Affinity Water: PR24 Business Plan Submission – Commentary

We have followed Ofwat's guidance in completing this commentary. We have used footnotes as suggested to reference the relevant sections in the main plan. Where we refer to chapters and sections, this relates to our 200-page narrative, also referenced as AFW01. Where we refer to appendices, we include the reference and title in the footnote.

Key Issues and our plan to address the key challenges for PR24

Our purpose is to provide high-quality drinking water for our customers and take care of the environment for our communities now and in the future. We have worked with customers and stakeholders to agree our long-term ambitions, which underpin our purpose and are themed around the environment, customers, communities and resilience[1]. We are financially resilient and our plan includes an equity injection of £150m to support increased investment in the next period.[2]

We have carried out our biggest ever engagement with customers so that our plans reflect a clear understanding of our customers and communities[3], and **their rising expectations for what we need to deliver**. We have been at the forefront of innovative and collaborative engagement to support our WRMP development through regional planning groups, and have taken an active role in working with Ofwat on the required Acceptability and Affordability Testing research[4].

Protecting and enhancing our environment is a key challenge for PR24, and we have recognised this in our long-term ambition to leave the environment in a measurably better state. We have high long-term environmental ambitions to reduce the abstraction needed from chalk stream aquifers, and bring in surface water from areas in the Midlands and to the west of our region to meet customers' demand[5]. We have worked with the quality regulators to understand and agree the obligations that drive our enhancement programme to support this ambition. Our plan will enable us to continue to maintain compliance and meet all our statutory and licence obligations now and in the future.

Our plan sets out stretching performance commitments, aligned to our customers' priorities, which will largely be delivered from base investment. Our commitments will

[1] Our Strategic Direction Statement, Appendix AFW03
[2] Section 9.3 Capital Structure for 2025 - 2030
[3] Chapter 4 What customers want and Appendix AFW04 – What customers and stakeholders want
[4] Appendix AFW45 – Affordability and acceptability research results
[5] Section 6.5 Enhancement investment and Appendix AFW14 – Enhancement investment cases

see us reduce demand on the environment by 40 Ml/d by 2030 through ambitious targets for leakage and water use, and maintain asset health and asset resilience to continue to provide a resilient service to customers[6].

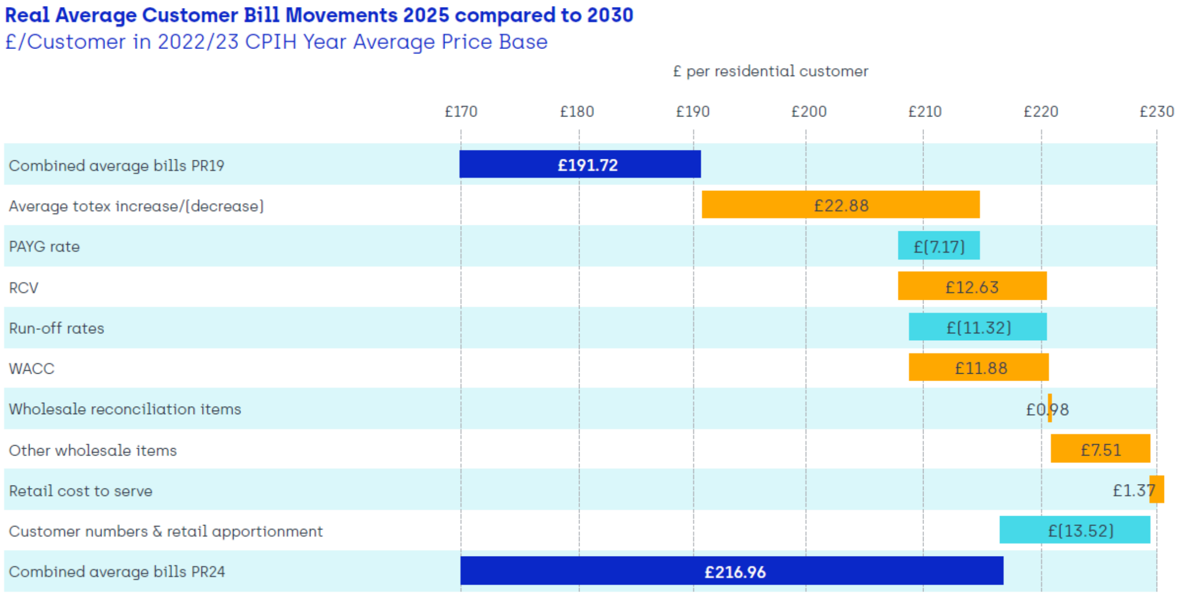
Adapting to climate change and the need to meet net zero emissions is a challenge all businesses need to continue to rise to in the coming years. We have ambitious plans to reduce our carbon footprint in the delivery of the operational GHG emissions performance commitment, including the continuation of our energy efficiency programme, moving our fleet to electric and switching to low carbon fuels for resilience[7]. To demonstrate our commitment to reducing our GHG emissions, we have included a bespoke performance commitment to reduce whole life carbon by 14% by 2030[8].

