



# Investor summary

Our Fast Track Plan

**WONDERFUL ON TAP**

**SEVERN  
TRENT**

# An introduction from the Chief Executive

We're truly delighted Severn Trent has been selected as one of only three Fast Track companies by Ofwat in its assessment of the PR19 plans submitted for 2020-2025. It means we have real clarity on what challenges and opportunities lie in front of us.

From the outset, it was always our intention to co-create a robust plan with our customers that not only promised improved service for them at an affordable price, but also delivered a broad set of commitments for all of our stakeholders.

In its feedback, Ofwat has recognised a number of key strengths in our plan, including:

- Our approach to customer engagement, using multiple channels to engage the widest possible range of our customer base, but in a targeted and thoughtful way;
- Our commitment to extend our influence far beyond our core purpose, to provide a meaningful societal contribution;
- A community dividend that will share outperformance with the communities it serves;

- Stretching performance commitments throughout our entire water and waste lifecycle to ensure improvement is not just focused on a handful of areas; and
- Our ambitious cost efficiency programme, reflected in an upper quartile cost plan in waste, water and retail.

We believe our plan will deliver a step change in performance for our customers and change the relationship we have with them and the broader communities we serve. A Fast Track plan confirms our regulator's support for our ambitions, gives us a full 14 months of planning time before the start of the next AMP with clarity on our commitments and targets, and finally, it provides a small financial benefit of c10 basis points on our RORE allowance.

The whole organisation is excited by the news of Fast Tracking and already preparing for a fast start in April 2020 and continuing success in AMP7.



**Liv Garfield**



# Serving our Communities

## Our Fast Track Plan for 2020-2025

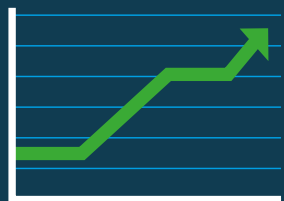
We think water's wonderful. It plays a critical role in all our lives. And that's why we all deserve a bold and ambitious plan for the future. So we will be keeping bills low, improving our service and making a positive societal impact in our communities while remaining financially resilient and continuing to deliver strong returns for our investors.



**One** of only **three**  
fast track companies

**1%**

dividend for  
community schemes



Growing RCV by  
c. **3.6%**  
in real prices

41 PCs including  
**35 ODIs**  
with enhanced values for  
internal sewer flooding



**Commended**  
for work on  
**social purpose**

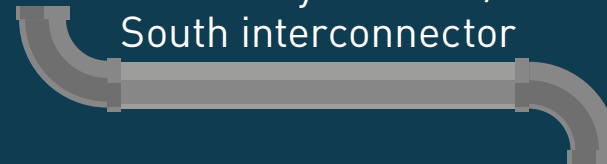
Base regulatory  
dividend of **5%**  
aligned with Ofwat  
guidance range



