PR19 Business Plan Presentation Pro-forma – August 2018 update

Briefing for Ofwat Non-Executive Directors and senior leadership

As indicated in our final methodology for the 2019 price review (PR19) published in December, this pro-forma draws together high level information and key metrics from the business plan and explains the drivers behind the business plan, the key benefits for customers and the impact on customer bills.

The pro-forma has been developed to support discussion at the PR19 business plan presentations taking place during September-October 2018, and to ensure a consistent approach across companies to briefing Ofwat board members for these. The pro-forma will be provided to Ofwat Board members and senior leadership ahead of these presentations. These presentations will not form part of our initial assessment of business plans process, nor are a substitute in any way for business plans.

The presentations are scheduled for an hour, with a presentation of 15 minutes followed by up to 45 minutes for questions and discussion. These presentations provide an opportunity for companies to set out their business plans to Ofwat, including Ofwat Board members. **We do not expect companies to use this pro-forma as the basis for the presentation itself.**

For PR19, we expect companies to deliver an ambitious business plan that delivers on our four key themes of innovation, great customer service, affordability and increased resilience. We are expecting companies to challenge themselves in these areas, and this pro-forma and the business plan presentations provide an opportunity for companies to demonstrate how they are meeting this challenge.

Guidance on completing the pro-forma

To support companies in completing this pro-forma, we have published guidance tables which include references to the relevant PR19 business plan tables to draw the information requested from. Where the information requested is not held in PR19 business plan tables, we have indicated where this should be drawn from by companies (for example, the PR14 final determination). The PR19 bill movement model has also been published in order to complete the bill movement waterfall chart (table 2.1).

Submission of pro-forma to Ofwat

We expect companies to submit the completed pro-forma, guidance tables and PR19 bill movement model to Ofwat along with PR19 Business Plans by 5pm Monday 3 September 2018.

Publication of the completed pro-forma

As outlined in our final methodology, to improve transparency we want companies to make their business plans available to us, companies, customers, stakeholders and other regulators. We therefore expect them to publish the whole of their business plans at the same time as they submit their plans to us in September 2018. We ask that companies publish their completed pro-forma, guidance tables and PR19 bill movement model alongside their business plans as well as submitting these to us on 3 September 2018.

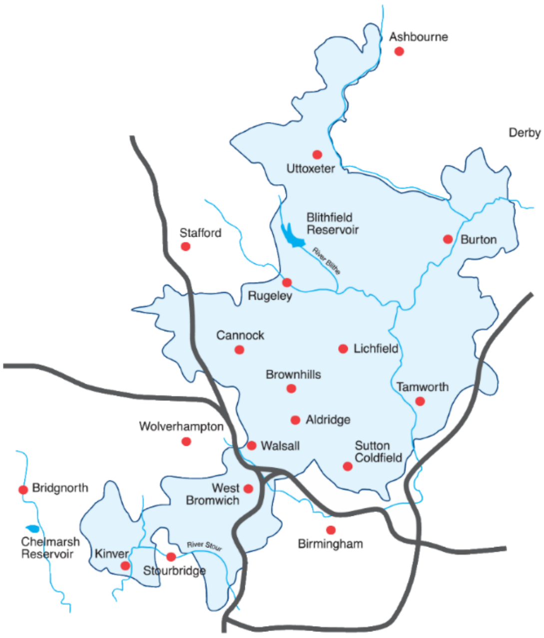
If a company considers some information should not be published – because it is commercially sensitive information, for example – then the company will need to provide its stakeholders and us with strong, robust reasons that are specific to the information concerned.

Contents

1. Background

1.1 Company pen pic

South Staffordshire Water is a water only company located in the Midlands with an area of supply broadly ranging from the urban Black Country in the south to the more rural southern Peak District in the North. Cambridge Water is our regional brand for the Cambridge area where we supply the city of Cambridge and its largely rural surrounding area.



