Investability and Financeability in PR24

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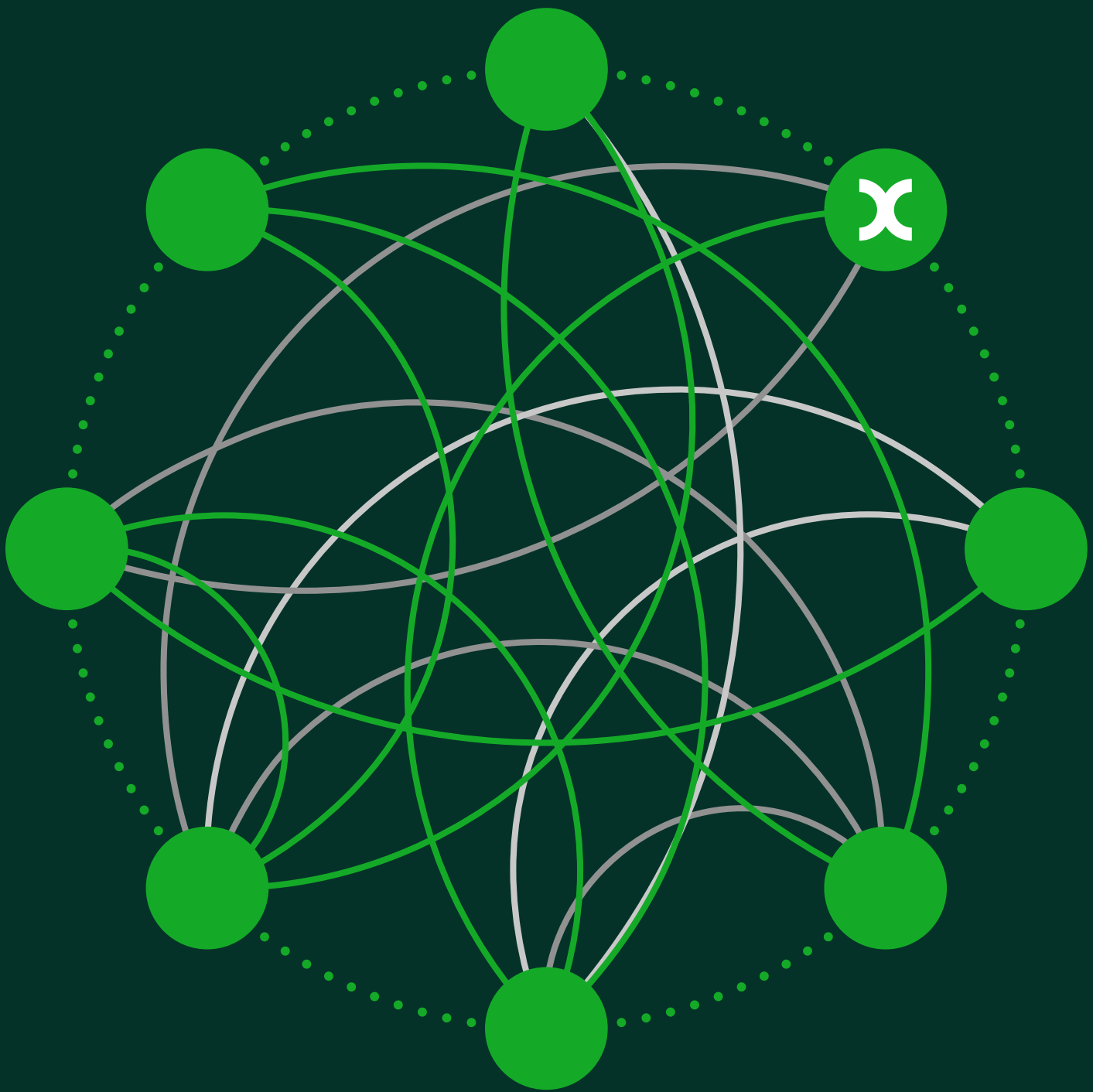
Prepared for Anglian Water

21 March 2025



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Executive summary

This report considers the investability and financeability of the England and Wales water sector in light of Ofwat's PR24 final determinations (FDs), and their wider implications. This report has been prepared for Anglian Water (ANH), to supplement its referral to the CMA against Ofwat's PR24 FD. The report also builds on Oxera's earlier sector report, which developed a framework for the assessment of investability.[1]

The water sector has entered a multi-decade period of significant CAPEX investment. Based on companies' Long-term Delivery Strategy (LTDS) submissions, the sector will spend over £270bn on enhancement programmes across the next 25 years, contributing to an almost trebling of regulatory capital value (RCV). Against this backdrop, **the decisions made for AMP8 will have far-reaching impacts on outcomes for customers and the environment into the future.** Customers, investors, and the sector, cannot afford to take a 'wait and see' approach.

It is therefore imperative that the sector is able to attract and maintain the confidence of investors who will commit to—and remain invested in—the sector. However, our analysis shows that Ofwat's PR24 FDs do not provide an attractive proposition for investors in the sector. By studying the implied net dividend yield, our research shows that **the sector would be unable to pay any net dividends in AMP8 and AMP9.[2] Instead, there is a continuing requirement for net new equity to be raised.** Even once the sector is able to pay dividends, the average yield is <1% p.a. from AMP10 to AMP12.[3] **On a cumulative basis, investors would only begin to record a net positive cash-flow position partway through AMP11—over 15 years after their initial investment.**

There is no evidence that **Ofwat has considered the impact on the investment proposition of this sustained shift to negative net cash flows**. Moreover, **if the water sector is not investable, it is not financeable.** Without being able to attract sufficient equity, companies'

[1] Oxera (2024), Investability at PR24, 27 August, accessed: https://www.oxera.com/wp-content/uploads/2024/08/Investability-at-PR24-1.pdf.
[2] We define the implied net dividend yield as the difference between equity required, and dividends payable. Where this figure is positive, dividends outweigh required equity investment, and investors are net cash flow positive (i.e. receive a net dividend). Where the implied net dividend yield is negative, required equity investments outweigh dividends, and investors are net cash flow negative (i.e. inject net equity). We calculate this for the notional company under Ofwat's FD framework, i.e. using notional gearing of 55%, PR24 cost of equity allowance. We use PR24 FD data for AMP8, and LTDS data from AMP9 onwards.
[3] Calculated as net dividends payable divided by notional regulated equity.

financial resilience and ability to raise debt would weaken, thereby harming investability prospects further.

