	85	-	-	-
Total	424	396	5	33	13

Source: Portsmouth Water analysis

This highlights the **additional totex risk** due to the reduction in allowances and additional requirements which has a midpoint of £13m, which is equivalent to **a -1% RoRE impact**.

In addition, the introduction of the timing element of the PCDs has created increased totex risk. The totex risk introduced by this PCD was two-fold:

- Late or early delivery of the meter and mains programs.
- Meter operability threshold that would recover all installation costs for meters that failed a connectivity threshold.

Timing PCD

In principle we agree that if companies' deliver projects late or early then there should be a penalty or reward for material divergence from the agreed delivery profile. The estimation by Ofwat was this was symmetrical at +/-0.16% RoRE in their analysis[1].

However, the application of the timing element has created a skewed risk and reward, which was not considered when Ofwat carried out their risk analysis, as it was carried out on high-level total cost basis rather than on an individual PCD basis. Our view of the timing risk associated with the mains renewals and metering programs is shown below.

Table 2: Totex Risk associated with Mains Renewals and Metering Timing PCD

PCD	Units	P90	P10
Mains Renewals	£m	+0.05	-0.5
Metering	£m	-0.88	-2.72
Total	**£m**	**-0.83**	**-3.22**
	% RoRE	-0.06%	-0.24%

[1] Ofwat PR24 DD RoRE P10 and P90 analysis.xlsx

Source: Portsmouth Water analysis

This has been based on the P90 assumption of 95% on-time delivery and P10 assumption of 65% on-time delivery as stated in your analysis. This has introduced an unintended risk into the overall Draft Determination.

Metering Threshold PCD

This has been covered by a separate representation below.

B. Our proposed remedy

We propose two remedies.

Totex Update

We have updated our totex numbers to include the additional elements that Ofwat required in our revised plan. We have reviewed the enhancement costs of our smart meter program and reallocated some costs to base. We have been unable to identify further efficiencies on the other enhancement programs and have therefore not updated our costs. We propose that you accept our updated totex numbers as below. This will re-align the risk range back towards the Final Methodology without introducing a significant skew to the risk profile.

Table 3: Proposed Totex allowance for Final Determination

£m (22/23 prices)	Base	Enhancement	Havant Thicket	Total
Total Totex	256	132	85	473

Source: Tables CW1-3

Timing PCD

Ofwat should recalibrate the individual timing elements of the PCD to deliver the risk range that was intended within the Draft Determination at +/-0.16%. Our proposal would be to recalibrate these PCDs by:

- Adjusting the rates to give a better balance between risk and reward.
- Removing the 95% read threshold for acceptance on installation.

<u>Adjustments</u>. We consider that adjusting the rates could deliver a more balanced risk profile for example:

- Reducing our mains renewal timing under performance incentive rate by 10% and adjusting the out-performance up would create a risk range of +/-0.06%.
- Reducing the metering timing under performance incentive rate by 10%, lowering the out-performance rate.
- Removing the 95% threshold on meter installations would reflect a risk range of +/-0.1%.

C. Conclusion

Totex allowed in the Draft Determination will result in material reduction in RoRE or result in underperformance against our commitments to customer and the environment. Our representations seek to support our position that our enhancement costs are efficient. In addition the PCDs require further calibration if they are to work as intended.

We are also proposing the smart metering PCD on operability is reconsidered; we support an incentive to ensure data availability, but the proposed target is unachievable and fundamentally undermines the investment case for smart meters. We have proposed a bespoke performance commitment to incentivise meter connectivity which is more proportionate when assessed in the round and considering that data availability is linked to PCC and leakage which both covered by performance commitments.

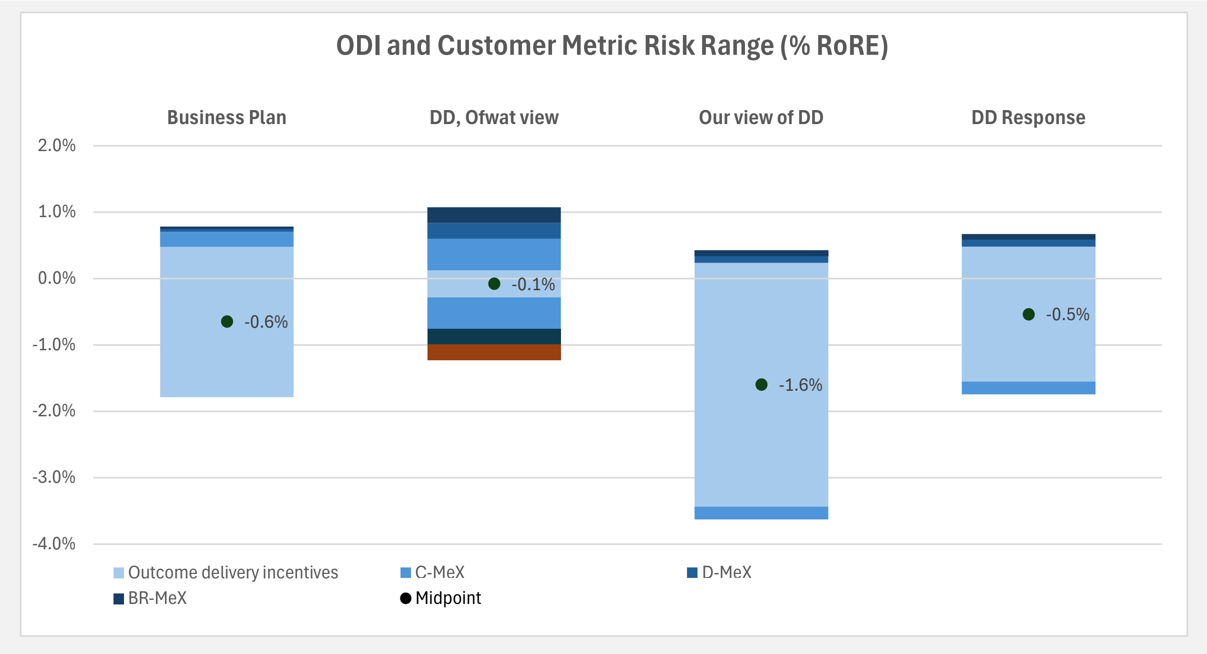
D. Business plan tables impacted

The CW totex tables have been updated as per our adjusted plan with further detail in our PRT EA 00 Expenditure Allowances.

We have incorporated the adjustments within ADD18 for the change against our Draft Determination view of RoRE for PCD timing and Totex risk.

3. OUTCOME DELIVERY INCENTIVE RISK

Figure 1: ODI and Customer Measures of experience range by submission



Source: Data obtained from data table RR30, Ofwat DD and proposed figures for DD response.

A. What is the issue?

Our Business Plan proposed a set of Outcome Delivery Incentives (ODIs) that we considered were proportionate and gave an average RoRE range of +1.1/-3.4% (+0.7%/-1.8% including Havant Thicket). We highlighted that the risk range was outside of the range given in the Final Methodology (+2%/-2%) for ODIs as shown below.

Ofwat's Draft Determination has set some more stringent targets and rates for some ODIs. This has created additional downside risk in the overall ODI package. The following ODIs have a significant impact on ODI risk:

- Discharge Permit Compliance
- Per Capita Consumption

We estimate that these two ODIs with the targets proposed in the Draft Determination contribute to a risk range of - 0.2%/-2.7% by themselves. The reasons for this are given in detail in our response on outcomes, PRT OUT 00 – Outcomes. A brief summary is provided below:

- Discharge Permit Compliance. Ofwat have proposed a set of unit rates that are calibrated based on larger Water and Sewerage Companies (WaSCs). A single discharge permit failure would result in a £3.8m ODI penalty for us, equivalent to -1.6% RoRE, compared to £1.6m or the average WaSC, equating to 0.1% RoRE.

- Per Capita Consumption. Ofwat have proposed setting 2025-30 PCC levels that continue from 2020-25 PCC target levels, with targets of 140.9 l/p/d in 2025-26 and 136.1 l/p/d in 2029-30. These fail to recognise the start point, which is higher (and for which we have incurred a penalty in AMP7). This has created a significant downside risk on the performance particularly in the early years of AMP8, when there is no reasonable prospect that we could meet the targets.

This is summarised in the table below.

Table 1: ODI Risk for Discharge Permits and PCC

ODI Measure		P10 (% RoRE)	P90 (RoRE %)
Discharge Permit Compliance		-1.5%	0.0%
PCC		-0.3%	-0.2%
Total		**-1.8%**	**-0.2%**

Source: Portsmouth Water analysis

These ODIs clearly are outside of the range of risk with a large bias to downside risk.

B. Our proposed remedy

We propose that the following remedies to these ODIs could reduce the risk to similar levels in WaSCs:

- Discharge Permit Compliance, the ODI rate is reduced from £0.228m to £0.007m per 1% of compliance, as per our representations in PRT OUT 00 – Outcomes. This would align the RoRE risk to that of a WaSC of 0.1% per failure. This would not affect the overall ODI and would be a bespoke adjustment for our outcomes.
- Per Capita Consumption, the baseline performance should be 150.2l/p/d, with our first-year target on 149.6 l/p/d with a final year target of 141 l/p/d (3-year average). This reduces the average RoRE risk range to +0.01/%-0.13%.

These changes would reduce the significant downside risk that the Draft Determination has introduced and move the risk as shown below.

Our representation would give a range of +0.9/-1.9% RoRE which is still inside of the Final Methodology range for ODIs although still with a significant downside skew with a mid-point of -0.5%. The risk ranges for ODIs is provided in PR24 Table ADD18.