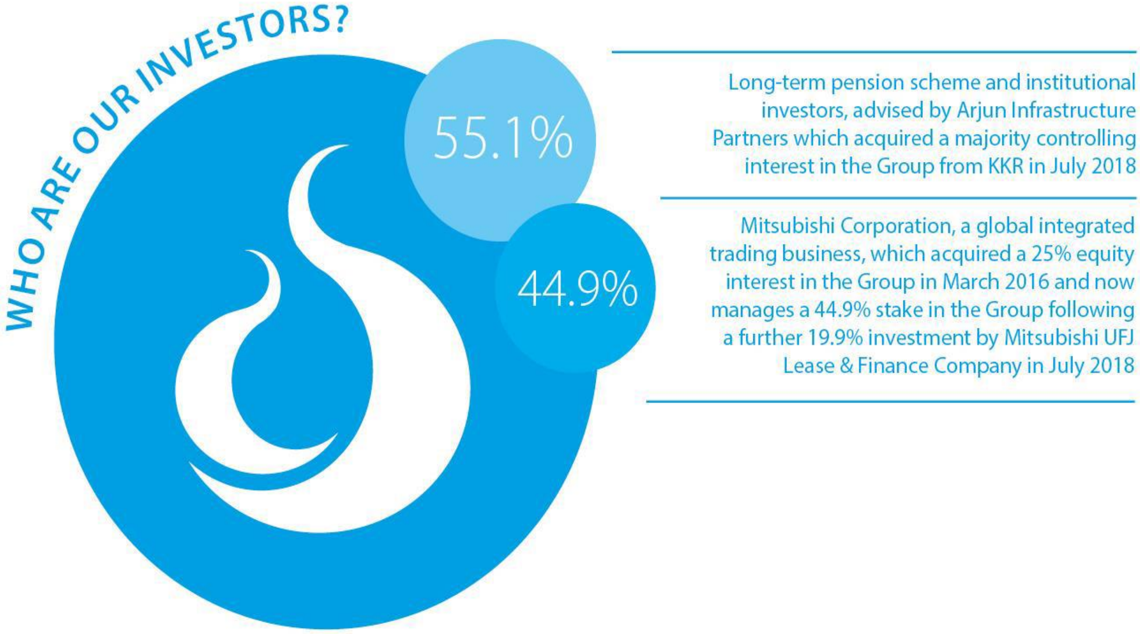
South Staffordshire

- 1,490 km^2
- Approx. 1.3million population served
- Three main sources
    - Blithfield Reservoir
    - River Severn
    - Borehole sources across the region

Cambridge

- 1,173 km^2
- Approx. 0.3 million population served
- All water sourced from boreholes

On 3 July 2018 the Global Infrastructure Fund of KKR together with its co-investors, sold their 75% equity stake in the Group which they had held since 2013 to pension funds and other institutional investors advised and managed by Arjun Infrastructure Partners Limited. These investors then sold a 19.9% stake to Mitsubishi UFJ Lease and Finance Company with Mitsubishi Corporation retaining its 25% interest.



1.2 List of attendees

Sir James Perowne
Independent Chairman
South Staffordshire Water PLC

Adrian Page
Group Chief Executive
South Staffordshire PLC

Phil Newland
Managing Director
South Staffordshire Water PLC

Caroline Cooper
PR19 Programme Lead
South Staffordshire Water PLC

Simon Sperryn
Chairman
Independent Customer Panel (Customer Challenge Group)

2. Key business plan metrics

PR19 key themes

Please set out here how you consider the approach you have taken to your business plan is consistent with the key themes for PR19 of innovation, great customer service, affordability and increased resilience. Where relevant, you may wish to additionally link this to information included elsewhere in this pro-forma [max. 300 words].

We are confident that our plan addresses these themes and, based on our research, they resonate strongly with our customers too.

We think innovation for a company of our size is mainly about having the right culture. For example, the Curapipe innovation from Israel came through a member of the team who had seen the idea and passionately advocated it. The proposal to functionally separate our household retail business was originally an idea based upon a review of the NHH market design and a belief that we could extract benefit from it for our household service too. The idea to open a highstreet location and embed ourselves in one of our most challenged communities supporting customers face to face came from customer feedback.

Our customer service strategy here has been to utilise technology whereever we can to offer customers choice and convenience. Apps, voice assistants, bots, and artificial intelligence are all in our plans. However some customers tell us that digital services are not for them and they are just as legitimate a group, albeit a more expensive one to look after. Great service that's great for all is our goal here.

We are making real progress with affordability. Our bills are already low. We are proposing to keep them flat for five years. We are doubling the number of customers we support and are using new technology and data services to spot early signs of financial distress and provide more equality through better void and gap management.

For resilience we have developed a whole new approach in partnership with Arup. It gives us our 'resilience lens' through which we can measure and weigh up current and proposed resilience benefits in all their various forms. Our proposed cost adjustment claim will transform resilience at our two main treatment works too.

Table 2.1: Waterfall chart

This chart provides an overview of what is driving changes to bills between 2019-20 and 2024-25. The inputs to the waterfall chart are in price base 2017-18 year average CPIH deflated. We have published the PR19 bill movement model in order for companies to developed the waterfall chart.

Inputs	**£ per customer**
2019-20 Bill	**140**
Changes between 2019/20 and 2024/25	
Change in RCV	9
Change in RCV run-off	0
Change in WACC	-2
Change in customer numbers	-9
Change in totex	7
Change in PAYG rate	-1
Change in other wholesale items	-8
Change in retail CTS	-8
Change in reconciliation items	-3
2024-25 Bill	**125**

Explanation of movement in customers' bills

Please set out the key factors that are driving the movement in customers' bills from PR14 to PR19 [max. 200 words].

Customer bills in real terms are falling by £15 or 11% from £140 to £125.

£8 of the reduction is as a result of significant cost savings achieved during the current period in our residential retail business, driven by the merger of our Cambridge and South Staffs call centres and billing systems.

A further £9 of the reduction is due to the 9% increase in the customer base. We are expecting signifcant housing growth over the period, particularly in the Cambridge region.

Other wholesale items reduce bills by £8 with £5 as a result of the reprofiling of bills and £3 from lower tax and pension costs.

The reduction in WACC at PR19 using Ofwat's current view set out in the final methodology reduce bills by a further £2.

Our totex proposals result in a £7 increase in customer bills. Our proposed upgrade of our two treatment works in the South Staffs region is projected to increase bills by £3 over the period.

Finally, RCV growth over the period contributes an extra £9 to the customer bill. We have used a natural RCV run-off and PAYG rate over the period.

Customer Expectations

Please provide a brief summary of your understanding of your customers' expectations and preferences for your business plan. [max 300 words].

From reviewing all the feedback from our robust new approach to engagement, the core "hygiene factors" which customers are trusting us to deliver on are listed below. The top two areas are most important to all our customers:

- having a clean, high-quality and reliable water supply;
- having bills that are fair, accurate and affordable with no unexpected changes. They want their water service to represent genuine value for money;
- receiving great customer service whenever we interact with them;
- reducing leakage on our network of pipes;

- protecting the natural environment. Our engagement has picked up that this areas has become increasingly important to customers this year; and
- helping those customers who may need extra support – both through financial support and other support when needed (e.g. bottled water during a supply interruption).