As with its draft determinations (DDs), Ofwat modelled equity injections in its FD to maintain a BBB+/Baa1 credit rating for the notional company, specifically, by keeping notional gearing around 55%. However, these 'equity solutions' are hypothetical—as investors are faced with base returns that are too low,[4] **there is no basis to ensure that Ofwat's assumptions for new equity issuance by the notional company would materialise.** Without equity, gearing will rise, credit ratings will decline, and ANH will face a higher cost of debt. The investment programme would become undeliverable.

Indeed, if equity is not forthcoming, **and even with no dividends paid**, the notional company under the FD would fail to meet financeability thresholds in order to maintain a BBB+/Baa1 rating.[5] This indicates that **based on Ofwat's regulatory allowances ANH is not financeable unless new equity is raised, thereby underlining the importance of ensuring an investable environment.**

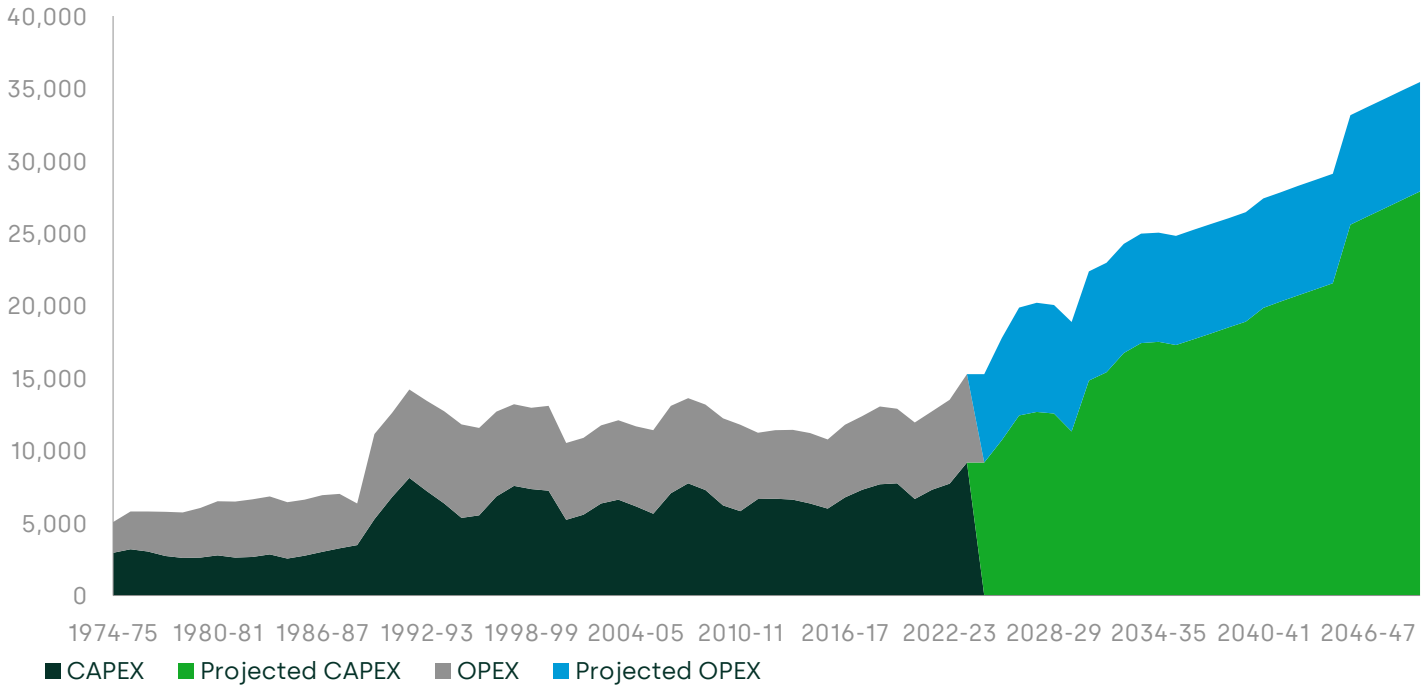
Using Ofwat's model, we develop a range of assumptions that would enable the notional ANH to be both investable and financeable. We find that if ANH's requested base returns are allowed, and RCV run-off rates are increased to the level of PR19,[6] the notional ANH could achieve a BBB+/Baa1 credit rating, and a net positive dividend (albeit small) for investors, after equity injections.

[4] Oxera (2025), PR24 Cost of equity estimation, 21 March.
[5] Ofwat first referred to the use of 'equity solutions' in its PR24 discussion paper. See Ofwat (2021), PR24 and beyond: Discussion paper on risk and return, December, p. 57, accessed: https://www.ofwat.gov.uk/wp-content/uploads/2021/12/PR24-and-beyond_Discussion-paper-on-risk-and-return.pdf.
[6] PR19 run-off rates were below the natural rate, but were restrained to manage the impact to customer bills.

1.1 The England and Wales water sector faces a steep increase in investment requirements across coming decades

When the England and Wales water sector was privatised in 1989, sector-wide expenditure over the previous two decades had averaged around £6bn per year (split roughly one third CAPEX and two thirds OPEX).[7] However, the water sector now faces a very different investment outlook.

Figure 1.1 WASC historical and projected spend (£m, real 2023–24 prices)



Note: Expenditure forecast based on PR24 Final Determinations for AMP8 and LTDS forecast enhancement CAPEX for the following periods. For AMP9 onwards maintenance CAPEX is assumed equal to the RCV run-off rate. OPEX forecast is based on the Price Control Financial Models up to 2030, and is then assumed to remain constant thereafter.
Source: Oxera analysis.