Our plan sets out £2.12bn of investment in our region, an increase of 19% compared to the current period. While our base investment will increase by a modest 7%, largely due to input cost pressures, our enhancement investment will nearly double, which reflects the need to respond and invest to the challenges of climate change and protecting the environment.

We have tested our investment plans through engagement with our supply chains to ensure our plan is deliverable. Our investment programme is largely delivered by tier 2 contractors, and the key focus areas for us are working in partnership and access to land for nature-based solutions, and planning for the strategic resource schemes, which will be delivered by DPC[9].

We have critically reviewed our investment plans, used industry-leading decision support tools to optimise our plans, challenged ourselves to ensure all investments in the plan are necessary, and all our costs are efficient[10], to ensure we are responding to the challenge of **delivering affordable bills.** The effect of our planned investment, and other levers, is shown below.

[6] Chapter 7 Outcomes
[7] Section 6.5 Enhancement investment and Appendix AFW14 – Enhancement investment cases
[8] Chapter 7 Outcomes
[9] Chapter 8 Deliverability
[10] Chapter 6 Costs



Our plan leads to an average bill increase of £25 to £217, which is still lower than average bills were in 2016 in real terms. Even though this is a modest rise, we are very mindful that customers are experiencing a wider cost of living crisis.

We were an early adopter of the social tariff, have recently gained support from customers to increase the cross subsidy to around £9.50, and anticipate 149,000 customers will be helped by social tariffs by 2030. We are trialling 'WaterSave', an innovative rising block tariff in 2023, which will mean the majority of customers will pay less with excessively high users paying more, and we plan four further tariff trials during 2025 – 2030[11].

Our plan is financeable for the notional company and the actual company is financially resilient. Our plans include an equity injection of £150m to support investment, and this will also reduce our gearing to 70.7% in 2025[12]. We have used Ofwat's view of WACC, and set PAYG and RCV run off to their natural rates and aligned with Ofwat methodology.

We are confident that our plan meets the challenges for PR24 and aligns with Ofwat's ambitions for PR24. Our Board has sought the highest level of challenge and assurance throughout the development of our plan and provides detailed assurance on each aspect of the development and delivery of our business plan[13].

[11] Chapter 5 Customer affordability and acceptability
[12] Chapter 9 Risk and Return
[13] Section 2.2 Board assurance statement

SUM1 – Performance commitments

Our plan delivers ambitious and stretching outcomes in line with our customers' expectations. We have actively engaged our customers in the development of our plan, changing our strategies to align our package of outcomes to their preferences. Most of our improvement in performance to 2030 will be delivered from base investment.

We are on an improving performance journey as a business and for individual PC metrics. For industry overall service delivery, from 'Lagging behind' in 2019 – 2020, we progressed into the 'Average' category in 2020 – 2021 and consolidated this position with further improved performance in 2021 – 2022 and 2022 – 2023. We have set ourselves the ambition of becoming one of the 'Leading' companies in 2025 – 2030 and we have reflected this in the targets we are setting for ourselves in our business plan[14].

We have followed the final methodology in setting stretching targets from base investment that goes above and beyond what we have achieved in the past, both on individual measures and across the broader scope of outcomes. For our water demand PCs, our WRMP and PR24 business plan are fully aligned and meet the guidance[15].

We have created detailed and costed activity-based plans, with quantified performance benefits to give line of sight between our investments, activities and performance. Our totex and performance plans are fully integrated making sure we can deliver on our promises[16].

Our outcomes package is fully compliant with the final methodology and meets the quality criteria.

SUM2 – Key business plan metrics

Our region is anticipating significant growth in the long term, and in the next five years we anticipate continuing the trend of moving to lower occupancy households, leading to a larger increase in households connected than for population, although both are predicted to increase.

We are reducing demand on the environment by targeting a further 15% reduction in leakage over and above the 20% reduction we are delivering in the current period. We will also continue our award winning Save Our Streams campaign to encourage customers to use less water, alongside the first phase of smart meter installations and associated customer-facing interfaces. Our performance

[14] Chapter 7 Outcomes

[15] We note the SUM table reports our projected CRI rather than the performance commitment. Our performance commitment is zero, as set out on page 148 of Chapter 7 Outcomes

[16] Chapter 8 Deliverability

commitment for business demand will deliver a reduction of 11% compared to the baseline in 2019-20[17].