Beneath these core priority areas sit other important priorities, which emerged consistently as future "hygiene factors":

- giving customers more control of their water usage and providing education on how to use water responsibly, particularly for the younger generations;
- planning for population growth and managing the impact of climate change to always ensure resilience of supplies;
- ensuring affordability of bills vs ensuring long-term resilience of assets to meet future demand;
- meeting the challenge of rising energy costs by lowering our carbon footprint; and
- investing in innovation to drive improvements, both operationally and the service experience.

We have seen these "hygiene" priority factors come through strongly time after time, such as in our Willingness to Pay valuations and the level of service stretch wanted in our Performance Commitment targets. Our extensive engagement with household customers around their expectations for what great service looks like, shows they expect a wide range of user friendly communications channels to access our services whenever they went on their terms – whether that's face-to-face or an app.

Table 2.2: Key business plan metrics

Metric	PR14 (2019-20) 31 March 2020 estimate	PR19 (2024-25) 31 March 2025 estimate	2019-20 to 2024-25 % change (leakage and PCC)
Number of residential water only customers (000s)	686.221	732.251	
Number of residential wastewater only customers (000s)	N/A	N/A	
Number of residential water and wastewater customers (000s)	N/A	N/A	
Total leakage (Ml per day) Based on PR19 definition, annual average	84.0	64.4	-23.3%
Leakage (cubic metres per km of main per day) Based on PR19 definition, annual average	9.71	7.14	-26.5%
Leakage (litres per property per day) Based on PR19 definition, annual average	111.41	81.03	-27.3%
Per Capita Consumption (PCC) Based on PR19 definition, annual average	132.3	130.1	-1.6%
ODI RoRE range	-2.0% / +0.7%	-1.1% / +1.0%	
Appointee WACC (real RPI)	3.54%	2.41%	
Appointee WACC (real CPIH)	4.56%	3.41%	
Credit rating – actual financial structure	Baa2 (Moody's)	Baa1 (Moody's)	
Metric	**PR14 (2015-2020 Average)**	**PR19 (2020-25 Average)**	
Adjusted interest cover notional	2.2x	1.4x	
FFO net debt notional	18.9%	11.9%	
Metric	**2017-18 Actual**	**PR19 (2020-25 Average)**	
Actual gearing (covenant debt)	66%	68%	
Adjusted interest cover actual	2.8x	1.8x	
FFO net debt actual	15.2%	12.0%	

Note: The above leakage and PCC values are combined for the South Staffs & Cambridge regions.

Commitment to financial resilience

Please set out here how you will maintain commitment to financial resilience [max. 150 words].

We have considered our business plan and applied a wide range of stress tests, up to 2025 and beyond to 2030.

We have stress tested our capital investment, operational and inflation rate fluctuations amongst others. And we have stress tested our operations against real-world experiences – specifically the freeze/thaw event earlier this year and the prolonged hot, dry spell that followed.

Our Board has considered the impact of all our stress tests on our ability to maintain our key financial metrics, including our credit ratings with Moody's and Standard & Poor's, as well as our ability to service debt. Based on the financial projections, stress tests and the mitigations we have put in place, we are satisfied overall that although our circumstances are more challenging than previously, we are financeable and able to absorb stresses to our business. The Board will keep our position under regular formal review during the period.

Table 2.3: RCV - PS

Control	1 April 2020 (£m) Opening RCV 2017-18 FYA (CPIH deflated)	30 March 2025 (£m) Closing RCV 2017-18 FYA (CPIH deflated)	% growth
Water resources RCV	13.6	22.4	64%
Water network Plus RCV	358.3	429.1	20%
Wastewater network Plus RCV	n/a		
Bioresources RCV	n/a		

Table 2.4: Dividends - PS

Metric £m Outturn (nominal prices)	2015-16	2016-17	2017-18		
Dividends (based on PR14 actual company structure)	6.1	8.5	15.4*		
Outturn (nominal prices)	2020-21	2021-22	2022-23	2023-24	2024-25
Dividends (based on PR19 actual company structure)	5.8	6.0	6.0	6.0	6.0

*includes £8.4m from the sale of the NHH retail business

Dividend Policy

Please provide a short statement here on your company's dividend policy [max. 150 words].

We are also mindful of the challenges set out in Ofwat's position statement around dividend yields and gearing.

Our Board has agreed and incorporated into our plan a base dividend yield of only 2% a year on average for our appointed activities with a policy of up to 3% yield. Our Board is committed to maintaining a strong balance sheet and this will maintain our gearing below 70% (based on covenant debt), despite the very significant level of investment being carried out over the lifetime of this plan. We anticipate that gearing should then reduce in the period beyond 2025 as the profile of our investment programme returns to a level that is closer to our historic norm.

3. Appendices

Appendix 1: Company presentation attendee biographies

Please include biographies for all company presentation attendees, including the Customer Challenge Group Chair (if attending).

[Max. 100 words per attendee]

Sir James Perowne – Independent Chairman – South Staffordshire Water PLC

Appointed Independent Chairman in April 2017, and an Independent Non-Executive Director since January 2011. Sir James spent 37 years in the Royal Navy where he was appointed Flag Officer Submarines in 1996 and also served as Deputy Supreme Allied Commander Atlantic in NATO. He was Chairman of the Central Region of the Consumer Council for Water serving for 8 years prior to joining South Staffordshire Water. James is Constable and Governor of Windsor Castle.