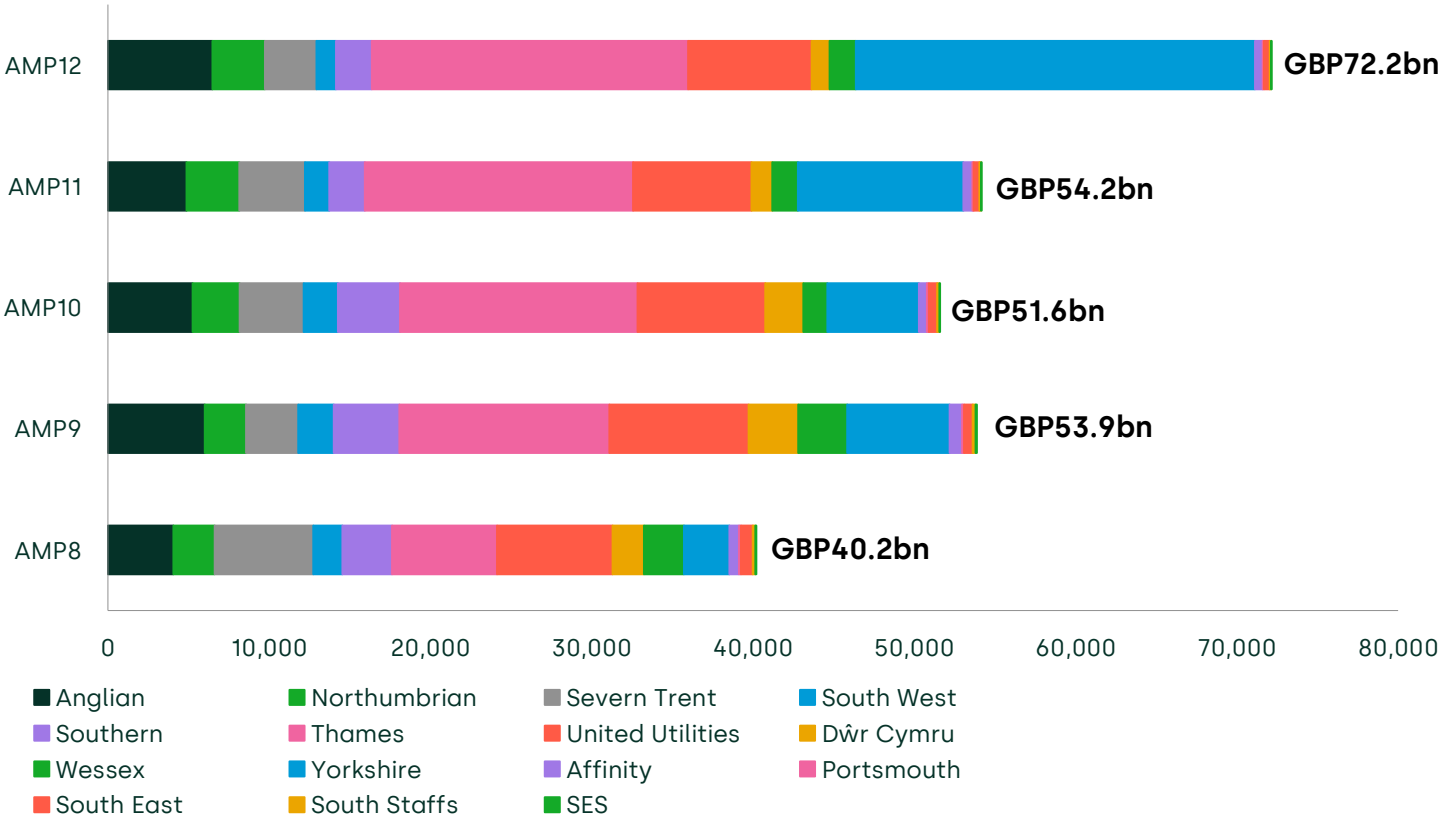
Specifically, water companies are at the start of a multi-AMP period of significant RCV growth, which is the fastest rate since privatisation. For

[7] In real terms, assuming a 2020 price base.

AMP8 alone, Ofwat's PR24 final determinations (FD) allow for a total industry expenditure of £104 billion, which represents a 71% increase over the previous regulatory period.

Critically, this step change in investments is not confined to AMP8 alone. This is reflected in the Long-term Delivery Strategies (LTDS) that companies put forward as part of their PR24 submissions, shown in Figure 1.2.

Figure 1.2 LTDS projected spend (£m, real 2022–23 prices)



Source: Oxera analysis.

Based on the LTDS, around £270bn of enhancement investment is anticipated from AMP8 through to the end of AMP12, with ANH accounting for around 10%.[8] In other words, the sector expects to deliver an enhancement programme roughly three times the sector's current

[8] Based on values submitted in companies' LTDS sections of the data tables provided alongside their October 2023 business plans.