**£156m**  
of real options  
approved

**£26m**

approved to begin  
feasibility of North/  
South interconnector



RORE range of  
**-2.7% - +1.5%**  
on customer ODIs



**Upper Quartile**  
on base costs



**£6.4bn**  
approved totex

# Totex

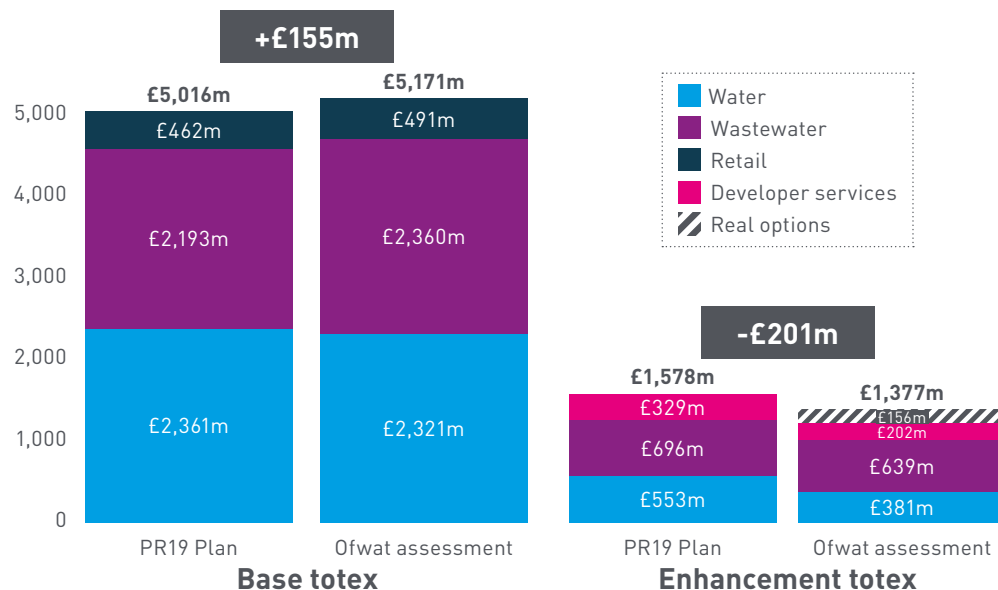
## Overall totex allowance

Our business plan included £6.6bn of totex investment broadly split into the totex we require to keep our current network operating well (maintenance spend); the investment we propose to make service enhancements and meet population growth demand (enhancement spend); and the money we need to run our retail operations.

In the round, Ofwat has approved 97% of our plan and we have been deemed 'efficient' across our core maintenance activity and retail business. The net reduction in spend proposals of c£200m is focussed on our enhancement spend. We will be reviewing our options for delivering our enhancement obligations and the associated impact on the scope of our investment programme.

When combined with approved real options spend, our total totex investment could reach £6.55bn.

## Overview of our £6.55bn approved totex plan



## Maintenance expenditure

At a more granular level, Ofwat assessed our plan for ongoing maintenance expenditure, which makes up almost 70% of our total totex, to be:

- **3%** better than the efficient level of expenditure for wholesale costs, maintaining our frontier position on waste.
- **6%** more efficient on our retail expenditure.

## Enhancement expenditure

Ofwat has allowed c£1.2bn of enhancement spend across waste and water, which when combined with the investment on 'real options' (detailed on the next page), could take the total investment in enhancement to c£1.4bn. The most significant adjustment to our proposal lies in new development and connections expenditure, for which Ofwat's assumptions are approximately half of ours, meaning a reduction of £127m. We will continue to explore the most cost efficient ways to deliver our enhancement plans, and close any investment shortfalls with innovation and commercial contract partnerships.

In total, given the changes in allowed totex and depreciation, the regulatory assessment of totex should deliver real RCV growth of c3.6% over AMP7



# Real options

## What are real options?

When we designed our PR19 plan there were a number of investment programmes we felt needed exploring to either meet emerging environmental needs or deal with water scarcity on a national level. There is still uncertainty of when and how these needs will crystallise, so we designed an industry first approach that we refer to as 'real options'. Simply put, we proposed a range of schemes with decision making criteria that define when that need for expenditure is triggered. We believe this approach provides customers with the protection that they will only pay when the need truly arises.

Ofwat has embraced our approach, added one proposal into our enhancement spend and approved two of the remaining three programmes to be included as real options in AMP7. These two programmes account for £156m of potential additional investment. Here are some further details:

### Wastewater environmental programme

- Up to £121m

We already have £350m approved in our base plan to continue to improve the quality of our rivers to meet legislation known as the Water Framework Directive (WFD).

There are a number of improvement schemes that won't receive ministerial approval before 2021. We have received permission to spend up to an additional £121 million to deliver those commitments in AMP7, if government approval is given.

### Water trading – interconnector

- £26m now included as enhancement spend

We believe the water industry needs to make large scale water trading a practical reality to help balance the demands of the South with the supply of the North. To do this we are exploring building a huge interconnector to transport water from the North West to the South East of England.

In our plans we included a real option to invest up to £40m in feasibility work for the project. Ofwat has accepted the need to act now and approved £26m of investment in AMP7.