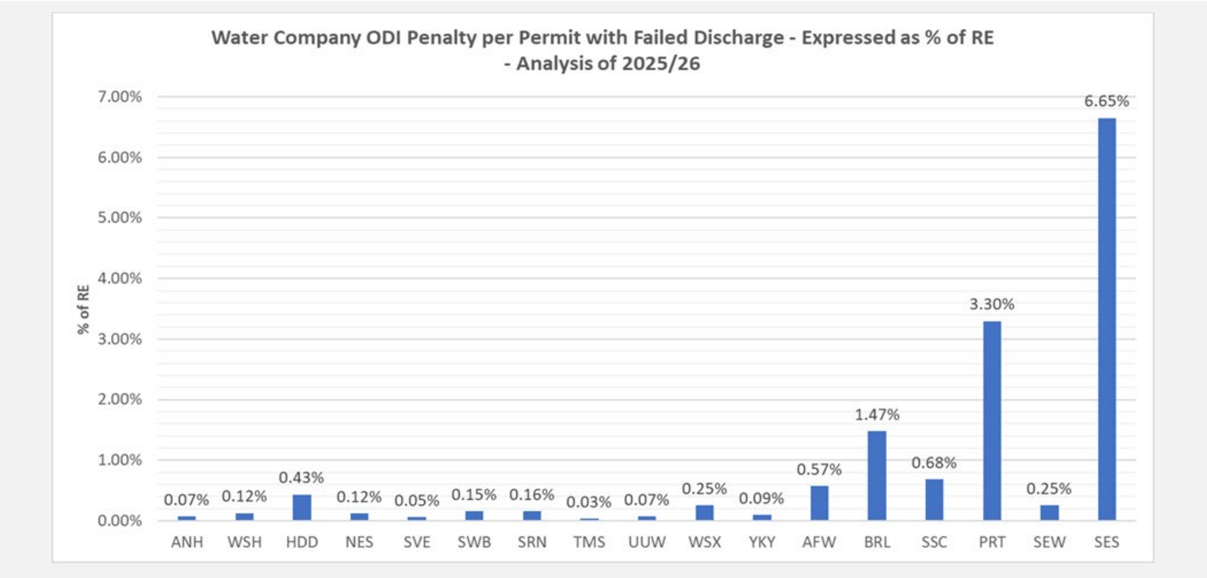
C. Supporting evidence

Supporting evidence for the recalibration of the ODIs is provided in our Annex PRT OUT 00 – Outcomes. Summary information is provided below.

Discharge Permit Compliance

The graph below shows the ODI penalty per permit failure, expressed as percentage of Regulated Equity. It shows that Portsmouth Water would receive an ODI penalty equivalent to 3.3% of regulated equity for a single discharge permit failure. This is in comparison to an average of 0.1% for WaSCs.

Figure 2: Comparison of Discharge Permit Compliance Failure per Permit



Source: Portsmouth Water analysis

Per capita consumption

For the Final Determination Ofwat needs to ensure it takes proper account of Portsmouth Water's current PCC performance and ensure that the targets it sets are realistically achievable given this starting point. Ofwat should use actual performance to set the baseline for the PR24 PCC PCL.

We propose Ofwat uses the lowest actual performance in 2020-25, adjusted for Covid-19, as the 2024-25 baseline. For us, the baseline would be 150.2 l/pers/d.

To set a start point based on the PR19 PCL would mean that Ofwat is effectively penalising the company twice for the same performance. It would also mean that Ofwat has failed to take account of the circumstances facing Portsmouth Water, for example the impact of low average bills and lower than average meter penetration.

Our target for 2029-30 is based on the metering programme benefits and is consistent with our WRMP24. The 2029-30 target 141.0 l/pers/d is challenging but achievable.

D. Conclusion

The ODI risk range for **Portsmouth Water** is significantly impacted by the calibration of the Discharge Permit Compliance rate and **the** Per Capita Consumption start point**. C**orrecting these will realign the risk range within the Final Methodology target range.

E. Business plan tables impacted

OUT tables are impacted by this representation as per our Annex PRT OUT 00 – Outcomes.

We have incorporated the adjustments within ADD18 for the change against our DD view of RoRE.

4. PERFORMANCE COMMITMENT DELIVERY RISK

A. What is the issue?

In the Draft Determination, PCDs were introduced to prevent customers from paying twice for the delivery of key enhancements for which allowances were provided. We agree with the principle that both customers and companies should be recompensed for work that is not completed or additional work required during the period.

Ofwat sets out its proposed PCDs in ‘PR24 draft determinations Price control deliverables appendix’, including a PCD for metering that covered the:

- New advanced monitoring infrastructure (AMI) enabled meter installations.
- Upgrades to existing meters.
- Replacement of meters.

As part of the measurement and recording Ofwat set the following criteria for the recognition of an active meter:

- The meter should measure and record water consumption data at least once an hour with a 95% or higher success rate,

  And,

- transmit the recorded consumption data to the smart infrastructural network at least once every 24 hours with a 95% or higher success rate.

We consider that the threshold of 95% is unachievable and is a level of commitment that meter manufacturers are not prepared to accept in a contract. This then transfers the risk to water companies who have little or no ability to improve the reading or transmission success rate, without incurring significant unfunded expenditure, which is not justified by the benefits.

Ofwat calculated the risk associated with the PCDs for timing only as +/-0.16%. It has been assumed that the refunding of under-delivery to customers was risk neutral, as the recovery of allowances was for unspent activity.

Impact of this element of the PCD

For the metering PCD this is not the case, as the 95% success threshold means that companies take the full risk for all meters that do not meet this target. This is measured against the individual meter. As such, any meter that is installed but fails to meet the threshold would not be paid for by customers.

In our discussions with manufacturers, the maximum level of guarantee would be under 90%. Based on the rates specified in the **Water Supply and Demand Balance PCDs** calculator, the impact on RoRE could range from:

Table 2: Meter PCD Risk for meters not achieving the 95% threshold

Risk level	Commentary	Total risk amount (£m)	RoRE %
P90	For this scenario we have assumed 75% of meters meet the 95% threshold	12	-0.9%
P10	For this scenario we have assumed 50% of meters meet the 95% threshold	17	-1.3%

Source: Portsmouth Water analysis

This has assumed that all the costs are recovered, and that this is not subject to cost sharing.

B. Our proposed remedy

In our Annex PRT OUT 00 – Outcomes we set out our proposed remedy, which is to recalibrate the PCD using two adjustments:

- Removal of the threshold target from the PCD, with two bespoke Performance Commitments included instead.
- Inclusion of a PCD focused on meter installation only.
- Collaboration with the Smart Metering Advisory Group (SMAG) on a deliverable operability target.

As an example, changing the threshold to a P90 of 95% and a P10 of 80% achieving the new threshold combined with a non-delivery rate approximately 66% of the current value would adjust the RoRE range to -0.1% to -0.33%.

We consider that these changes could significantly reduce the RoRE associated with this PCD.

C. Supporting evidence

We have provided further evidence of the requirement for the reconsideration of the Metering PCD within our representations in PRT OUT 00 – Outcomes.

D. Conclusion

This PCD adds a significant risk to all water companies and in particular to those with current low smart meter penetration. In its current form this adds a significant downside risk that could lead to unintended behaviours.

E. Business plan tables impacted

No business plan tables are impacted by this representation.

5. BIAS IN DRAFT DETERMINATION

A. What is the issue?

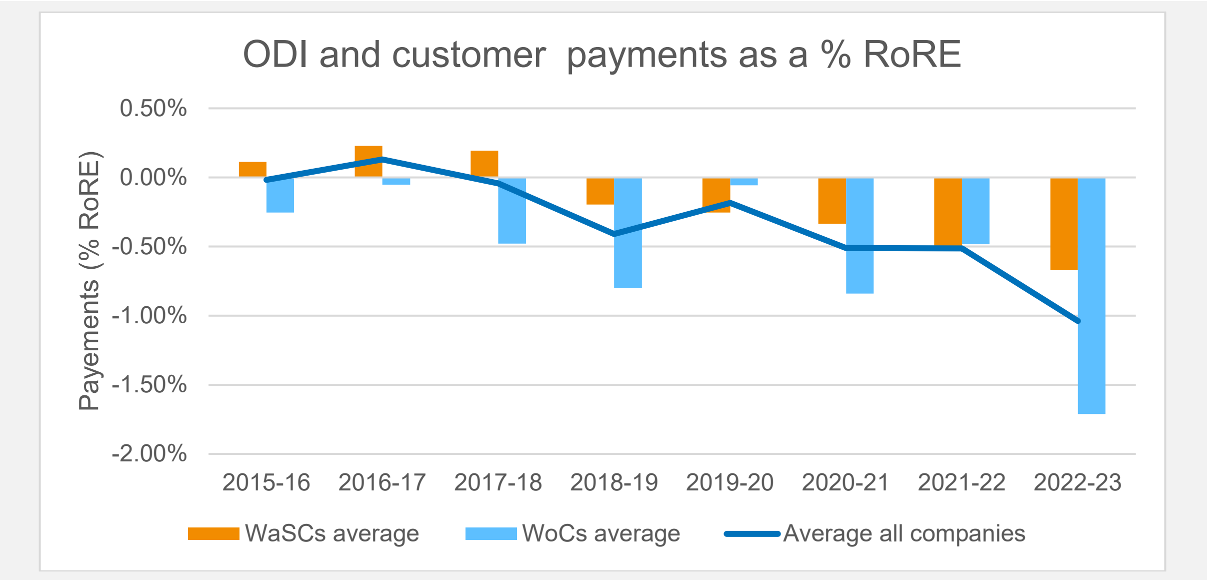
The Draft Determination has an in-built risk bias to the benefit of customers within the overall package of measures and allowances. These manifest in two ways:

- A bias for larger companies (WaSCs) who have a lower level of risk and range.
- The overall package has been designed on a generic basis and risk provided by companies in submissions have been assumed to be the same on more stringent ODI targets and the lower allowance provided based on your definition of an 'efficient' company.