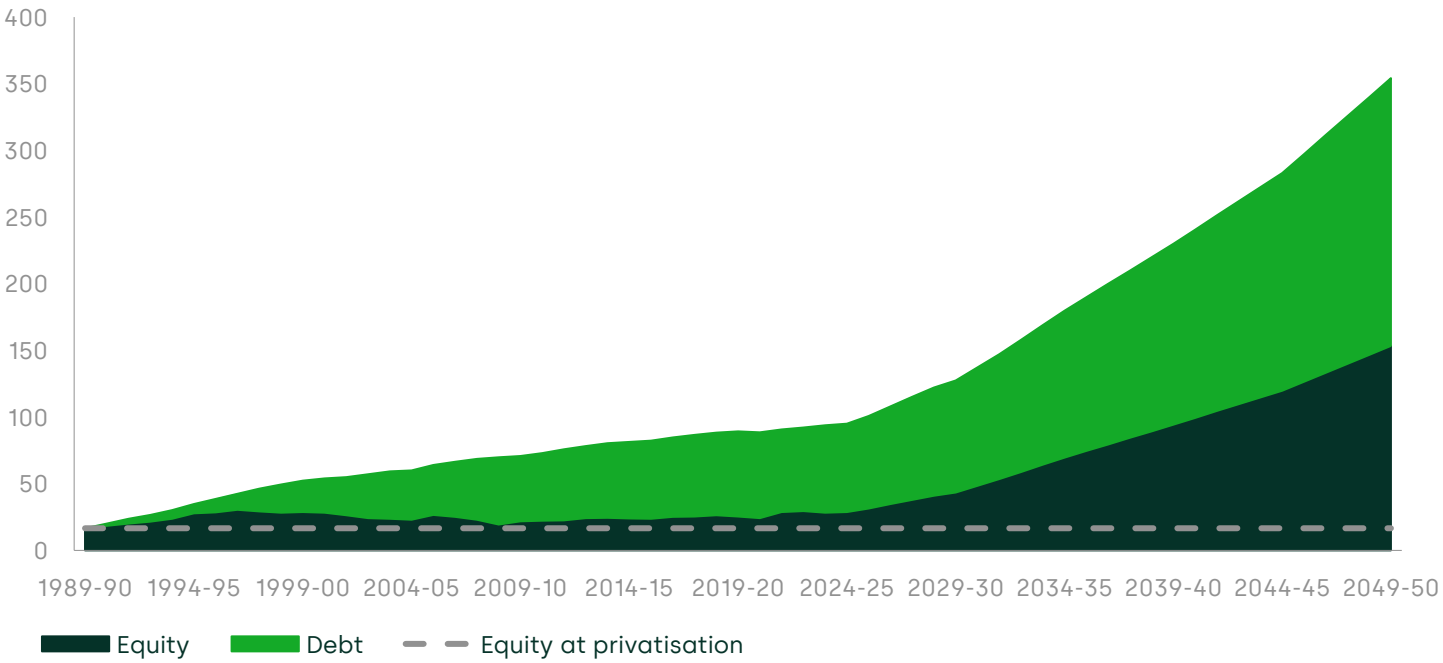
regulatory capital value (RCV). ANH, in particular, is expected to more than double its RCV over AMP8–AMP12, in real terms.

1.2 Financing this large increase in investment will require significant new equity and debt

The anticipated enhancement programme will need to be financed by large amounts of capital investment from both equity and debt investors. In the PR24 FDs for example, Ofwat assumed notional equity injections of £12.6bn over AMP8, equivalent to 22% of opening regulated equity. For ANH, Ofwat assumed equity injections of £1.5bn (2022–23 prices), or 27% of its opening regulated equity.

The need for equity on this scale represents a paradigm shift for the sector. Since privatisation, RCV growth has largely (though not entirely) been debt-financed, as shown in Figure 1.3. This highlights **how raising new equity on the scale Ofwat anticipates has not previously been tested during Ofwat's regime.**

Figure 1.3 Water and sewerage company RCV since privatisation, split by debt and regulated equity (£m, real 2023–24 prices)



Note: RCV growth forecast based on PR24 FDs for AMP8 and LTDS forecast enhancement CAPEX for the following periods. For AMP9 onwards maintenance CAPEX is assumed equal to the RCV run-off rate, and all new enhancement CAPEX from AMP9 is assumed to be financed by the notional gearing of 55%. 'Equity at privatisation' refers to equity on companies' balance sheets at the point of privatisation.
Source: Oxera analysis.

As shown in Figure 1.3, beginning from AMP8 in 2025, the England and Wales water sector RCV is anticipated to grow significantly in real terms, financed by both debt and equity—from AMP8 (2025–30) through to AMP12 (2045–50), **approximately £140bn in debt and over £110bn in equity is needed in the next 25 years across the sector on notional basis.** Our estimates for each AMP are shown in Table 1.1.

Table 1.1 Estimated debt and equity capital financing requirements from AMP8–AMP12 (£bn, real 2022–23 prices)

	AMP8	AMP9	AMP10	AMP11	AMP12	Total
Debt	17.1	28.7	27.7	29.2	39.1	141.8
Equity	14.3	23.5	22.6	23.9	32.0	116.3

Note: Figures are estimated by drawing upon Ofwat's FD per annum figures for AMP8, assuming notional gearing, and Ofwat's modelled equity injections. For AMP9 onwards, figures are based on company LTDS submissions, using the midpoint RCV (average RCV) of each AMP and capital breakdown assuming notional gearing. Invested equity includes equity injections and retained earnings.
Source: Oxera analysis.

This highlights that raising new equity of this scale is considerably different to any other investment period since privatisation. This inevitably draws attention to Ofwat's assumptions in its PR24 FD, in particular those around equity injections. For example, in AMP8 alone, Ofwat modelled sector-wide equity injections of £12.6bn, equivalent to 27% of the sector's opening regulated equity (using 55% notional gearing). For ANH, Ofwat assumed equity injections of £1.5bn, or 33% of its opening regulated equity. In other words, **ANH is expected to raise around a third of its opening regulated equity in the coming AMP8, on a notional basis.**

Plainly, this underlines the **need to ensure that the regulatory environment is conducive to attracting the requisite equity investment**. Failing this, companies would not be able to deliver on the enhancement programme needed by the sector and its customers, thus negatively impacting the environment, customers, and the economy.

1.3 Ofwat's PR24 FD shows that the notional company is an unattractive investment because investors will not see net dividends for ten years, at the earliest

Ofwat's PR24 FD does not provide a compatible environment for the raising of equity capital. Indeed, numerous aspects of Ofwat's FD fail to