Our network will grow by a small amount, primarily for new developments in our region and for the first phase of new interconnectors to help transfer water across our region[18]. Due to the water saving measures we plan, our distribution input will fall by around 40 Ml/d (around 5%) by 2030 compared to 2025. Although we are distributing less water, we need to transport that water further as we move away from the unsustainable chalk stream abstractions and transfer more water in to our region. This means that both our overall energy consumption, and the energy needed per megalitre of water, will increase in the next five-year period.

RCV is growing over the period which reflects the level of enhancement investment that is required. This is higher than in the current period as enhancement investment will nearly double between 2025 – 2030 compared with during 2020 – 2025.[19] The investment needed is primarily for the mandatory programmes within the WRMP and WINEP.

SUM3 – Cashflows and WACC

Our plan presents a robust and financially resilient firm with a capital structure that enables us to maintain strong credit ratings, and withstand potential downside scenarios, while raising capital to fund our investment programme for the benefit of customers and the environment[20].

Our plan includes an equity injection of £150m into the regulated company in 2025 - 2026 (subject to acceptance of Final Determination and other factors). The additional equity will reduce our gearing to 70.7% by 31st March 2026 and support investment over the period 2025 - 2030[21].

We have completed significant analysis to ascertain the risk profile of the plan and our view is that the conditions specified in the final methodology lead to a downside skew for RoRE risk ranges. We have articulated some of the reasons for the downside skew and have outlined ways to correct this by mitigating risk at source[22].

We have adopted the early view WACC of 3.29% contained in the final methodology. However, we note the importance of ensuring return is

[17] Chapter 7 Outcomes
[18] Section 6.5 Enhancement investment
[19] We note that in the tables column G of line SUM2.26 is 0 rather than calculating the total RCV at 2029-30
[20] Chapter 9 Risk and return and Appendix AFW48 – Centrus Report
[21] Section 9.3 Capital Structure for 2025 - 2030
[22] Section 9.4 Risk

commensurate with risk, and is set at a level appropriate to attract investment to the sector[23].

We have set our PAYG and RCV run off levels at the natural rate which aligns to our customer preferences and Ofwat's methodology. Compared with the current period, the increase in proportion of enhancement investment leads to a lower natural PAYG rate, while adopting the reducing balance approach to RVC run off spreads the investment over a longer period of time[24].

We have completed analysis and commissioned external assurance to support our Board Assurance statements that the notional company is financeable and the actual company is financially resilient[25].

SUM4 – Expenditure

Our totex investment plan for 2025 - 2030 is the largest in our history, delivering a resilient, high quality, water service across our communities and supporting our ambitious performance commitments. It will allow us to continue to deliver all our statutory and licence obligations[26].

Our totex for 2025 - 2030 is 19% larger than our 2020 - 2025 determination, driven primarily by increased enhancement investment needed to deliver our environmental ambition. This investment will also contribute to increasing our resilience and to meeting our Net Zero ambitions. There is an increase in wholesale and retail base costs, reflecting increases in key input costs. The majority of our investment (93%) is mandatory and not discretionary, and we do not consider there to be any grey areas.

Our base investment for 2025 - 2030 includes the costs to run our business and maintain the health of assets, and deliver our ambitious package of performance commitments[27].

Our enhancement investment for 2025 - 2030 is nearly double that of the current period and reflects our ambition to reduce unsustainable abstraction. Over 70% of investment is directly linked to WINEP and WRMP statutory programmes, with a further 15% addressing raw water deterioration under DWI obligations[28]. We have undertaken significant deliverability engagement, planning and assurance and

[23] Section 9.5 Return and Appendices AFW22 – Risk and return cost of equity, AFW23 – Inference analysis and AFW47 – Alternative WACC
[24] Section 9.6 PAYG and RCV run off rates
[25] Section 2.2 Board assurance statement and Appendix AFW48 – Centrus report
[26] Chapter 6 Costs
[27] Section 6.4 operating expenditure: key investments and Appendix AFW13 – Base costs
[28] Section 6.5 Enhancement investment and Appendix AFW14 - Enhancement investment cases

confirm that our investment is deliverable[29]. Our LTDS ensures we will not regret any of our enhancement investments[30].

We have a state-of-the-art approach to investment planning for PR24, adopting latest best practice approaches in business case development and portfolio optimisation, to ensure best value investment decisions that reflect what our customers want[31].

We have customer protections including ODIs and PCDs covering all our enhancement investment[32], and we have set out our affordability strategy which includes use of both social and innovative tariffs to deliver fairer bills for those who struggle to pay[33].

[29] Chapter 8 Deliverability
[30] Appendix AFW51 – Long-Term Delivery Strategy
[31] Chapter 6 Costs and Appendix AFW08 Our investment development process
[32] Section 6.5.6 Customer protections through Price Control Deliverables and Appendix AFW19 – Price Control Deliverables, and Chapter 7 Outcomes and Appendices AFW17 – Outcomes and AFW18 – Bespoke performance commitments
[33] Section 5.3 Affordability measures