ODI Risk Bias against Water only Companies

Since 2014, Water only Companies have consistently received lower ODI returns than WaSCs. The graph below shows the ODI and Customer Experience payments as a %RoRE from 2015.

Figure 1: Historical ODI and Customer Measure payments (% RoRE)



Source: WCPR data report and SDR analysis model

The clear trend has been for WoCs to be penalised to a higher degree over the eight years, which on average has resulted in a differential of 0.4% of RoRE.

In Ofwat's Draft Determination, the analysis[2] of the total Outcomes risk has the following data for companies:

[2] Ofwat PR24 DD RoRE P10 and P90 analysis.xlsx

Table 1: Outcomes Risk differential in Draft Determination

Company type	P10 Mean (% RoRE)	P90 Mean (% RoRE)
All companies	-2.47%	2.02%
WaSCs	-2.27%	2.02%
WoCs	-2.91%	2.01%
Differential	**-0.64%**	**-0.01%**

Source: Ofwat PR24 DD RoRE P10 and P90 analysis.xlsx

The table clearly indicates that there is a wider risk range for WoCs and that the P10 downside is -0.64% worse for WoCs.

Overall risk package bias

Ofwat's overall risk package for companies was produced on a top-down basis using generic sector assumptions and an overlay of each company's risk based on their Business Plans.

For Portsmouth Water Ofwat used the following sources for their analysis.

Table 2: DD source of risk range data for our company

Risk type	Source
Wholesale water costs	PRT business plan
PCD (timing only)	Top level assumption
Retail costs	Sector wide
Additional control costs	PRT business plan
ODIs	PRT business plan
Customer measures of experience	PRT business plan
Finance	Sector wide
Revenue and Other	Sector wide

This analysis did not take into consideration the factors imposed as part of the Draft Determination on companies through Ofwat's view of an efficient company.

We have completed an analysis of the Draft Determination against our Business Plan and there is a clear disparity with Ofwat's analysis of risk in the Draft Determination.

Table 3: Our view of the impact of the Draft Determination on our RoRE

Company view of DD impact on RoRE (%)	2025-26	2026-27	2027-28	2028-29	2029-30	Average
Wholesale totex	-1.0%	-2.7%	-2.9%	-3.9%	-4.6%	-3.0%
Retail totex	-0.1%	-0.1%	-0.1%	0.0%	0.0%	-0.1%
Outcome delivery incentives	-0.5%	-0.7%	0.0%	-0.2%	-0.3%	-0.3%
Financing	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Customer measures of experience	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Revenue & other	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
RoRE total	-1.6%	-3.5%	-2.9%	-4.1%	-4.9%	-3.4%

These individual cases have been discussed in the sections above.

B. Our proposed remedy

The Draft Determination included significant downside risk for us through an implicit bias in outcome risk and a larger bias in the overall package towards customers.

For the Final Determination Ofwat should adjust its processes to review the level of risk for each company against the final methodology, including the impact of the additional stretch that they have imposed for each company on outcomes and allowances. We propose that these are adjusted on an individual company basis to provide a risk range that is more aligned with the final methodology and where Ofwat are unable to meet the zero position, it should adjust the return on equity to reflect any material skews in risk.

C. Conclusion

The risk envelope has changed significantly from previous determinations and each company has its own risk envelope. Ofwat's risk analysis was undertaken at too high a level and did not address the specific risks that the Draft Determination imposed on companies. We propose more detailed analysis that removes biases and returns each company to the final methodology risk framework.

6. OTHER DOWNSIDE RISKS

A. What is the issue?

There are a number of other policy positions taken in the Draft Determination that increase the downside risk in AMP8. In some areas we support the policy intervention by Ofwat, but the approach needs either recalibration or refinement to balance the risk between customers and investors. The major issue is that the current Draft Determination reflects a layering of risk and additional complexity, and the following areas further increase the asymmetry of risk and reward and create significant liquidity risk for companies.

Treatment of energy costs in AMP8

Water UK has commissioned Baringa to review the treatment of energy costs in the Draft Determination. We support Ofwat policy intention, but the current approach is flawed and results in a further shortfall on totex allowances that has not been appropriately considered in the balance of risk and reward. A summary of Baringa's conclusions is provided below.

"The direction that Ofwat is proposing in terms of the treatment of energy costs in PR24 is broadly appropriate and aligned with Ofwat's statutory duties which include protecting the interests of consumers and securing that water companies can finance the delivery of their functions. However, the approach to implementation that Ofwat proposes risks being detrimental to the recovery of efficient energy costs. The adjustment that Ofwat is proposing to modelled costs (including energy) would actually reduce energy cost allowances by almost £250m over AMP8 (2025-30). Given the scale of companies' expenditure on energy (e.g. they anticipated spending £1.27bn in FY25), this reduction to allowed costs would represent a material difference to their overall energy costs.

Allowed energy costs over the 2025-2030 period would be lower than Ofwat's pre-RPE modelled (and allowed) costs, which are based upon analysis over the period FY12 to FY23. We do not expect energy prices to decrease over the AMP8 period relative to the FY12 to FY23 period, so Ofwat's adjustment would lead to a decrease in the allowance given to water companies, when they are likely to be paying more for energy. This is not borne out by forecasts of energy prices, particularly when additional costs such as policy costs and network charges are considered. Jonathan Brearley (CEO of Ofgem), speaking to the House of Commons Energy Security and Net Zero Committee in May 2024 said that "prices remain significantly higher than they were before the crisis," and looking ahead he cautioned that "prices are expected to remain high and volatile over time". On 23 August 2024, Ofgem announced the retail price cap would rise by 10% in October 2024."

Water Business Rates

Business rates payable by all water companies are subject to a revaluation in 2026, the first year of AMP8, and a further revaluation in 2029. Ofwat has not included any adjustment to the cost allowance for business rates in its Draft Determination but has provided for a 90:10 cost sharing arrangement for business rates (i.e. 90% of any cost increase will be recoverable from customers, and vice versa for any reduction). We have taken advice from a business rates consultant, who has confirmed that, subject to any unanticipated changes in methodology, the business rates payable by all water companies are certain to increase as a result of the 2026 revaluation.

Ofwat's proposed approach in the Draft Determination creates two issues.

(iii) With no adjustment until PR29, companies will bear the cashflow risk on a material item of expenditure for a significant proportion of the AMP8 period, eroding financial resilience.
(iv) Allowing only 90% of a cost that is certain to increase, amounts to an unjustified additional efficiency challenge on companies.

Run-Off Rates

Portsmouth Water's run-off rates have been set to align with capital maintenance costs or aligned to recovery over the life of the assets in use, to ensure costs are recovered. We support industry concerns on Ofwat's adjustment to run off rates to address affordability concerns. By reducing RCV run-off to address affordability concerns, Ofwat is expecting companies to raise equity to subsidise bills in AMP8 at a cost to future customers and this compounds liquidity challenges of underfunding of totex and downside risk on performance commitments. We do not believe Ofwat has adequately supported its case to adjust run-off rates.

Gated review with deferred RCV recognition

Ofwat have introduced a number of additional mechanisms to deal with uncertainties. One mechanism is approval of additional totex through a gated review process where totex is recognised in the RCV and allowed revenue at PR29. This form of gated review creates further challenges to investability of the sector. In the specific case of Havant Thicket, a similar approach on CAM2 could result challenges maintaining Baa2 rating.

B. Our proposed remedy

Treatment of energy costs in AMP8

Water UK Baringa report proposes the following remedy

"We recommend Ofwat, when calculating the RPE factor, replace the Ofgem day ahead electricity baseload energy price for the base forecast year with DESNZ extra-large users price data (that includes hedging activity). We also propose that same DESNZ data is used to calculate the uplift to modelled base costs. Finally, we recommend that the base year takes account of most recently available data of prices and is moved forward to FY24 (from FY23). This ensures consistent and appropriate prices and indices are used and the most recent available data on representative, hedged, energy costs is used. This recommended alternative option would increase allowances during AMP8 by £972m compared to Ofwat's negative adjustment of £244m. This represents a £1.2bn difference, highlighting the importance of addressing this issue at Final Determinations."

Water Business Rates

With respect to business rates we propose that:

(i) Ofwat allows for full recognition of business rates increases (i.e. a 100% sharing rate), subject to companies being able to demonstrate that they have appropriately challenged the revaluation.
(ii) Ofwat specify business rates as a Notified Item for PR24, so that if any increases are of a sufficient magnitude, either alone or in combination with other relevant changes of circumstance, they can be adjusted for via an Interim Determination of K.

Run-Off Rates

We have submitted our Draft Determination representation run-off rates in line with our PR24 submission and not adopted the Ofwat Draft Determination adjustments.

Gated review with deferred RCV recognition

We have recommended inclusion of notified items for the increases in scope on the Havant Thicket programme rather than a gated review mechanism. See PRT HT 00 - Havant Thicket for more details.

C. Supporting Evidence

Treatment of energy costs in AMP8

The Water UK commissioned Baringa report has been included as a supplementary report:

"PRT RR 02 Ofwat's PR24 Draft Determinations for the treatment of energy costs in AMP8".

Water Business Rates

See our Draft Determination response ***PRT EA 00 – Expenditure Allowances*** for more details.

Run Off Rates

The Water UK commissioned Oxera report has been included as a supplementary report:

"PRT HT 03 Investibility at PR24".