Adrian Page – Group Chief Executive – South Staffordshire PLC

Appointed as a Director in July 1998. Adrian was appointed as Group Chief Executive for South Staffordshire Plc in January 2013 having been Group Finance Director since April 2004. Previously he was Group Finance Director of South Staffordshire Group Plc from1998 to 2002 and with ACT Group and KPMG.

Phil Newland – Managing Director – South Staffordshire Water PLC

Appointed as Managing Director in April 2014. From 2006 Phil worked within the South Staffordshire Plc Group as Managing Director of Echo Managed Services Ltd supplying technology and retail services to the water industry. Previously Phil was a Management Consultant with Automatic Data Processing (ADP) and Terence Chapman Associates. Before that Phil was a software engineer.

Caroline Cooper – PR19 Programme Lead – South Staffordshire Water PLC

Caroline joined South Staffs Water in 2003. Appointed as PR19 Programme Lead in 2016 having been Head of Asset Management and prior to that an Asset Management Analyst. Previously she was an Analyst with Severn Trent Water. Caroline has an MA in Water and Environmental Management.

Simon Sperryn – Chairman – Independent Customer Panel (Customer Challemge Group)

A career at the interface between business and government; for 30 years Chief Executive of Chambers of Commerce and professional bodies, including London Chamber of Commerce, Lloyd's Market Association, and the Chartered Institute of Purchasing and Supply; during that time, Chairman or Board member of local and regional organisations in economic development, education and training, small business support, policing and the arts; more recently Independent Assessor for national accreditation by British Chambers of Commerce, and mentor to CEOs of not-for-profits organisations.

Appendix 2: Business plan executive summary

Please provide a copy (in file formats that can be opened in word) of the executive summary for your business plan.

Executive summary

Everything we do starts and ends with our customers. They trust us to always deliver high-quality water services that represent good value for money. They also want bills that are fair and affordable. At the same time, we are keenly aware of the role we play in the economy and society. We have a responsibility to maintain and improve public health, encourage economic development, and protect and enhance the environment for current and future generations. So, we have gone further than ever before to 'co-create' with our customers an ambitious and stretching business plan for 2020 to 2025 and beyond that delivers what they want while also enabling us to meet these wider objectives.

We are continually striving to do more for our customers, challenging ourselves to provide them with the services they pay for and meet their rising expectations. Between 2020 and 2025, we will invest and spend £590 million to deliver a significant improvement in service our customers have told us they want. At the same time, we will give them certainty and stability by keeping bills flat for five years. We are starting from a strong position. Our current performance – with a net reward position – shows that we can be relied on to deliver the plan our customers want. In addition, our performance during this year's freeze/thaw event and the prolonged hot, dry spell that followed it demonstrates that we are resilient to a range of extreme situations in terms of our responsiveness and recovery.

We are also proud that our business is a leader on cost. So, we will continue to be at the leading edge of water companies in England and Wales in terms of the efficiency of our business and the low bills our customers pay. This will be accompanied by a set of performance promises for our customers that we are confident will place us among the very best in the water sector.

At a glance

We are an efficient, ambitious yet conservatively financed provider of an essential public service. Our gearing is one of the lowest in the sector. We have the **3rd** lowest bills in the sector at **23%** below the average. We have a strong track record and are an upper quartile performer on costs and on core service provision. We have reduced our retail costs by **20%** since 2015.

Our plans are ambitious; based on what our customers have told us they want, we will deliver the highest level of water quality without interruption or restriction, targeting upper quartile on all core performance commitments. We will reduce leakage in our two regions by **25%** and **15%**. Our targeted supply interruptions performance is **31%** less than the current level. Our water quality customer contacts will improve by **35%**.

Our overall investment programme is our largest ever – **40%** greater than the current period.

We will also invest **£63 million** in our two largest treatment works to deliver for our customers delivering substantial improvements in water quality and resilience – never envisaged in their original designs. **83%** of our customers support this investment as well as having formal support from the Drinking Water Inspectorate.

We will pay an appointed dividend of just **2%** and maintain our gearing at below **70%** and our credit ratings at investment grade despite a substantial increase in investment.

We will maintain a flat average nominal bill of **£144** through the period delivering an **11%** real terms reduction and giving customers the certainty they asked for.

Our plans are supported by **84%** of our household customers and **84%** of non-household customers.

Understanding the things that matter to our customers

Engaging with our customers is really important to us. So, we have made a step change in our approach to customer engagement – focusing our attention on talking with and listening to our customers to really understand what they want. In developing this plan, we have engaged with more than 40,000 customers directly. We have also set up a Young Innovators' Panel, enabling us to engage directly with future customers. And we have used a far wider range of techniques to engage with our customers, including in-depth interviews, focus groups, online surveys, and innovative role-playing exercises. This has given us a clear view of the things that matter most to customers. These are:

- having clean, high-quality and reliable water supplies;
- having bills that are fair, accurate and affordable;
- receiving great customer service;
- reducing leakage on our network of pipes;
- protecting the natural environment;
- helping those customers who may need extra support.

We know what our customers want. These priorities are at the heart of our business plan. They are how we are making water count.

Our promises to our customers

This plan focuses on outcomes, which are the promises we have made to our customers on the services they want us to deliver. These are set out below.

To ensure we maintain their trust in us, it is vital we deliver these promises. So, we have developed 28 'performance commitments', which are the areas where they have said they want to hold us to account. They have helped us to design them. We have set ambitious and stretching targets for each of these commitments, which go much further than we have before.