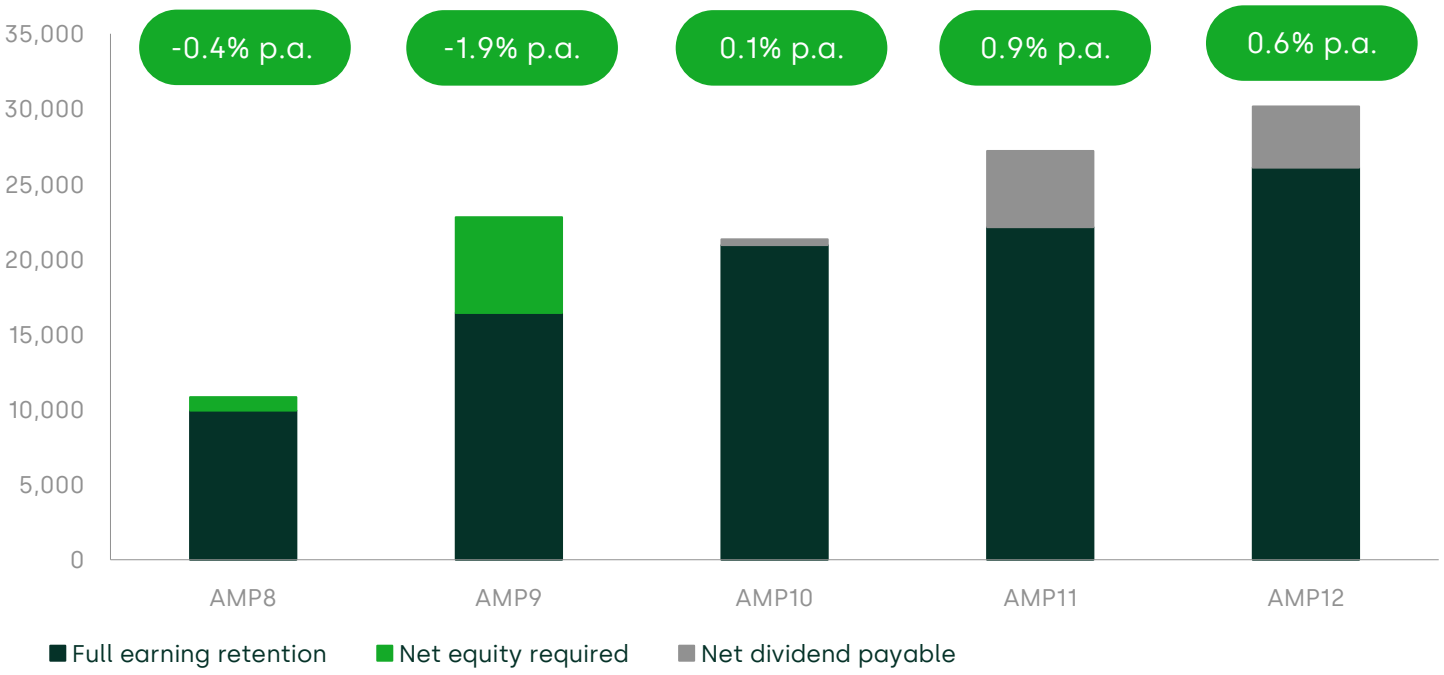
consider the very real challenges to investment, such that the outlook for investors in the water sector is unpromising. Before detailing the specific parameter choices that drive this, this can be summarily illustrated by considering the immediate prospects investors are faced with.

Drawing on the PR24 FD figures and data from companies' LTDS submissions, we use Ofwat's allowed cost of equity of 5.1% (CPIH-real) to estimate the base returns generated by the sector through to AMP12. We then derive the required debt and equity capital needed to fund the sector's CAPEX programme, while maintaining notional gearing at 55%.

Our results show that, at the sector level, even if all base returns were retained to fund investment, i.e. no dividends are paid, net new equity would still be required for the notional company in AMP8 and AMP9. In other words, **notwithstanding Ofwat's dividend payment assumptions for the notional company in the PR24 FD, investors would face an 'implied net dividend' that is negative for at least ten years from the start of AMP8.** [9] This is shown in Figure 1.4.

[9] We define the implied net dividend yield as the difference between equity required, and dividends payable. Where this figure is positive, dividends outweigh required equity investment, and investors are net cash flow positive (i.e. receive a net dividend). Where the implied net dividend yield is negative, required equity investment outweigh dividends, and investors are net cash flow negative (i.e. inject net equity). Equity injections are also needed to reflect Ofwat's assumption of opening notional gearing in AMP8 of 55%, reduced from 60% in AMP7. This effectively assumes a de-gearing of the sector between AMP7 and AMP8. While this impact is not presented in our results here, we have analysed this scenario and present it in the Appendix.

Figure 1.4 Sector equity profile and implied net dividend, no de-gearing (£m real, 2022–23 prices)



Note: Callouts show the average implied net dividend on a per annum basis, for each year of the respective AMP. Sector refers to WaSCs only. We assume no de-gearing of the notional company in this specification.
Source: Oxera analysis.

It is only from AMP10 that the water sector would be in a position to pay dividends, after accounting for equity required to maintain notional gearing, and to fund enhancement programmes. However, this 'excess' equity equates to a net dividend yield of only 0.1% p.a., averaged over AMP10. While this improves to 0.9% and 0.6% p.a. in each of AMP11 and AMP12 respectively, **the level of implied net dividends shows that the investment proposition has shifted to a materially longer and uncertain payback period, which is less attractive to equity investors.** This is worse when considering the cumulative net dividends that investors would receive over this time period.