7. UNCERTAINTY MECHANISMS

A. Additional uncertainty mechanisms proposed

We did not include any additional uncertainty mechanisms in our original Business Plan submission. In our Draft Determination response we are proposing two additional uncertainty mechanisms which reflect either Ofwat's treatment in the Draft Determination or new risks that have emerged since submission of the original plan. These three mechanisms relate to:

- Business rates revaluations in 2026 and 2029
- Changes in PFAS concentrations in our water resources or changes to the regulation of PFAS that would require capital investment
- Havant Thicket CAM2

Water Business Rates

Business rates represent a material cost to water companies. A revaluation of our rateable value, from which the business rates payable are calculated, is required by statute to be undertaken every three years, with the next revaluation falling in 2026. The advice that we have received is that there is a near-certainty that rates will increase and that this increase could be material. However, the precise magnitude of the increase is uncertain.

We are therefore proposing that business rates should be allowed as a Notified Item within the Final Determination, so that prices can be adjusted if increases are sufficiently material. This would be in line with the approach taken at previous price reviews in relation to business rates revaluations.

PFAS

Since submission of the Business Plan the DWI has signalled that it is considering a potential change in the way that it measures PFAS concentrations for regulatory purposes. Changes in regulatory approach, or changes in the concentration of PFAS chemicals at our abstractions, could lead to the need for material capital investment in AMP8. We also know that this is an area that is attracting increasing scrutiny from customers and stakeholders, and this could lead to a requirement for further investment to invest in AMP8.

Within our Draft Determination response we include an additional business case associated with the risk of material investment in AMP8 at one of our major production sites at Fishbourne. This is considered the highest risk site, but there remains a risk that other sites will be impacted during AMP8.

To better understand the nature of these risks and potential uncertainty mechanisms, working with other companies we commissioned a review by Jacobs. We support the proposals set out in that report for a bespoke uncertainty mechanism targeted specifically at addressing PFAS risks. We provide a copy of the Jacobs report within our response as PRT RR 04 PFAS Uncertainty at PR24.

Havant Thicket

There are two significant engineering changes required on the Havant Thicket scheme.

Alignment works: To facilitate optimal delivery of the Hampshire Water Transfer and Water Recycling DPC project and the Havant Thicket reservoir, changes to the initial reservoir design and substantive alignment works are needed, including a combined tunnel for the two pipelines (the original design required only one). The combined tunnel will mean Southern Water does not need to construct a separate pipeline tunnel for its DPC project.

Reservoir design changes: Change in reservoir design due to exceptional ground condition issues that could not have been foreseen are required to ensure the safety of the reservoir embankment. The change of design and cost recovery is covered in the Bulk Supply Agreement with Southern Water through an Other Material Change of Circumstance (OMCC) clause.

The combined impact is expected to increase cost by c£270m and delay the programme by a minimum of two years. Ofwat propose to allow for the additional scope and costs for the alignment works via a second cost adjustment mechanism. We recommend the reservoir design changes are assessed at the same time to enable efficient financing of the scheme. The timing of the cost adjustment mechanism is subject to the outcome of the planning process associated with the changes to the pipeline; this is expected to conclude later in 2024.

We are recommending the re-introduction an IDoK clause for Havant Thicket with a Notified Item for the allowed scope changes to allow adjust cost allowances in AMP8 following the cost adjustment mechanism. To ensure Southern Water can recover costs from its customers we are recommending the use of an Allowed Revenue Direction (ARD) under Southern Water's Condition T (for Havant Thicket) in relation to Southern Water's BSA2 costs. This could be delivered through a wording change to Southern Water's Licence Condition T so that it explicitly gave Ofwat the power to change their allowed revenues to enable them to comply with the Havant Thicket Agreement.

SECTION 3

RESPONSE TO DRAFT DETERMINATION ACTIONS

8. RESPONSE TO DRAFT DETERMINATION ACTIONS

A. Draft Determination Commentary / Requirement

Ofwat have requested Portsmouth Water provide board assurance and evidence of assessment of financial resilience in 2025-2030.

"We are requesting six other companies – Affinity Water, Northumbrian Water, Portsmouth Water, SES Water, South Staffs Water and Yorkshire Water – to provide board assurance and supporting evidence to confirm and explain how they have assessed that they will maintain adequate levels of financial resilience in 2025-30. We do not require these companies to provide financial resilience plans in response to the draft determinations, but we do require them to demonstrate how they have updated their assessment of financial resilience in the context of the draft determinations."

PR24 draft determinations: Aligning risk and return appendix, p65

While Ofwat have requested additional evidence of financial resilience it met the expectations of the Quality and Ambition Assessment.

Minimum expectation	**The company's Board has provided assurance that it will maintain financial resilience during 2025-30 and in the long-term, taking account of its business plan under its financing and capital structure. We also expect this to be supported by sufficient and convincing evidence of the steps taken to provide this assurance and of the steps to improve financial resilience where necessary.**
Our assessment	Portsmouth Water's plan met our minimum expectation. The Board of Portsmouth Water provided assurance that the company will remain financially resilient on its actual structure during 2025-30 and in the long-term. The company set out the evidence the Board had considered in providing that assurance. In addition, the evidence the company had assessed on financial resilience was supported with third-party assurance. In its assessment Portsmouth Water added a company specific adjustment (CSA) which is in line with our guidance and used an allowed return of 3.43%. It also proposed a separate allowed return of 4.13% for the Havant Thicket Reservoir price control. The company stated it has an upfront equity commitment during 2020-25 of £150 million, of which £120 million had been received as of October 2023, to support the construction of the Havant Thicket Reservoir. The Board stated that it does 'not see a requirement for additional equity during AMP8 (2025-30) unless an additional project is awarded'. Portsmouth Water's business plan references that its investors, Ancala, have confirmed their ongoing support for the Havant scheme and that equity is available to support further growth. During 2025-30, Portsmouth Water is targeting a Moody's Baa2 rating on both its notional and actual structure. The company has highlighted that Moody's rating assessment creates a ceiling rating of Baa2 through the construction phase of the Havant Thicket Reservoir due to the size of the project relative to Portsmouth Water's Regulatory Capital Value (RCV). We note that the financial metrics provided in the base case are largely consistent with a Baa2 rating and in some instances, Baa1. To test its assessment of financial resilience Portsmouth Water modelled 11 downside scenarios including eight scenarios prescribed by us and a combined scenario. The company proposed restricting or withholding dividends as its main mitigating action to address its downside scenarios as well as utilising the undrawn Holdco debt facility, although it considered that in its most extreme scenarios a further equity injection may be required.

PR24 draft determinations: Portsmouth Water - Quality and ambition assessment appendix, p9

In commentary in the overview of the Portsmouth Water Draft Determination challenged the sustainability of gearing >70% in the longer term and requested we address feedback in the QAA assessment in our response to the DD.

"Portsmouth Water provided Board assurance of its financial resilience over 2025-30 under its actual financial structure. The company's plan targeted a credit rating of Baa2 which is below the target set in our determination however, we understand the company's ability to achieve a higher credit rating is likely to remain constrained through the period of construction of the Havant Thicket reservoir. Gearing is forecast to reach 71.4% over the 2025-30 period, which is above the level we consider reasonable for a water company to maintain adequate levels of financial resilience in the long term. The company may need further investor support to manage the Havant Thicket project and to maintain its financial resilience in 2025-30 and the long term.

Portsmouth Water will be responsible for ensuring its dividend policy and dividend payments made in 2025-30 are made in accordance with its licence. Portsmouth Water's licence requires it to take account of its performance in paying or declaring dividends. We have considered the company's dividend policy for 2025-30 which we assess to be broadly in line with our expectations. However, we expect the company to address our feedback set out in our QAA assessment in its response to our draft decision."

Ofwat: Overview of Portsmouth Water's PR24 draft determination, p14

Minimum expectation	**The business plan sets out the company's dividend policy for 2025-30 and the policy is in line with our expectations.**
Our assessment	Portsmouth Water's plan did not meet our minimum expectation but the impact of this on our ability to conduct our price review was not material. The company's proposed dividend policy for 2025-30 is not in line with our expectations. The policy did not set out the company's approach to determining dividends with respect to the following key factors in our dividend guidance: • how dividends declared or paid will take account of delivery for the environment over time; • the policy does not evidence that dividends declared or paid will be designed with the principle that dividends reward efficiency and the effective management of risks to the Appointed Business; and • the policy does not set out that the benefits of inflation will not be paid out if they're not clearly linked to outperformance or the prudent actions of management, as set out in our dividend guidance. The following factors were mentioned in the dividend policy, but we would have expected more detail to demonstrate: • how dividends declared or paid will take account of other obligations including employees', other stakeholders' interests and pension obligations; • how past performance will be factored in, to ensure investors are not rewarded more than once for each year's performance; and • how dividends declared or paid will take account of current and future investment needs. The base dividend yield on an actual company structure is 3.43% based on dividends paid in the price control period, the company state this reflects performance over 2024-29 as dividends are paid in arrears. The company assumed a base yield of 3.12% on actual regulatory equity, based on 2025-30 performance and resulting declared dividends. Whilst the policy could have set out more detail, it covered the key factors. In the round we assessed the policy met our expectations although the company could consider developing its policy to provide further detail on the specified areas listed above ahead of finalising its policy for 2025-30.

B. Representations

Financial resilience and dividend policies have been considered in the context of the increased scope of the Havant Thicket scheme to accommodate the alignment works with the Southern Water water recycling scheme and the change in reservoir embankment design. This will be addressed through a second Cost Adjustment Mechanism post the PR24 Final Determination. However, given that this is now our central case, we have considered the financial resilience implications despite cost not being assessed at PR24.

We have noted the commentary in the Draft Determination and taken the following actions.