Our Board, has set the ambition, strategic direction and ensured it is deliverable. The Independent Customer Panel (Customer Challenge Group) has scrutinised the strength and quality of our engagement with customers, and the shape of the plan that is the result of that engagement. Finally, we have cross-referenced our plan against the requirements of Ofwat's methodology for the 2019 price review. We are confident that it meets these. We have used all of these inputs and challenges to help us develop the best plan for our customers and our business.

Delivering the services our customers want

We will ensure that we always provide the clean, high-quality and reliable water supplies our customers have said they expect now and in the future, whatever challenges we face. So, we will invest more than £293 million in our assets over the lifetime of this plan.

This includes spending £63 million to upgrade our Hampton Loade and Seedy Mill water treatment works by adding an extra treatment stage and clean up to 100 km of trunk mains leaving both works. Together, these two treatment works supply water to nearly 60% of customers in our South Staffs region. As such, they are critical assets for us. This is an ambitious programme of investment that will substantially improve both the quality of the water and the resilience of the works. We have considered a number of options for this work and have the support of our customers and the Drinking Water Inspectorate for our planned investment.

Helping to move the water sector forward by delivering what our customers want – innovation

We have **launched a pioneering start-up project and opened a community hub** – placing ourselves in one of the most socially deprived parts of our South Staffs region. Through this project, we are engaging with customers face-to-face and building long-term, sustainable relationships with trusted local providers and community organisations. We plan to expand this work and will share the results with the rest of the sector and other key stakeholders.

Working with our supply chain, we are **bringing a new and innovative leakage technology** to the UK market – trenchless automated leakage repair (TALR) by Curapipe System Ltd. This technology enables leaks in water distribution pipes to be sealed from the inside without the need to dig up roads or use conventional lining techniques. We will be the first company in the sector to use this technology commercially and will share the results of this work with others.

And in another first, we will **functionally separate our household retail activities from our wholesale activities**. We think the non-household retail water market, which opened on 1st April 2017, has created a new dynamic in the sector that will also benefit household customers. Separating our retail and wholesale activities will create a sharper focus on the role each one has in delivering excellent services to customers and make them mutually accountable to one another.

Our customers have told us how important it is to them that we reduce leakage. So, we will invest £65 million to maintain our network of pipes. This includes significantly reducing leakage by 25% in our South Staffs region and by 15% in our better-performing Cambridge region. This is a challenging and ambitious reduction – we are confident that the measures set out in our plan will help us to achieve this. Our plans to reduce leakage are part of a wider programme to reduce water demand. Our customers want us to continue to protect the natural environment. This includes abstracting less water. So, we will invest £19 million to help them manage how much water they use. It also includes reducing the volume of water each person uses to 128 litres a day on average in our South Staffs region and 138 litres a day on average in our Cambridge region.

Our customers are at the centre of all our plans. We want to improve the experience they have with us and make the way they deal with us easy and straightforward. So, we will invest nearly £12 million a year to deliver exceptional customer service, enabling them to engage with us in a way that best suits their individual circumstances. This includes implementing a new debt management system and using technology to enable more self-service and improve proactive customer communications.

We want to be at the heart of the communities we serve and always do the right thing for our customers. By working in partnership with other organisations and sharing data more effectively, we can identify those customers who may need more support. Among other things, this will enable us to provide financial support by 2024/25 to 40,000 customers who are struggling to pay their bills.

Finally, we know that our business runs most effectively for customers when our people are happy and engaged, and our suppliers feel valued and are treated fairly. So, we will make ourselves accountable by monitoring and publishing the results of our employee engagement. In addition, we will achieve Investors in People accreditation by 2020/21. We will also make clear commitments to pay our suppliers fairly, with a particular focus on small businesses.

We are mindful of the challenges set out in Ofwat's policy statement on 'Putting the sector back in balance' around dividend yields and gearing, which is the ratio of a company's debt to the value of its equity capital. Our Board has agreed and incorporated into our plan a base dividend yield of only 2% a year for our appointed activities. Our Board is committed to maintaining a strong balance sheet and this will maintain our gearing below 70%[1], despite the very significant level of investment being carried out over the lifetime of this plan.

This plan is challenging. Our stress testing shows that the combination of the reduction in allowed returns and recent changes in debt rating guidance leaves no room for further regulatory tightening if the business is to maintain the strong investment grade credit quality and the access to the capital markets that is needed to fund the service improvements and bill levels that our customers want.

Keeping bills affordable

We know that our customers expect value for money for the services we deliver. They have also told us they want bills that are affordable and stable. In response to this, we have taken the step of keeping the amount they pay in their bills flat (what we call 'flat nominal bills'). During the period, we will take on the risk of inflation for our customers.

[1] Based on covenant levels of net debt.

Our typical nominal household water bill for each of the five years between 2020 and 2025 is **£144**. While this presents more of a challenge for our business, it means our customers will know that either the price of their unmetered water bill or that the price of each unit of water they use will stay the same. Our plan is ambitious, but it is set within the context of this certainty for customers, which is possible to implement by a simple licence change.

How our plan meets Ofwat's objectives and the UK Government's priorities

As a regulated water company, we have taken account of Ofwat's objectives of great customer service, affordable bills, resilience in the round and innovation in our plan. We have also been mindful of the UK Government's priorities for the water sector on protecting customers and securing long-term resilience, and have considered the wider objectives of other regulators – the Environment Agency and of the Drinking Water Inspectorate – and the Consumer Council for Water.