### Supply demand – metering

Up to £35m

Meters provide considerable benefits to our water network, providing us with useful data and helping reduce water consumption.

We want to increase the amount of meters we install in AMP7 by 300%, but we know that delivering on this ambition will require a significant increase in voluntary take up. Due to this uncertainty we requested funds for the meters we actually install, rather than receiving the full allowance up front. This means customers only pay when we deliver.

Ofwat has approved this approach and it is now a case for us to deliver on our ambition, up to a maximum of £35m.

## How do real options work?

Real options use the ODI framework, with reward and penalty set at the unit cost of the investment.

**Metering** – 100% of the cost will be recovered through revenue, in-period, with the standard two year lag.

**Wastewater environmental programme** – the cost will be recovered in accordance with our approved PAYG rate, meaning 59% will come through revenue and 41% will be added to the RCV. As an end of AMP measure the RCV adjustment and revenue will be recognised in AMP8.

# Financing

**We will continue to have the lowest bills in England, with a proposed 5% reduction**

## Preparedness for AMP7

We will be entering AMP7 in a strong financial position. Based on Ofwat’s latest Monitoring Financial Resilience Report, we are in the top quartile for our average nominal interest rate, with a balanced mix of debt and gearing below Ofwat’s notional AMP6 level. This gives us a solid platform to start AMP7 with a competitive cost of debt, and the balance sheet capacity to support one of the largest investment programmes in the sector.

## Financial Levers

Our PR19 business plan uses the financial levers made available to ensure a fair balance of charges over time, and to maintain strong financial resilience. These have been largely unchanged by Ofwat, with no adjustment to our Pay-As-You-Go (PAYG) rate and only a small intervention on our RCV run off rate.

	Plan	Actual
PAYG rate	59%	59%
RCV run-off rate	4.9%	4.7%

Ofwat accepted our innovative approach to ensure RCV grows more in line with CPIH, making a small adjustment to the run off rate to reflect their forecast of the long term RPI-CPIH wedge, rather than our proposed forecast of the wedge through AMP7. The overall 0.2 percentage point change will reduce revenue by c.£10m per annum, with a corresponding increase to RCV growth over the five year plan period.

## Funding Opportunities

Our approved investment plan and maturing debt profile will give us one of the largest AMP7 funding requirements in the sector, both by value and as a proportion of gross debt. The £3 billion of debt we plan to raise (£1.8 billion of refinancing and £1.2 billion of new debt) therefore gives us more opportunity than most to drive our cost of debt down even further. We are well advanced with our funding strategy, with access to a wide range of sources and with £250 million of forward starting RPI-CPI swaps already secured to better match future asset growth.

## New debt to raise vs Sector



# Customer ODIs

## Overview

Ofwat has shown its support for the scale and ambition of our plan by making relatively few interventions on our ODI proposals. Our track record of translating what our customers want into stretching commitments mean we submitted a plan with unrivalled risk and reward levels for AMP7. Our confidence in delivery meant we set ambitious targets with very few caps (on how much we could earn for outperformance) or collars (on the size of the penalty for underperforming). Ofwat has embraced uncapping in totality but have put a sharing mechanism in place should the company's customers ODI payments exceed 3% of RORE.

## Performance Targets

As expected, Ofwat has adjusted the targets for the three comparative ODIs for which performance will be measured relative to the industry. These are supply interruptions, internal sewer flooding, and pollutions. Ofwat indicated these targets will be set on the basis of Upper Quartile, which was only revealed when all companies had submitted their plans.

With the exception of the CRI water quality ODI, no other changes have been made to our plan, which compares favourably to the 11 target interventions we received in PR14.

## Incentive rates and caps and collars

We recognise that Ofwat need to strike a balance between rewarding performance and the impact on customer bills.

Reflecting this, Ofwat added caps and collars for seven of our measures and extended the collars on a further two measures. They have applied similar interventions across the industry.

While these changes serve to limit the potential upside from ODIs, the inclusion of seven new penalty collars provides us with additional downside protection.



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