- We have reviewed financial resilience implications of the Draft Determination and commissioned Centrus Financial to provide further Board assurance.
- We have amended our dividend policy to reduce the dividend yield to 2% of regulatory equity to align with PR24 guidance.
- Company gearing is maintained below 70% through 2025-2030 and we assume additional equity support to maintain regulatory gearing below 70% in line with our Baa2 rating guidance.

In addition to the review of financial resilience of the draft determination we have also:

- Engaged Moodys Rating Assessment Service to assess the implications of the increased scope of Havant Thicket on our credit rating.
- Extended the remit of the Centrus Financial financial resilience assessment to assess the financing implications of the expanded Havant Thicket scheme including:
    - Equity requirement
    - Implications on credit rating
    - Implications on PR24 financing strategy

C. Dividend Policy

We are amending our dividend policy to align to Ofwat guidance and financeability assumptions for AMP8. This aligns with the financing strategy outlined in our PR24 plan submission for the Havant Thicket scenarios reflecting the increased cost of the scheme.

We have reduced the dividend yield in our Draft Determination representations to 2% based on actual company structure on the basis that there is a requirement for new equity to support the increased scope on Havant Thicket.

Dividend Yield

Our Board and investors do not think a 2% yield is a sustainable policy to ensure the sector is investable, but it is seem as an acceptable and pragmatic approach through the construction phase of Havant Thicket, taking into consideration that the total cost and regulatory allowance will not be known until the CAM2 cost assessment exercise is completed early in AMP8.

PR24 Submission (Ofwat Financial Model Dashboard)

Dividends	2025-26	2026-27	2027-28	2028-29	2029-30	Total
Dividends (£m real)	2.46	7.87	7.55	7.46	7.40	32.74
Dividend yield %	0.89%	2.81%	2.58%	2.49%	2.45%	2.24%

PR24 Draft Determination Representation (Ofwat Financial Model Dashboard)

Dividends	2025-26	2026-27	2027-28	2028-29	2029-30	Total
Dividends (£m nominal)	3.12	4.22	4.39	4.66	4.88	21.28
Dividend yield %	1.03%	1.40%	1.33%	1.36%	1.30%	1.28%

We note Ofwat feedback on our dividend policy. We have continued to update and improve the quality of our dividend disclosures in our Annual Report and Accounts (the latest set of dividend disclosures are included in the Appendix of this document).

Dividend Disclosures

QAA Feedback: how dividends declared or paid will take account of other obligations including employees', other stakeholders' interests, and pension obligations

APR24 dividend disclosures includes references to health and safety and pensions and the assessment of performance for customers and the environment includes community measures (also included in company bonus assessment).

"The Board takes a wider assessment of performance and considers health and safety and pensions as indicators of social responsibility. In the past three years the defined benefit pension scheme has remained in surplus and RoSPA accreditation has been maintained. The pensions scheme has been closed to future accrual; all employees have transferred to the defined benefits scheme and employer contributions have been increased to a maximum of 15% for all employees."

QAA Feedback: how past performance will be factored in, to ensure investors are not rewarded more than once for each year's performance

The Board assesses performance in-year and over a three-year rolling period when considering whether a dividend payment is appropriate. The dividend policy assesses performance against a basket of performance commitments against in-year performance and wider performance against regulatory commitments.

The policy also contains a mechanism to reduce dividend yield for net penalties to ensure dividends are adjusted where commitments to customers and the environment are not met. This ensures moneys returned to customers for underperformance are funded through reduced dividends and dividends paid reflect performance in-year.

QAA Feedback: how dividends declared or paid will take account of current and future investment needs

Our dividend policy in AMP7 considered whether dividend yield of 4% was justified given the level of RCV growth. The Board were comfortable that there was sufficient equity support for a 4% yield following the £170m equity commitment. The 4% yield was calculated based on the PR19 RCV and not adjusted to reflect the increased totex allowance agreed in through the cost adjustment mechanism.

The policy for AMP8 will be reviewed following the Ofwat Final Determination but the dividend yield has been reduced to 2% of regulatory equity in anticipation of the increased cost of the Havant Thicket scheme and the requirement for more equity from shareholders. A 2% yield is not seen as a sustainable yield to attract and retain equity investment in the long term but is seen as a sensible pragmatic policy while total construction costs and risk are not fully understood.

QAA Feedback: how dividends declared or paid will take account of delivery for the environment over time

Our dividend policy requires an assessment of performance vs environmental commitments based on the in-year performance commitments but also considers performance over a rolling three-year period to ensure we both assess performance for the environment over time and ensure one-off events do not result in volatility of returns for investors.

Our AMP8 policy will be reviewed but it will take into consideration the PR24 environment commitments including:

- PCC, leakage, serious pollution, discharge permit compliance, biodiversity, and net zero
- Enhancement expenditure PCDs

Our policy will continue to include a mechanism to reduce dividends declared for net performance commitment penalties and a wider assessment of performance over a three-year rolling period.

QAA Feedback: the policy does not evidence that dividends declared or paid will be designed with the principle that dividends reward efficiency and the effective management of risks to the Appointed Business

Our dividend policies consider our performance against totex allowances as a measure of efficiency and risks are assessed as part of the wider Board evaluation of dividend policy.

"Totex performance has been considered in approving the dividend declaration. The Board were satisfied that actual and projected expenditure remains in line with forecast and within the PR19 final determination cost allowance. Underlying regulatory gearing was 33% after taking account of the Havant Thicket Cost Adjustment Mechanism increased Totex, and within the limits set in the Gearing Outperformance Sharing Mechanism."

QAA Feedback: the policy does not set out that the benefits of inflation will not be paid out if they're not clearly linked to outperformance or the prudent actions of management, as set out in our dividend guidance

Our dividend policy aligns with the allowed return on equity based on the published RCV. The return on equity is an inflation stripped return. Our investors accept a lower return to ensure they have inflation linked returns to align with their liabilities.

There is no mechanism to increase our dividend policy to distribute any potential gains from a high inflation environment. Currently 100% of our debt is index-linked (with historic bonds linked to RPI) meaning inflationary gains are lower than for other companies in the sector.

We think introducing further restrictions on dividend distributions creates a significant risk to investability of the sector and are not proposing specific mechanisms in our dividend policy. We will ensure that Board consider the issue through the annual approval of dividends and associated disclosures.

D. Financial Resilience

We have reviewed the financial resilience of our resubmitted plan post Draft Determination but also considered the implications of the planned changes of scope of the Havant Thicket to reflect the alignment works with the Southern Water water recycling scheme and changes to the reservoir design to address ground condition concerns.

We commissioned Centrus Financial to carry out Board assurance on the financial resilience of the Draft Determinations and requested they evaluate three scenarios***. (see PRT RR 01 for full report)***

1. Ofwat's Draft Determination outcomes overlaid on Portsmouth Water's PR24 Business Plan submission.
2. Portsmouth Water's response to the Draft Determination plan which include additional totex allowance (using the Ofwat's Draft Determination WACC).
3. Portsmouth Water's response to the Draft Determination plan + scope of the reservoir is increased to include alignment works (using Ofwat's Draft Determination WACC).

Centrus repeated the downside sensitivity on the Draft Determination outcome as a worst-case scenario for the PR24 determination. The Centrus analysis assumed a 4% dividend yield, the change in dividend policy will increase headroom and reduce new equity requirement for the alignment works.

Under all scenarios Portsmouth Water was able to maintain a minimum investment grade credit rating of Baa3 and remain compliant against financial ratios. In most cases the risk of downgrade can be managed through withholding dividends or additional shareholder support.

The full report is provided with this report in supporting document PRT RR 01 Centrus Financial Draft Determination Financial Resilience Report

Board Assurance | Key Assumptions

Centrus have been engaged to assess the financial resilience of Portsmouth Water's (the Actual Company, PWL) business plan overlaid with the Draft Determination outcomes prescribed by Ofwat

Financial Resiliency Assessment Criteria	▪ Centrus assess Financial Resilience of the actual company (PWL) currently rated Baa2 stable. Financial Resilience test is based on whether the company can maintain a credit rating of at least Baa3 Moody's under prescribed downside scenarios ▪ In assessing key ratios, we take an average of the first 3 years and an overall AMP8 average to compare against credit rating thresholds ▪ Additionally, Centrus have assessed the financial resilience of PWL through assessing compliance with debt covenants under the prescribed downside scenarios
Information Centrus has Assessed	▪ Ancala's valuation model with Ofwat's Draft Determination (DD) outcomes overlaid on Portsmouth Water's PR24 Business Plan submission ▪ The Ancala model includes base case & prescribed downside scenarios for the Actual Company ▪ Projected Moody's credit rating metrics provided for AMP8
Representations	▪ We were presented with two Representation scenarios where we did a shadow credit analysis but have not tested the plans for Financial Resilience. The two scenarios received are: ▪ PW DD Rep: PW response to the DD plan which include additional totex allowance, using the Ofwat's DD WACC to be conservative. ▪ PW DD Rep + Alignment Works: PW response to the DD plan + scope of the reservoir is increased to include alignment works using the Ofwat's DD WACC

Board Assurance | Financial Resilience - Actual Company

Centrus assesses the Actual company financially resilient under all the scenarios tested

Question	Centrus Assessment
Are the DD scenarios and the Response to the DD scenarios Baa2?	▪ Both our DD Business Plan and the responses we've reviewed align with a Baa2 rating using Moody's methodology. Assessment of credit ratings has also been informed by recent repeat of RAS process to assess the impact of increased scope. Moody's has assigned a credit rating of Baa2 under all scenarios examined. However, we are aware of a potentially negative revision in Moody's industry outlook. Should this revision materialise, the DD Business has enough headroom to retain the credit rating of Baa2. ▪ However, under the response to the DD, where we are assuming that the reservoir scope is increased to include alignment works there is **a risk that this structure could be downgraded to Baa3**, particularly if Ofwat does not grant appropriate allowances where PW can recover allowed revenue within AMP8. ▪ We understand that PW considers the structure where alignment works take place in AMP8 to be their central case. To eliminate uncertainty and enable PW to accurately project its equity requirements for AMP8, we recommend that PW conduct an additional Rating Assessment Service (RAS) under this scenario where Moody's are asked to assume that their proposed changes are implemented
Is the DD scenario financially resilient?	**Moody's Baa3 Rating** – Under all sensitivities tested, the actual company is financially resilient. This rating is compliant with the license agreement but would result in full drawdown of Holdco facilities under all sensitivities ▪ **Covenant compliance:** Under all sensitivities, the actual company remains compliant with both the ICR and gearing lock-up and default levels ▪ **Moody's ratios:** Moody's ratios remain compliant with a Baa3 rating guidance – the rating level which is our threshold test of financial resilience ▪ **Levers:** PW has many levers to mitigate or manage any downside scenarios. Three obvious levers to manage issues are (a) to draw upon the Holdco facility, (b) to withhold dividends or © to inject more equity. Under many sensitivities, we have assumed that the current Holdco facility would be utilised to manage and solve the issue. No sensitivity tested required the additional withholding of dividends or an additional equity injection to rectify the financial issue. These levers remain in reserve.