We firmly believe our plan meets these key objectives. For us, **great customer service** means enabling efficiency and ease through a rich set of online services alongside highly effective traditional communication channels while making sure we still take the time to provide a personal face-to-face service for those that need it. At the same time, we will keep bills **affordable**. So, as well as already having some of the lowest bills of any water company, we will increase significantly the number of customers we support.

In addition, we are increasing our overall **resilience** now and in the future through targeted investments and the use of an innovative technique for assessing resilience in the round and measuring improvements. And we will be **innovative** – looking at different ways of doing things so that our customers always get the best service we can provide them. This includes exploring new operating models, exploiting emerging technology through to tackling leakage in a new way.

Ours is a long-term business. We have been in private ownership providing an essential public service for more than 160 years. We are already looking ahead to 2025 to 2030. This means planning for future growth in our Cambridge region and the impact this will have on water resources, and looking at investment that our early modelling suggests we will need to make in our strategic mains network in our South Staffs region.

So, our plan for 2020 to 2025 and beyond is about making water count – for our customers, the communities we serve and the environment we all rely on and enjoy – now **and** in the future.

Appendix 3: CCG report executive summary

Please provide a copy (in file formats that can be opened in word) of the executive summary from the CCG report on your company.

SOUTH STAFFORDSHIRE AND CAMBRIDGE WATER CUSTOMER PANEL

INDEPENDENT REPORT TO OFWAT

EXECUTIVE SUMMARY

All water companies in England and Wales are required to establish an independent Panel, or Customer Challenge Group (CCG), to provide assurance to Ofwat that the company's five-year Business Plan has been the subject of effective customer engagement, and that customer preferences are reflected in the Plan. **This document** is the Panel's report to Ofwat, which is to accompany the PR19 Business Plan of South Staffs Water, incorporating Cambridge Water.

To ensure that this Report covers everything required of us, section 2 consists of a Compliance Matrix, which maps the contents of the Report against **Ofwat's Aide Memoire** on the role of CCGs.

We have gone further than most CCGs to ensure the **Panel's independence**, by establishing a Company Limited by Guarantee which owns the Panel. Our composition and method of working are described in the third section of this Report.

Although Ofwat does not require CCGs to **monitor company performance**, the Panel has regularly reviewed performance against the targets set for the current AMP. This has helped our understanding of the drivers behind the business and the regulatory framework within which it operates, and it has helped us to challenge more effectively the PCs and ODIs proposed for AMP7.

The Company has welcomed challenge, has been open and transparent, and has logged and diligently responded to our challenges. This Report gives evidence of our challenges and the Company's responses, with examples.

The Company has made **a step change in customer engagement** between PR14 and PR19 in terms of scope, professionalism and cost. Specialist staff have been recruited, and more than £800K invested, compared with not quite £300K for PR14. Over 40,000 customers have taken part in the programme and a real effort has been made to give balanced attention to the two areas of operation.

The Company has gone to great lengths to encourage **Panel involvement in every aspect of customer engagement**, from developing the strategy through to research into business plan acceptability and affordability. We have helped with selection of some of the research agencies, attended project kick-off meetings, commented on methodology, critiqued consultation materials and questionnaires, tested online surveys, observed customer co-creation workshops and focus groups, and challenged researchers at project de-briefs.

The Panel was consulted on early drafts of the Company's Water Resources Management Plans (WRMPs). We have no reason to doubt that the Company has correctly followed the statutory and regulatory guidance in drawing up its Plans, but **we are concerned about the supply/demand balance in the Cambridge region**, and its sensitivity to assumptions about matters outside the Company's control. We support the alignment of timing of Drought Plans, WRMPs and Business Plans

Inevitably the influence that customer preference exerts over the Plan has depended heavily on the generation and application of triangulated data from **Willingness to Pay** research. We have challenged aspects of that process with the researchers and their independent academic reviewer. The Panel believes the team has done its best to comply with Ofwat's methodology correctly. We have little confidence in Willingness to Pay as a credible way of ascribing monetary values to service improvements, and recommend that, if it is used in future, it should be carried out nationally so that less cost falls on the customers.

The Company's PR19 **CAPEX Plan** is for investment of £288m, compared with £205m estimated out-turn in AMP6. Most of the additional sum (£57m) is for upgrades to water treatment works in Staffordshire for which a Cost Adjustment Claim (CAC) is being made. This reflects the customers' top priority of water quality, and attracted 85% acceptability by customers.

The Panel has scrutinized the **processes used to compare investment proposals**, from Cost Benefit Analysis to support the efficacy and efficiency of the investments, to Multi-Criteria Analysis, which included customer preferences. Our investigations have included holding talks with the Company's external assessor.

In its investment plans, performance commitments and proposed ODIs, **the Company has reflected customer priorities as evidenced in its research**. Our report summarizes the process they have followed for triangulating a range of data from research and customer insight.

The Panel is not aware of any **regulatory concerns** that might threaten the viability of the Business Plan. We have benefited greatly from the membership and active participation of CCWater and the Environment Agency in the Panel. We are aware that the Drinking Water Inspectorate has recorded its support for the investments covered by the CAC.

We consider that the Company has put in place effective policies and systems to deliver on Ofwat's expectations for support for those facing **vulnerability**. Research results have been acted on promptly by introducing new support services without waiting for PR19.