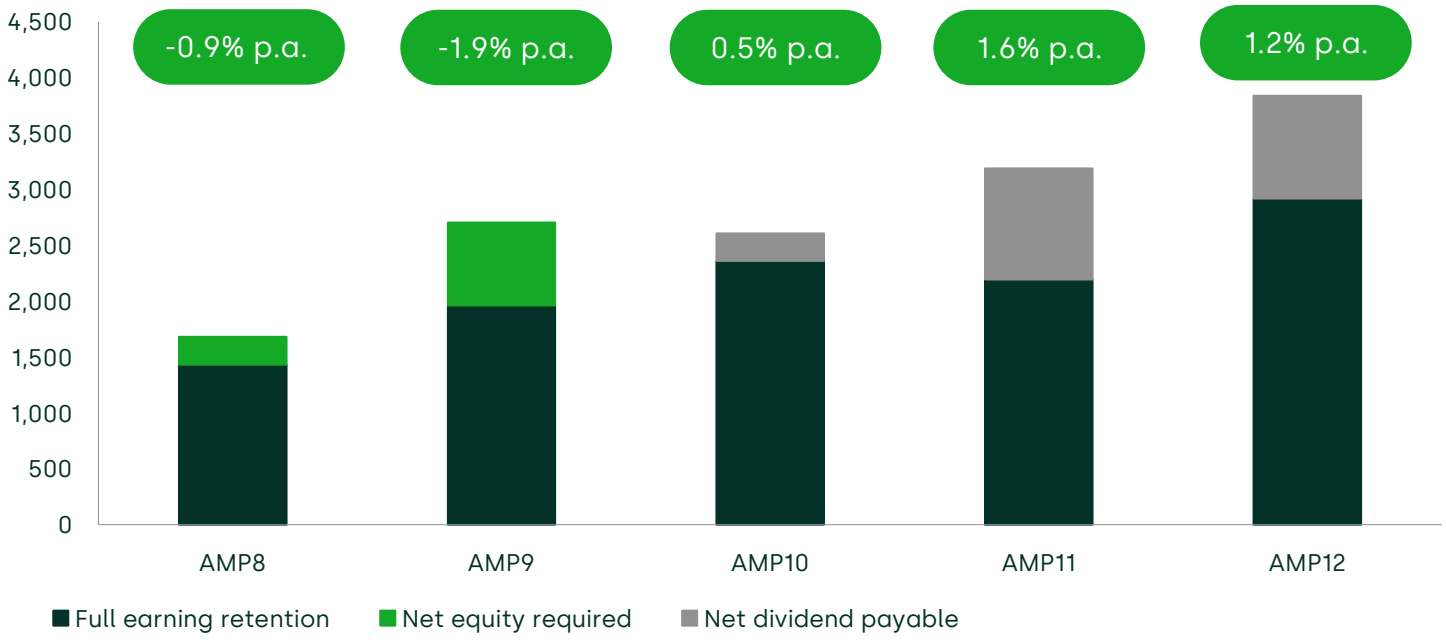
Figure 1.5 Cumulative net dividends, ANH v Sector (WaSCs only), no de-gearing (£m real, 2022–23 prices)

	AMP8	AMP9	AMP10	AMP11	AMP12
Anglian	-249	-993	-747	247	1167
Sector	-901	-7257	-6870	-1799	2263

Note: ANH shown on LHS axis. Sector refers to WaSCs only. We assume no de-gearing of the notional company in this scenario.
Source: Oxera analysis.

Figure 1.5 shows that **on a cumulative basis, investors in the water sector, as seen through the lens of Ofwat's notional company, would only receive net positive dividends partway through AMP11—over three AMPs or over 15 years after the initial AMP8 investment, on average**.

Figure 1.6 ANH equity profile and implied net dividends, no de-gearing (£m real, 2022–23 prices)



Note: Callouts show the average implied net dividend on a per annum basis, for each year of the respective AMP. We assume no de-gearing of the notional company in this scenario.
Source: Oxera analysis.

Even upon achieving net positive cash flows, **investors would not receive a reasonable dividend yield on their investments, even up to AMP12**. Our analysis in Figure 1.6 shows that for ANH's investors, upon achieving net positive cash flows partway through AMP11, the implied net dividend yield would only be 1.6% p.a. in AMP11, and 1.2% p.a. in AMP12. This compares to 0.9% and 0.6% p.a. for the sector in each of AMP11 and AMP12.

In short, for the notional ANH, its investors are faced with the prospect of only turning net cash flow positive, on a cumulative basis, on their investment after c. 3 AMPs (or after c.15 years), and even then only to receive a net dividend yield of under 2% p.a. in AMP11 and AMP12.

Significantly, this is before any de-gearing is factored into the analysis. As Ofwat's PR24 FD sets the notional gearing at 55% at the start of AMP8 (reduced from 60% in AMP7), this assumes, hypothetically, that the notional company de-gears between AMP7 and AMP8. To illustrate the impact of this assumption, we also build this into our analysis of the equity injection required to achieve the reduction to the notional gearing. Our results are presented in the Appendix.

1.4 Conclusions

AMP8 is the start of a multi-AMP period of a step-change in the level of investment. This acceleration in spending and the associated need for equity capital is at a scale and pace which has never been tested under Ofwat's regulatory regime. Given this background, it is imperative that Ofwat provides an environment that supports investment, by ensuring that water companies are able to attract the requisite equity capital needed in order to finance these investment plans, and ultimately to deliver for customers and the environment.

However, Ofwat's PR24 FD does not create such an environment. Our analysis shows that notwithstanding Ofwat's dividend assumptions, investors in AMP8 would only receive net positive dividend yields partway through AMP10, and even then, would receive yields of <1% p.a. through to AMP12. On a cumulative basis, this means that investors in the notional company would only achieve a net positive cash flow position from partway through AMP11—over 15 years after their initial investment.

Such an investment proposition is highly unlikely to be attractive to any investor. This consequently impacts the sector's ability to raise equity to finance its investment programmes, and diminishes its ability to deliver for customers and the environment.