Actual Company | Moody's Scorecard

Under the representations, PW maintains its current Baa2 rating, subject to no change in Moody's industry view

		Moody's Scorecard		Centrus Assessment		
		Weighting	Moody's Guidance	Sub-Factor Outcome Detail		Scorecard-Indicated Outcome
REGULATORY ENVIRONMENT AND ASSET OWNERSHIP MODEL	Stability and Predictability of Regulatory Regime	15.00%	As per the latest Moody's report on PWL dated 29th July 2024	*Assumed that these ratings will remain unchanged through-out AMP8. However, Moody's have indicated that they are considering updating their view on the sector subject to a materially improved FD*	-->	Aa
	Asset Ownership Model	5.00%			-->	Aa
	Cost and Investment Recovery (Ability and Timeliness)	15.00%			-->	A
	Revenue Risk	5.00%			-->	Aa
SCALE AND COMPLEXITY OF CAPITAL PROGRAM	Scale and Complexity of Capital Program	10.00%	Baa: total annual capex 8%-12% of RCV Ba: total annual capex 12%-20% of RCV B: total annual capex 20%-30% of RCV CAA: total annual capex >30% of RCV		-->	Caa
FINANCIAL POLICY	Financial Policy	10.00%	As per the latest Moody's report on PWL dated 29th July 2024	*Assumed this will remain unchanged. The additional equity to remain a low level of gearing is credit positive*	-->	Baa

		Weighting	Moody's Guidance	*Base Case*			*PW DD Rep*			*PW DD Rep + Aligment*		
LEVERAGE AND COVERAGE	Adjusted Interest Coverage Ratio (AMP8 average)	12.50%	Baa: 1.5-2.5x Ba: 1.2 -1.5x	*2.50x*	-->	Baa	*1.83x*	-->	Baa	*1.52x*	-->	Baa
	Net Debt / RCV (AMP8 average)	10.00%	A: 40-55% Baa: 55%-70%	*56.4%*	-->	Baa	*56.1%*	-->	Baa	*64.2%*	-->	Baa
	FFO / Net Debt (AMP8 average)	12.50%	Baa: 10-15% Ba: 6-10%	*6.72%*	-->	B	*5.27%*	-->	B	*4.57%*	-->	B
	RCF / Net Debt (AMP8 average)	5.00%	Baa: 6-10% Ba: 4-6%	*3.74%*	-->	B	*2.52%*	-->	B	*3.28%*	-->	B
	Scorecard-Indicated Outcome Before Notch Lift					Ba2			Ba2			Ba2
	Notch Lift:					+1.5 notches			+1.5 notches			+1.5 notches
	Scorecard-Indicated Outcome					Ba1			Ba1			Ba1
	Additional 2-notch adjustment					+2 notch			+2 notch			+2 notch
	Acutal Rating Assigned					Baa2			Baa2			Baa2

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Moodys RAS / Moodys Downgrade Risk

We see the third scenario as the relevant scenario to assess financial resilience and financing strategy, even though the additional costs associated with the Havant Thicket change of scope are not being assessed in the PR24 process.

We have sought assurance that our financing strategy can achieve a Baa2 rating by engaging Moody's Rating Assessment Service (RAS). This mirrors the assurance approach used to support the first Cost Adjustment Mechanism and financing exercise. The Moody's RAS process was design to test whether Portsmouth Water can support the higher cost of Havant Thicket and maintain its Baa2 rating under a range of funding scenarios where deferral of RCV recognition and allowed revenue to PR29 increases.

The conclusion of the report is that the additional scope can be delivered maintaining the Baa2 rating required to raised debt and equity, but the risk of downgrade increases if recognition of RCV and allowed revenue is deferred to PR29. This risk increases if Moody's implement their proposed sector wide rating methodology changes resulting from a downgrade in the stability and predictability of regulatory regimes.

This is discussed in more detail in the representation document on Havant Thicket PRT HT 00 PR24 DD Response – Havant Thicket.

[redacted]

[redacted]

APPENDIX A

APR24 DIVIDEND POLICY AND DISCLOSURES

DIVIDEND POLICY

Annual Performance Report Dividend Disclosures

In May 2023 Ofwat introduced a new licence condition that required that dividends should only be declared or paid in accordance with a dividend policy that has been approved by the Board and which complies with the following principles:

(a) that dividends declared or paid will not impair the ability of the Appointee to finance the Appointed Business, taking account of current and future investment needs and financial resilience over the longer term.

(b) that dividends declared or paid take account of service delivery for customers and the environment over time, including performance levels, and other obligations; and

(c) that dividends declared or paid reward efficiency and the effective management of risks to the Appointed Business.

In June 2023 Ofwat issued guidance on the factors it would consider in assessing dividends paid or declared, for the purposes of compliance with the licence condition.

We describe below the dividend policy approved by the Board, how this meets Ofwat's expectations and how the policy has been implemented in respect of dividends paid in 2023-24 (in respect of 2022-23 performance) and dividends declared in respect of 2023-24 performance.

Dividend policy

Dividend policy is set to align with the five-year business plan agreed with Ofwat. A new dividend policy was adopted in April 2020 in line with the proposal in our PR19 business plan submission. The policy was set in line with regulatory guidance in Ofwat's PR19 Final Methodology and the Draft Determination.

The policy was revised for the financial year 2021-22 to reflect additional guidance provided in Ofwat's PR19 Final Determination to reflect a yield of 4% on regulated equity (compare with 5% in the previous published dividend policy). The policy is reviewed annually to reflect feedback on the Annual Performance Report and further guidance from Ofwat.

In assessing our dividend policy and our proposed dividend the Board consider the following factors:

(a) Delivery of performance commitments to customers and stakeholders over a rolling three-year period, this includes:

   a. Customer Service: C-Mex, D-Mex, Written complaints.

   b. Performance Commitments: Leakage, Interruptions to supply.

   c. Commitments to customers: Vulnerable customers, Sustainable abstraction, Community commitments.

   d. Employees: Health & Safety, Pensions.

(b) Overall financial performance of the appointed and non-appointed business including performance against Totex allowances and other regulatory financial incentives.

(c) Financeability tests on medium-term liquidity, and long-term financial viability testing to consider long-term financial resilience, including consideration of future capital requirements to support RCV growth and investment requirements.

(d) Compliance with regulatory requirements, in particular Licence Condition P and Licence Condition F.

In considering these factors the Board is confident that we meet the requirements of our licence condition and Ofwat's guidance, which require an in-the-round assessment of performance over time against its performance commitments (factors (a) and (b)), its investment plans and cost efficiency (factor (c)) and other areas of its operations (factor (d)).

In accordance with the policy a base dividend is calculated as 4% of the equity component of the average RCV for the financial period.

- We calculate our base dividend based on the notional company to align to the risk and reward assumptions at PR19. We base distributions on the notional company structure to reduce volatility due to the timing of deployment on new equity through AMP7, and to create clarity for investors.
- We monitor the dividend yield in line with the calculation methodology in the Annual Performance Report that reflects dividend yield on the actual company equity component to ensure we remain in line with PR19 guidance and Ofwat expectations.

DIVIDEND POLICY

Performance	Measure	2020-21	2021-22	2022-23
Customer service	C-Mex Rank	1st	3rd	2nd
Developer service	D-Mex Rank	3rd	3rd	2nd
Written complaints	Complaints per 10k connections	✓	✓	✓
Leakage	ODI Target	✓	✓	✗
Interruptions to supply	ODI Target	✓	✓	✓
Vulnerable customers	Priority Services Register / Social Tariff	✓	✓	✓
Sustainable abstraction	Abstraction Incentive Mechanism	✓	✓	✓
Community commitments		✓	✓	✓
Health & Safety	RoSPA accreditation	✓	✓	✓
Pensions	Scheme in surplus	✓	✓	✓
ODI	Overall ODIs achieved	20/26	18/26	19/26

In deciding to pay a dividend the Board were satisfied that Portsmouth Water had consistently delivered on its commitments to customers and the environment. Customer experience for households and developers has been upper quartile in each year to 2022-23. Written complaint levels were the lowest in the industry in 2021-22 and while complaint numbers increased marginally in 2022-23, we remained an upper quartile performer.

Customer interruptions have been the lowest in the industry through the period and there were no restrictions imposed on customers despite the driest year on record since 1975. Performance commitments in relation to the Priority Services Register, social tariffs and Abstraction Incentive Mechanism have been met, along with delivery on our community commitments supporting local STEM fairs, single use plastic campaigns and engagement on Havant Thicket. The leakage target was missed for the first time this regulatory cycle, impacted by extreme weather conditions. The Board considers the performance over three years and does not feel that failing this measure in isolation should result in an adjustment to dividends.