The Company has been ambitious in its policy of aiming for **upper quartile performance in all PCs.** We have challenged in detail the 28 ODIs proposed for AMP7, resulting in a number of changes. In acceptability research, nearly 2/3 of participants considered that all the ODIs are sufficiently stretching, scores for individual ODIs being much higher.

The Company's customer research provides renewed evidence of the unpopularity of the **ODI incentive regime** and confirms strong customer preference for price stability through the five year period. We urge Ofwat to reconsider its policy of forcing price rises mid-term as a reward for over-performance. The reconciliation of customer preference with the RoRE range undermines the link between ODIs and what customers are willing to pay, which adds to our concerns about this flawed regime.

We reviewed the Company's **Assurance** Framework at our first meeting and the Assurance Plan annually thereafter. The Panel has interviewed the external auditors of the Company's Annual Performance Review (APR), who have agreed to share their reports with the Panel.

The Company asked the Panel to help make its **communications with customers** and the public easy to understand. We commend them for the openness with which they report their performance on a web-based dashboard and have publicized on their website the results of PR19 customer research.

Research into **Business Plan acceptability and affordability** shows a high level of trust in the Company, with 67% of household customers giving scores of 8 or more out of 10. The Business Plan was acceptable to 84% of informed respondents, only 1% finding it unacceptable. 70% described the Company's proposed bill level as affordable, rising to 76% after being informed about the Business Plan.

Appendix 4: Current operational performance

Table 4.1: PR14 Performance Commitments

Please indicate in the table below which PR14 performance commitments have been met and which have not been met over the PR14 period. This table is not for Service Incentive Mechanism (SIM) data, for which table 4.2 has been provided. For financial ODIs please also indicate total forecast outperformance payment or underperformance penalty for the PR14 period.

No.	ID (eg W-A1)	Performance commitment	2015-16 PCL met?[2]	2016-17 PCL met?	2017-18 PCL met?	2018-19 PCL met? (forecast)	2019-20 PCL met? (forecast)	Cumulative ODI (outperformance payments or underperformance penalties) £m to 4 decimal places 2012-13 prices, net of tax	
								15/16-17/18 Actual	18/19-19/20 Forecast
1	1.1	Mean zonal compliance (MZC, combined company)	No	Yes	No	No	No	-0.2003	0.0000

[2] **PCL met? - i**f the performance commitment level (PCL) for the reporting year was met, or is forecast to be met, enter 'Yes'. If the PCL for the reporting year was not met, or is forecast not to be met, enter 'No'. If a PCL has not been set for the reporting year enter "-" (hyphen).

No.	**ID** (eg W-A1)	**Performance commitment**	**2015-16** PCL met?[2]	**2016-17** PCL met?	**2017-18** PCL met?	**2018-19** PCL met? (forecast)	**2019-20** PCL met? (forecast)	**Cumulative ODI** (outperformance payments or underperformance penalties) £m to 4 decimal places 2012-13 prices, net of tax	
2	1.2	Acceptability of water to customers (comined company)	No	No	No	Yes	Yes	-0.4986	0.0000
3	2.1	Interruptions to supply (combined company)	Yes	Yes	Yes	Yes	Yes	2.0240	0.9060
4	2.2	Serviceability infrastructure (combined company)	Yes	Yes	Yes	Yes	Yes	0.0000	0.0000
5	2.3	Serviceability non-infrastructure (combined company)	Yes	Yes	Yes	Yes	Yes	0.0000	0.0000
6	4.1	Leakage (South Staffordshire operating region)	Yes	Yes	No	Yes	Yes	0.0000	0.0000
7	4.2	Leakage (Cambridge operating region)	Yes	No	No	Yes	Yes	-0.2166	0.0000
8	4.3	Water efficiency (household per capita consumption (PCC) reported annually, combined company)	Yes	Yes	No	Yes	Yes	0.0000	0.0000
9	4.4	Biodiversity (cumulative total hectares of land under management per year, combined company)	Yes	Yes	Yes	Yes	Yes	0.0000	0.0000
10	4.5	Carbon emissions from power consumption (tonnes, combined company)	No	No	No	No	No	0.0000	0.0000
11	5.1	Independent customer surveys of value for money and affordability (combined company)	Yes	Yes	Yes	Yes	Yes	0.0000	0.0000

No.	ID (eg W-A1)	Performance commitment	2015-16 PCL met?[2]	2016-17 PCL met?	2017-18 PCL met?	2018-19 PCL met? (forecast)	2019-20 PCL met? (forecast)	Cumulative ODI (outperformance payments or underperformance penalties) £m to 4 decimal places 2012-13 prices, net of tax	
12	5.2	Support for customers in debt (combined company)	Yes	Yes	Yes	Yes	Yes	0.0000	0.0000
13	3.1	Service incentive mechanism (SIM, combined company)	No	No	No	No	No	0.0000	0.0000
14	3.2	Customer satisfaction surveys (combined company)	Yes	Yes	No	Yes	Yes	0.0000	0.0000
15	3.3	Community engagement (combined company)	No	No	Yes	Yes	Yes	0.0000	0.0000
							Total cumulative financial ODI	**1.1085**	**0.9060**

Note: the above reputational SIM score target of 90 was set under the prior methodology and not revised when the methodology changed in 2015.