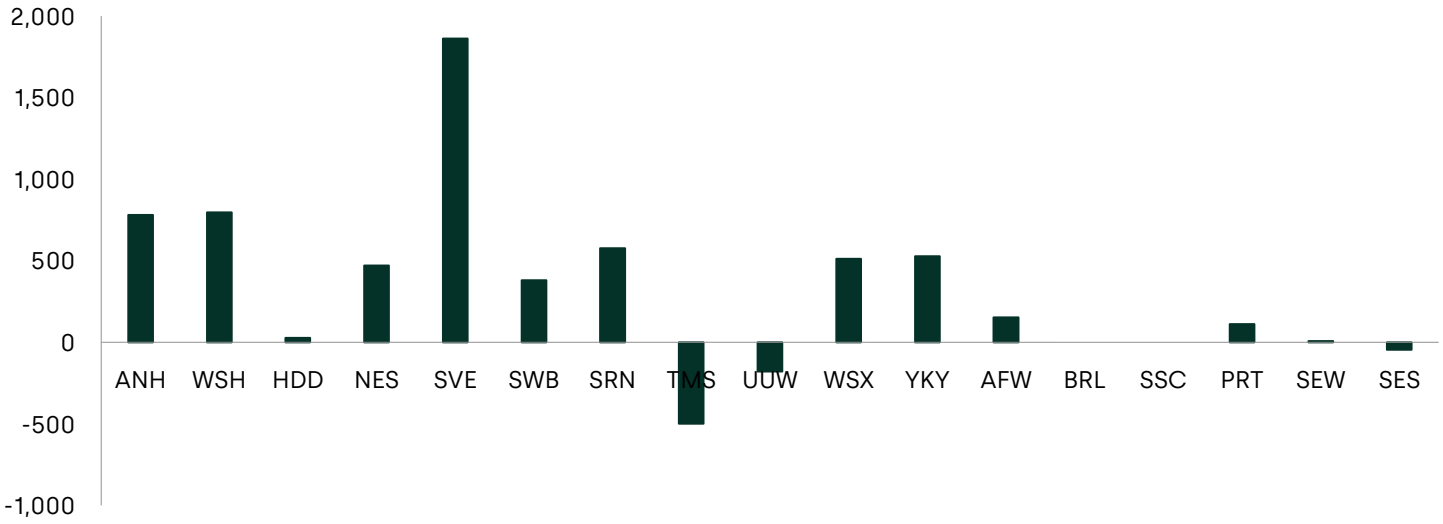
2 Financeability in PR24

2.1 Financeability hinges on hypothetical investability assumptions by Ofwat

In simple terms, if the water sector is not investable, it would also not be financeable. Without being able to attract sufficient equity, companies' financial resilience would dwindle, ultimately hampering the delivery for customers. Similarly then, a sector that is not financeable would also not be investable.

Applying this to Ofwat's PR24 FD approach of modelling for hypothetical and considerable 'equity solutions', and given the context set out in Section 1, we consider that **Ofwat's assumptions over equity investment being forthcoming are unrealistic**. This has a direct impact on the actual funds the sector is able to raise, and raises challenges to financeability—which in turn further weakens the ability to attract capital.

Figure 2.1 Delta between Ofwat's PR24 FD modelled notional equity injections v Company DD responses on notional equity injections (£m real, 2022–23 prices)



Source: Oxera analysis.

In Ofwat's FD model for ANH, Ofwat assumes that equity injections would be c. £1.5bn (real, 2022–23 prices)—this is c. £780m more than

what ANH had modelled in its DD response.[10] Notwithstanding that this assumption of additional equity is hypothetical (not least because ANH's own modelled injection of c. £740m is conditional only upon the base return being set at the appropriate level), it is observable that this is necessary to resolve financeability gaps arising from Ofwat's FD allowances.[11] However, **Ofwat does not consider whether this is achievable, particularly in light of the need for further equity injections in future AMPs.** If the equity cannot be raised, then ANH will not be able to maintain a BBB+/Baa1 credit rating on a notional basis. The result must be a sharp reduction in the proposed investment programme.

2.2 Ofwat's PR24 FD is not financeable and signals challenges to financial resilience and investability

Ofwat's own PR24 FD model shows that the notional ANH is not financeable, even without any changes to Ofwat's assumptions and all its modelled equity injections. This is because of the following amendments to ratings agency criteria.

1 In November 2024, Moody's downgraded their score for the UK water sector from Aa to A, reflecting Moody's assessment of the stability and predictability of the regulatory environment. This had the knock-on impact of increasing the Baa1 adjusted interest coverage ratio (AICR) threshold to 1.6–1.8x (from 1.5–1.7x previously), while the gearing threshold was reduced to 68% (from 72% previously).[12]

2 In February 2025, S&P, in announcing several downgrades of water companies, highlighted that the regulatory advantage for water companies had reduced to Strong/ Adequate (from Strong previously), while its view of volatility was increased to Medial for some companies. The net effect of this is that S&P's funds from operations (FFO)/Net Debt thresholds were updated

[10] This increase occurred concurrently with Ofwat increasing the dividends paid assumption to 4% in the FDs, from 2% in DDs. Effectively, this means that the increase to equity injections partly finances the increased dividend payment assumption.
[11] Specifically, Ofwat's additional modelled equity injection was determined by solving for the notional gearing assumption of 55%. Where gearing rises past 57.5%, equity was then modelled to be injected to return to notional gearing of 55%.
[12] Moody's (2024), Moody's Ratings places Anglian Water's A3 ratings on review for downgrade, 13 November.

across the sector.[13] For our assessment in this section, we use the range of 11–14% to maintain a BBB+ rating.[14]

3 In several ratings actions taken in February 2025, Fitch indicated at its sector view, citing higher business risk and aspects of the FD that could lead to greater uncertainty. In doing so, Fitch tightened its ratings thresholds for the sector and for the BBB+ rating, namely its post-maintenance interest coverage ratio (PMICR, cash: 1.7–2.0x, from 1.6–1.9x previously, and nominal: 1.9–2.1x, from 1.8–2.0x previously). Also the threshold for gearing has been lowered to 60–65%, from 62–67% previously. [15]

Table 2.1 shows the outputs from Ofwat's financial model for ANH without any input changes or updates. Given the changes to the thresholds highlighted above, it is clear that the notional ANH under Ofwat's FD is not financeable, as (i) the AICR metric is barely above the Moody's and Fitch thresholds, and (ii) the FFO/Net Debt metric fails to come within S&P's criteria range.[16] If the cost of debt were updated to our cut-off of 31 January 2025, these metrics would be even weaker—this is shown in the Appendix.[17]

[13] For the purposes of the financeability assessment in this sector, we use the range of 11–14% for the notional ANH to maintain a BBB+ rating. This is due to the actual ANH rating benefiting from a whole-business securitisation (WBS) structure, which accords it a higher rating of A-. At this rating, the updated threshold range is 11–14% (from 9–11% previously). As the notional company is not assumed to benefit from the WBS and its one-notch uplift, we thus consider that a fair threshold range for BBB+ should be 11–14%. See: (i) S&P Ratings (2025), U.K. Water Regulatory Framework Support, Low Financial Flexibility In Coming Regulatory Period Drive Rating Actions, 15 February, (ii) S&P Ratings (2024), Criteria | Corporates | General: Corporate Methodology, 2 May, accessed https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/12913251.