The Board takes a wider assessment of performance and considers health and safety and pensions as indicators of social responsibility. In the past three years the defined benefit pension scheme has remained in surplus and RoSPA accreditation has been maintained. The pensions scheme has been closed to future accrual; all employees have transferred to the defined benefits scheme and employer contributions have been increased to a maximum of 15% for all employees.

Overall ODI performance over the last three years remains strong with >70% performance commitments being met, and a net reward being achieved over the three-year period. Per capita consumption in 2022-23 remained above the ODI target, as it was impacted by increased consumption during Covid, and the water quality ODI measure, which was not met in 2021-22, was recovered in 2022-23. The Board noted the improvement plans on leakage and per capita consumption but concluded that overall performance supported payment of a dividend.

Full details of ODI performance are outlined in the 2022-23 Annual Performance Report which can be found on our website.

Financial resilience over the longer term

Totex performance has been considered in approving the dividend payment. The Board were satisfied that actual and projected expenditure is expected to be in line with forecast and within the PR19 final determination cost allowance. Underlying regulatory gearing was 64% after taking account of the Havant Thicket Cost Adjustment Mechanism increased totex and within the limits set in the Gearing Outperformance Sharing Mechanism.

The Board considered whether the dividend paid should be adjusted to reflect the RCV growth in AMP7 but were satisfied that the £20m equity and future equity commitments supported maintaining a dividend policy of a 4% yield on regulated equity. Subsequently Portsmouth Water investors have confirmed a further £150m equity commitment (£170m in total) to support the increased costs of Havant Thicket and £120m was received in first half year of 2023-24.

The Board noted the successful financing exercise conducted to finance Havant Thicket. The confirmation of £340m of new debt facilities and £150m of additional committed equity ensures financeability tests on medium-term liquidity and financial viability have been met and financial performance was in line with expectations.

The Board also considered compliance with the regulatory licence, including Licence Condition P clauses on dividend policy and credit ratings / cash lock up and licence Condition F Regulatory Accounting Statements. The dividend payment is subject to agreeing a licence derogation to maintain a single credit rating (now received from Ofwat).

In considering whether it is prudent to make dividend payments the Board reviewed whether the headroom in financing plans and the level of equity deployed was sufficient to support a dividend payment during construction of the Havant Thicket reservoir. The Board's conclusion was that payment of a dividend is appropriate.

Adjustment to dividend paid

One adjustment was made to the dividend paid in line with our stated dividend policy.

- The base dividend was reduced by £0.994m for interest payments from intercompany debt with holding companies within the group.
- No adjustment was made to the dividend in relation to ODI performance.
- A net ODI reward was included in charges for 2023-24 based on performance in 2021-22. However, the Board did not recommend any adjustment to dividend at this stage, with ODI performance in respect of 2022-23 to be considered following publication of Ofwat's final determination of in-period ODIs in November 2023.

Dividend Yield

Regulatory gearing and calculated dividend yield for 2023-24, as reported in Table 4H, is 49% and 1.8% respectively based on the PR19 Final Determination.

The calculations do not reflect the increased Totex allowance agreed with Ofwat through the Cost Adjustment Mechanism for Havant Thicket that concluded in January 2023. The result is that regulatory gearing is overstated for 2023-24 as additional debt supporting investment is reflected in the calculation without recognising an increase in RCV (the RCV will be recognised in a midnight adjustment at PR24).

As shown below, restating the gearing and dividend yield for the additional Totex funding results in regulatory gearing of 33% and a dividend yield of 0.9% (below the PR19 guidance of a 4% yield). We have included additional information in table 4H to reflect the adjusted calculations for information. Further information on the cost adjustment mechanism can be found here:

https://www.ofwat.gov.uk/wp-content/uploads/2022/12/Havant-Thicket-CAM-final-decision-document.pdf

DIVIDEND POLICY

Dividend workings for 2023-24 (paid in year)

Dividend calculations		2022-23
	Total: Average RPI inflated RCV (year average) - nominal (year average prices)	£81.107m
	Total: Average CPIH inflated RCV (year average) - nominal (year average prices)	£76.633m
	Total: Average post 2020 investment RCV (year average) - nominal (year average prices)	£50.750m
	Total: Average total RCV (year average) - nominal (year average prices)	£208.489m
	Regulatory equity notional (PR19FD)	40%
	Regulatory equity notional (PR19FD)	£83.396m
	Dividend yield (per dividend policy)	4%
	Base Dividend - Return on Regulated Equity	£3.336m
	Base Dividend - Recirculating Dividend	£0.000m
	Base Dividend	**£3.336m**
Less	Adjustment for intercompany interest payable to holding companies	(£0.994m)
Less	Adjustment for in-period Outcome Delivery Incentive penalties	£0.000m
Add	Adjustment for in-period Outcome Delivery Incentive rewards accumulated	£0.000m
Other	Performance against commitments to customers and stakeholders*	
Other	Financial performance supports dividend payment	
Other	5-year Totex expected within PR19 Financial Determination limits	
Other	Regulatory gearing within limits of PR19 Gearing Outperformance Sharing Mechanism	
Other	Financial resilience: Medium term liquidity / Financial Viability Tests	
Other	Regulatory licence compliance	
	Dividend Declared For Year	**£2.342m**
	Interim Dividend - Return on Regulated Equity	£0.000m
	Interim Dividend - Recirculating dividend	£0.000m
	Interim Dividend Paid/Proposed	**£0.000m**
	Final Dividend - Return on Regulated Equity	£2.342m
	Final Dividend - Recirculating dividend	£0.000m
	Final Dividend (paid in following year)	**£2.342m**

* See the 2022-23 Annual Performance Report for further details

Dividend yield calculations		2022-23
	Dividend Paid - Return on Regulated Equity	£2.342m
	Dividend Paid - Recirculating Dividend	£0.000m
	Dividend Paid in Year	**£2.342m**
PR19 Final Determination		
	Closing RCV - Water Resources	£9.792m
	Closing RCV - Water Network +	£195.171m
	Closing RCV - Havant Thicket	£50.713m
	Closing RCV - Total	**£255.676m**
	Actual gearing (RAR per stats & PR19 RCV)	48.99%
	Net debt	£125.258m
	Actual equity	£130.418m
	Actual yield	**1.80%**
PR19 Final Determination and Cost Adjustment Mechanism		
	Closing RCV - Water Resources	£9.792m
	Closing RCV - Water Network +	£195.171m
	Closing RCV - PR19 Havant Thicket	£50.713m
	Closing RCV - Havant Thicket CAM additional RCV (recognised at PR24)	£128.909m
	Closing RCV - Total	**£384.585m**
	Actual gearing	32.57%
	Net debt	£125.258m
	Actual equity	£259.327m
	Actual yield	**0.90%**

Cost Adjustment Mechanism RCV Increase		2022-23
	CAM RCV Adjustment, Real 2017-18 Prices	£98.578m
	CPIH Index (closing)	136.28
	CPIH Index (actual) - FYE - Inflate from FYE 2017-18	130.8%
	CAM RCV Adjustment, Nominal	**£128.909m**

Dividend declared for 2023-24 (to be paid in July 2024)

The Board have declared a dividend relating to performance in 2023-24 of £3.223m. No interim dividend relating to financial year 2023-24 was paid in year so the full amount is expected to be paid in July 2024.

The dividend does not include a recirculating element as the intercompany loan structure was unwound in 2023. Portsmouth Water's investor Ancala has committed £170m of further equity to support Havant Thicket reservoir development. The initial £20m was received in February 2022 and a further £120m was received into the group in July 2023, £60m has been deployed as new equity and the remaining amount has been used to repay the intercompany loan to South Downs Limited. The final £30m is anticipated to be drawn down later in 2024.

In making this dividend recommendation the Directors have carefully considered the relevant factors and believe a 4% dividend yield is appropriate, given that RCV growth is supported by new shareholder equity. Calculation of the dividend is set out in the table on pages 32 and 33.

Performance for customers and the environment

The Board assessed company performance for customers and the environment before determining that a dividend can be paid. Performance has been assessed over a rolling three-year period.

DIVIDEND POLICY

Performance	Measure	2021-22	2022-23	2023-24
Customer service	C-Mex Rank	3rd	2nd	1st
Developer service	D-Mex Rank	3rd	2nd	9th
Written complaints	Complaints per 10k connections	✓	✓	✓
Leakage	ODI Target	✓	✗	✗
Interruptions to supply	ODI Target	✓	✓	✓
Vulnerable customers	Priority Services Register / Social Tariff	✓	✓	✓
Sustainable abstraction	Abstraction Incentive Mechanism	✓	✓	✓
Community commitments		✓	✓	✓
Health & Safety	RoSPA accreditation	✓	✓	✓
Pensions	Scheme in surplus	✓	✓	✓
ODI	Overall ODIs achieved	18/26	19/26	20/26

In deciding to declare a dividend the Board were satisfied that Portsmouth Water had consistently delivered on its commitments to customers and the environment. Customer experience for households has been upper quartile in each year and for 2023-24 C-Mex performance is the best in the sector. Our ranking on the D-Mex measure of service to developers has deteriorated in the year but remains average for the sector. The deterioration is because we failed to issue a number of new mains quotations and designs within the target time. The significant change in our position is partly reflective of the small number of interactions with developers we work with, compared to larger companies, as a small change in performance can have a large impact on our ranking.

The number of complaints per 10,000 connections remains extremely low compared to our peers, despite a small increase in the year from 669 to 754.