Table 4.2: PR14 Service Incentive Mechanism (SIM) Performance

SIM Performance	2015-16	2016-17	2017-18
Total annual SIM score (out of 100)	86	84	87

Appendix 5: PR19 proposed performance commitments

Table 5.1: Common Performance Commitments

No.	Common performance commitment[3]	ID (eg W-A1)	2019-20 forecast performance level (where relevant)	2024-25 proposed performance commitment level	ODI type	In period / end of period ODI	2019-20 to 2024-25 % change (leakage and PCC PCs)
1	**Water quality compliance** – the DWI's Compliance Risk Index (CRI), a score greater than or equal to zero, where zero is least risk	D1	3.9	0	Under	End of AMP	
2	**Water supply interruptions** – average supply interruption greater than 3 hours (minutes per property)	D2	00:07:00	00:04:50	Out & under	End of AMP	
3	**Mains bursts** – number of water mains bursts per 1,000 kilometres of total length of mains	D4	131	120	Out & under	End of AMP	

[3] This table includes all PR19 common performance commitments with the exception of C-Mex and D-Mex, as the design of these is different.

No.	Common performance commitment[3]	ID (eg W-A1)	2019-20 forecast performance level (where relevant)	2024-25 proposed performance commitment level	ODI type	In period / end of period ODI	2019-20 to 2024-25 % change (leakage and PCC PCs)
4	**Unplanned outage** – proportion of unplanned outage of the total company production capacity (%)	D5	1.92	1.7	Out & under	End of AMP	
5	**Leakage** – megalitres per day (Ml/d), three-year average	C1 / C2	84.9	68.4	Out & under	End of AMP	-19.4%
6	**Per capita consumption** – average amount of water used by each person that lives in a household property (litres per person per day), three-year average	C3 / C4	132.3	130.2	Out & under	End of AMP	-1.6%
7	**Risk of severe restrictions in a drought** – percentage of the population the company serves that would experience severe supply restrictions (e.g. standpipes or rota cuts) in a 1-in-200 year drought	D3	0	0	NFI	0	
8	**Treatment works compliance** – % compliance with environmental permits at water and wastewater treatment works (EA's Environmental Performance Assessment definition)						
9	**Internal sewer flooding** – number of incidents per year (sewerage companies only)						
10	**Sewer collapses** – number per 1,000 kilometres of sewer (sewerage companies only)						

No.	Common performance commitment[3]	ID (eg W-A1)	2019-20 forecast performance level (where relevant)	2024-25 proposed performance commitment level	ODI type	In period / end of period ODI	2019-20 to 2024-25 % change (leakage and PCC PCs)
11	**Pollution incidents** – category 1-3 pollution incidents per 1,000km of sewerage network, as reported to the Environment Agency and Natural Resources Wales (sewerage companies only)						
12	**Risk of sewer flooding in a storm** – percentage of population at risk of sewer flooding in a 1-in-50 year storm (sewerage companies only)						

Appendix 6: Expenditure

Table 6.1: Totex - PS

Total expenditure	Price Base	PR14 final determination 2015-2020	Proposed for PR19 2020-2025
Water network plus (£m)	2017-18 FYA (CPIH deflated)	443.905	483.476
Water resources (£m)	2017-18 FYA (CPIH deflated)		54.553
Wastewater network plus (£m)	2017-18 FYA (CPIH deflated)		
Bio resources (£m)	2017-18 FYA (CPIH deflated)		
Residential retail costs	Outturn (nominal prices)	74.100	58.601

Table 6.2: Direct Procurement for Customers (DPC) proposals

No.	Project name	Total project cost (£m) 2019-20 to 2049-50 2017-18 FYA (CPIH deflated)
	None	

Appendix 7: Trust, confidence and assurance

Please explain how the company's full Board has demonstrated that its governance and assurance processes will deliver operational, financial and corporate resilience over the next control period and the long term.

Please explain how the company's full Board has assured themselves that the business plan will enable trust and confidence, including how the company's Board has taken account of the decisions Ofwat set out in its decisions for PR19 business plans to put the sector in balance.

[max. 400 words]

We have considered the approach taken to ensure that resilience will be managed in the interest of customers for the long term. At an early stage the Board saw an innovative approach to modelling resilience (our 'resilience lens') and this became embedded within our process for choosing the best investment options for our customers and our business whilst always considering its implications for overall resilience. We are confident that the challenging set of performance targets being proposed will also make an important contribution towards improving overall resilience as the business improves it naturally creates resilience 'headroom', in the round.

Our Board has also reviewed in detail our financial resilience. As part of our annual reporting, we assessed the long term viability of the company based on our business plan projections. Based on the financial projections, the stress tests performed and the mitigations considered, we declared that the Company is financially resilient for at least the seven years to 2025. Beyond 2025 we anticipate our financial ratios will improve naturally as our investment levels reduce towards a historic norm.

We are mindful of the challenges set out in Ofwat's policy statement on 'Putting the sector back in balance'. Transparency is a core value and we already share more operational performance data with our customers than any other company.

Our Board has agreed and incorporated into our plan a base dividend yield of only 2% a year on average for our appointed activities with a policy of up to 3% yield. This is below Ofwat's indicative range of between 4% and 5% but reflects the position of the business in a period of high investment.

We agree that in relation to performance related pay, there should be an appropriate balance between financial metrics and those that more directly benefit customers. So, we propose to continue our current structure that apportions approximately one-third of variable pay to customer service, outcome delivery incentive performance and financial performance (including totex and cost efficiency), respectively.

We support the sharing of any out performance as a result of gearing above 70% in line with Ofwat's mechanism based on our covenant debt. We have not proposed a sharing mechanism for any outperformance for a low cost of debt due to our relatively high embedded debt cost on borrowings which were raised efficiently at the time but which are now expensive compared to current rates.