Customer interruptions have been the lowest in the industry through the period and performance for 2023-24 was the best performance in recent years. Performance commitments in relation to the Priority Services Register, social tariffs and Abstraction Incentive Mechanism have been met, along with delivery on our community commitments supporting local STEM fairs, single use plastic campaigns and engagement on Havant Thicket.

The Ofwat leakage target was missed for the second time this regulatory cycle. Leakage initially increased in 2022-23 as a result of very dry conditions followed by severe winter weather and following this a recovery programme was implemented. While we have not met the target, which is based on a three-year average calculation, leakage has reduced during the year from 32.2 Ml/d to 28.2 Ml/d, a reduction of 12%. Not meeting the leakage target has had no direct impact on customers and we have not had to put in place any usage restrictions. The Board therefore concludes that missing the leakage target should not result in an adjustment to dividends beyond the impact on the overall ODI penalties, especially in the light of the success of the recovery programme.

The Board takes a wider assessment of performance and considers health and safety and pensions as indicators of social responsibility. In the past three years the defined benefit pension scheme has remained in surplus and RoSPA accreditation has been maintained. The pensions scheme has been closed to future accrual; all employees have transferred to the defined benefits scheme and employer contributions have been increased to a maximum of 15% for all employees.

Overall ODI performance over the last three years remains strong with >70% performance commitments being met, and a net reward being achieved over the four years of the regulatory period. Per capita consumption remained above the ODI target, as it was impacted by increased consumption during Covid and has remained above target. The smart metering programme in AMP8 will be the key to unlocking consumption reduction in future.

The Board also considered the increase in the CRI water quality score in the year. It noted that the increase in the CRI score was driven principally by issues with sampling equipment at our Farlington water treatment works and did not reflect the quality of water received by customers. Having considered the root causes of the increase in the CRI score, the fact that there was no impact on the water quality received by customers and the corrective action that has been taken, the Board concluded that no further adjustment to dividends, beyond that arising from the ODI penalty of £0.8m, was appropriate.

Financial resilience over the longer term

Totex performance has been considered in approving the dividend declaration. The Board were satisfied that actual and projected expenditure remains in line with forecast and within the PR19 final determination cost allowance. Underlying regulatory gearing was 33% after taking account of the Havant Thicket Cost Adjustment Mechanism increased Totex, and within the limits set in the Gearing Outperformance Sharing Mechanism.

The Board considered whether the dividend paid should be adjusted to reflect the level of RCV growth in AMP7 but were satisfied that the extent of the equity commitments made by shareholders to support the construction of the Havant Thicket reservoir – a total of £170m - supported maintaining a dividend policy of a 4% yield on regulated equity.

The Board is satisfied that following the successful financing exercise conducted in 2022-23 with confirmation of £340m of new debt facilities and £170m of committed equity ensures financeability tests on medium-term liquidity and financial viability have been met and financial performance was in line with expectations.

The Board has noted the potential for an additional financing requirement to fund changes in the scope of the Havant Thicket reservoir scheme to support Southern Water's water recycling project, which will require adjustments to the reservoir pipeline and reservoir inlet. These changes will be subject to a regulatory process during 2024 and any additional funding requirements, including the need for additional equity, will be considered as part of that process. The Board is satisfied that, based on the current agreed project scope, appropriate funding and facilities are in place to support delivery of the current scheme.

The Board also considered compliance with the regulatory licence, including Licence Condition P clauses on dividend policy and credit ratings / cash lock up and licence Condition F Regulatory Accounting Statements. It is satisfied that there are no compliance issues which would impact the payment of any dividend.

In considering whether it is prudent to make dividend payments the Board reviewed whether the headroom in financing plans and the level of equity deployed was sufficient to support a dividend payment during construction of the Havant Thicket reservoir. The Board's conclusion was that payment of a dividend is appropriate.

Adjustment to dividend paid

One adjustment was made to the dividend declared in line with our stated dividend policy.

- The base dividend was reduced by £0.604m for intercompany interest and £0.054m in relation to ODI performance following confirmation of the net penalty in Ofwat's final determination of ODIs for 2022-23 in November 2023.
- Brought forward net rewards from the first two years of AMP7 were £1.004m; an increase to base dividend for £0.054m has been applied to offset the net penalty for 2022-23.
- The Board has not recommended any adjustment to dividend at this stage in relation to 2023-24 performance but noted that we expect to apply an adjustment to reflect a net ODI penalty for 2023-24 performance when Ofwat publish their ODI final determination in November 2024.
- The Board believe it appropriate to apply adjustments to dividends in the year that penalties are reflected in customer charges. This ensures dividends reflect performance for the customer and environment but also ensure that investors are sighted to changes to earnings and ensures it can be reflected in forward planning.
- We anticipate the net adjustment to 2024-25 dividends will be a reduction of £0.3m.

ODI Reward / Penalty	2020-21	2021-22	2022-23	2023-24	2024-25
ODI reward b/f	£0.000m	£0.000m	£0.360m	£0.934m	£0.950m
Indexation		£0.000m	£0.032m	£0.070m	£0.025m
Ofwat ODI Final Determination (November in following year)		£0.889m	£0.543m	(£0.054m)	(£1.265m)
Penalty adjustment to dividends		£0.000m	£0.000m	£0.054m	£1.265m
Reward adjustment to dividends		(£0.529m)	£0.000m	(£0.054m)	(£0.975m)
ODI reward c/f	**£0.000m**	**£0.360m**	**£0.934m**	**£0.950m**	**(£0.000m)**

DIVIDEND POLICY

Dividend workings for 2023-24 (declared to be paid in July 2024)

Dividend calculations		2023-24
	Total: Average RPI inflated RCV (year average) - nominal (year average prices)	£83.197m
	Total: Average CPIH inflated RCV (year average) - nominal (year average prices)	£77.350m
	Total: Average post 2020 investment RCV (year average) - nominal (year average prices)	£79.245m
	Total: Average total RCV (year average) - nominal (year average prices)	£239.792m
	Regulatory equity notional (PR19FD)	40%
	Regulatory equity notional (PR19FD)	£95.917m
	Dividend yield (per dividend policy)	4%
	Base Dividend - Return on Regulated Equity	£3.837m
	Base Dividend - Recirculating Dividend	£0.000m
	Base Dividend	**£3.837m**
Less	Adjustment for intercompany interest payable to holding companies	(£0.604m)
Less	Adjustment for in-period Outcome Delivery Incentive penalties	(£0.054m)
Add	Adjustment for in-period Outcome Delivery Incentive rewards accumulated	£0.054m
Other	Performance against commitments to customers and stakeholders	
Other	Financial performance supports dividend payment	
Other	5-year Totex expected within PR19 Financial Determination limits	
Other	Regulatory gearing within limits of PR19 Gearing Outperformance Sharing Mechanism	
Other	Financial resilience: Medium term liquidity / Financial Viability Tests	
Other	Regulatory licence compliance	
	Dividend Declared For Year	**£3.233m**
	Interim Dividend - Return on Regulated Equity	£0.000m
	Interim Dividend - Recirculating dividend	£0.000m
	Interim Dividend Paid/Proposed	**£0.000m**
	Final Dividend - Return on Regulated Equity	£3.233m
	Final Dividend - Recirculating dividend	£0.000m
	Final Dividend (paid in following year)	**£3.233m**

Dividend yield calculations		2022-23
	Dividend Paid - Return on Regulated Equity	£2.342m
	Dividend Paid - Recirculating Dividend	£0.000m
	Dividend Paid in Year	**£2.342m**
PR19 Final Determination		
	Closing RCV - Water Resources	£9.792m
	Closing RCV - Water Network +	£195.171m
	Closing RCV - Havant Thicket	£50.713m
	Closing RCV - Total	**£255.676m**
	Actual gearing (RAR per stats & PR19 RCV)	48.99%
	Net debt	£125.258m
	Actual equity	£130.418m
	Actual yield	**1.80%**
PR19 Final Determination and Cost Adjustment Mechanism		
	Closing RCV - Water Resources	£9.792m
	Closing RCV - Water Network +	£195.171m
	Closing RCV - PR19 Havant Thicket	£50.713m
	Closing RCV - Havant Thicket CAM additional RCV (recognised at PR24)	£128.909m
	Closing RCV - Total	**£384.585m**
	Actual gearing	32.57%
	Net debt	£125.258m
	Actual equity	£259.327m
	Actual yield	**0.90%**

Cost Adjustment Mechanism RCV increase		2022-23
	CAM RCV Adjustment, Real 2017-18 Prices	£98.578m
	CPIH Index (closing)	136.28
	CPIH Index (actual) - FYE - Inflate from FYE 2017-18	130.8%
	CAM RCV Adjustment, Nominal	**£128.909m**

Dividend declared for 2023-24 (to be paid in July 2024)

The Board have declared a dividend relating to performance in 2023-24 of £3.223m. No interim dividend relating to financial year 2023-24 was paid in year so the full amount is expected to be paid in July 2024.

The dividend does not include a recirculating element as the intercompany loan structure was unwound in 2023. Portsmouth Water's investor Ancala has committed £170m of further equity to support Havant Thicket reservoir development. The initial £20m was received in February 2022 and a further £120m was received into the group in July 2023, £60m has been deployed as new equity and the remaining amount has been used to repay the intercompany loan to South Downs Limited. The final £30m is anticipated to be drawn down later in 2024.

In making this dividend recommendation the Directors have carefully considered the relevant factors and believe a 4% dividend yield is appropriate, given that RCV growth is supported by new shareholder equity. Calculation of the dividend is set out in the table on pages 32 and 33.

Performance for customers and the environment

The Board assessed company performance for customers and the environment before determining that a dividend can be paid. Performance has been assessed over a rolling three-year period.

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