[14] See footnote above.

[15] Thresholds shown refer to a BBB+ issuer default rating. The cash PMICR is equivalent to the AICR. See: (1) Fitch (2025), Fitch Revises Osprey Acquisition's Outlook to Negative; Affirms Anglian Debt at 'A-', 14 February, accessed: https://www.fitchratings.com/research/corporate-finance/fitch-revises-osprey-acquisition-outlook-to-negative-affirms-anglian-debt-at-a-14-02-2025, (2) Fitch (2025), Fitch Affirms UUW's Senior Unsecured at 'A-'; Downgrades UU's Senior Unsecured to 'BBB+', 12 February, accessed: https://www.fitchratings.com/research/corporate-finance/fitch-affirms-uuw-senior-unsecured-at-a-downgrades-uu-senior-unsecured-to-bbb-12-02-2025.

[16] Our FFO/Net Debt results presented in this report, unless otherwise stated, refers to the 'alternative calculation' as depicted in Ofwat's FD model. This is because this version of the metric is based on S&P's approach which removes the indexation of index-linked debt from the FFO component.

[17] This is presented in the Appendix. We update Ofwat's FD model to reflect market updates to the iBoxx A/BBB benchmark index, plus the 30bps benchmark index adjustment allowed on the cost of new debt.

Table 2.1 ANH notional key financial ratios under Ofwat's FD model

Key financial ratios	2025-26	2026-27	2027-28	2028-29	2029-30	AMP8 average
Adjusted cash interest cover ratio (AICR)	1.71	1.71	1.71	1.71	1.71	1.71
Funds from operations / net debt (FFO/Net Debt)	9.29%	9.40%	9.39%	9.44%	9.66%	9.45%
FFO/Net Debt (Ofwat approach)	10.23%	10.31%	10.30%	10.33%	10.49%	10.34%

Note: In this table we present both the 'Ofwat approach' and 'alternative approach' (the latter as denoted in Ofwat's FD model for the FFO/Net Debt metric). The 'alternative approach' is the metric relied upon by S&P in making its ratings decisions as it removes from FFO the impact of indexation of index-linked debt—therefore, we present this metric only from this point forwards.
Source: Oxera analysis.

Extending this analysis, we find that (i) without the FD modelled equity injections, the notional ANH fails to meet the BBB+/Baa1 ratings thresholds, and (ii) **even if no dividends were paid, the notional ANH under Ofwat's FD would still fail to meet the financeability criteria.**[18] This is shown in Table 2.2, where the Moody's and Fitch AICR/ PMICR threshold is breached in Year 4 of AMP8 and onwards.

Table 2.2 ANH notional key financial ratios under Ofwat's FD model, assuming no equity injections, and no dividends paid

Key financial ratios	2025-26	2026-27	2027-28	2028-29	2029-30	AMP8 average
Adjusted cash interest cover ratio (AICR)	1.74	1.74	1.72	1.69	1.66	1.71
Funds from operations / net debt (FFO/Net Debt)	9.69%	9.64%	9.41%	9.21%	9.23%	9.41%

Source: Oxera analysis.

[18] We present in the Appendix analysis results with equity injections removed but dividends kept unchanged from the FDs. We do not update for market data to our cut-off in this analysis to keep the FD model otherwise unchanged. Results show that the notional ANH is unlikely to be financeable.

In other words, even after equity injections and dividends are set to zero, the notional company cannot meet the thresholds for a BBB+/Baa1 rating. **We therefore consider that Ofwat has failed to meet its financeability duty in its PR24 FD.** This further weakens the investability of the sector.

This is made more material when we study the longer-term impact of Ofwat's PR24 FD on the financeability of the notional ANH going into AMP9 and beyond. Using economic-form analysis, we apply Ofwat's PR24 FD combined with data from company LTDS submissions to develop a long-term view of financeability, using the implied AICR as a proxy.[19] Results are presented in Table 2.3.

Table 2.3 Notional ANH economic-form analysis of AICR to AMP12

	AMP8 average	AMP9 average	AMP10 average	AMP11 average	AMP12 average
Economic-form AICR	1.70	1.59	1.52	1.50	1.50

Note: Economic-form modelling calculated based on Ofwat FD allowance updated for market data as of 31 January 2025.
Source: Oxera analysis.

Our analysis corroborates the results from the FD financial model, and finds that the notional ANH would fall below the AICR thresholds by Year 4 of AMP8. Unless interest rates fall, the overall cost of debt will increase in future AMPs as new debt is raised at higher rates than companies currently pay on average on their debt. This leads to a steady weakening of the AICR, tending towards 1.5x.[20] **This shows that the allowed rate of return on equity in the PR24 FD is too low for the notional company to start AMP9 with a BBB+/Baa1 credit rating. Maintaining AICR above the 1.7x threshold level would require the allowed cost of equity to trend towards 7% in future AMPs.**

[19] The economic form exercise focuses on the AICR metric, and calculates this as the WACC divided by cash interest costs. For this exercise, we adopt fully Ofwat's PR24 FD methodology for the estimation of the cost of capital, and update this for market data up to our cut-off of 31 January 2025. Simultaneously, we model for the proportion of new debt using the notional gearing assumption, and rate of RCV growth as under the FD and LTDS. We then draw these assumptions through to AMP12, and calculate the implied AICR for each year.
[20] This level is met once the proportion of new debt on the notional company balance sheet mechanistically reaches 100%, i.e. carries a cost equivalent to the cost of new debt under the PR24 FD. This is a reasonable modelling assumption in place of forecasting the future cost of debt.

Coupled with our earlier analysis, this illustrates the importance of setting a higher cost of equity allowance because equity needs to be attracted not just for AMP8, but also for AMP9 and onwards.

2.3 Using Ofwat's model to determine the appropriate balance of assumptions to achieve financeability

Building on the exercise in Section 2.2, we next use Ofwat's FD model to resolve iteratively the financeability challenges apparent in the FDs. We first set the cost of equity at the level which we consider is necessary to attract the requisite equity, i.e. a basis for investability. Next, we solve for the required net equity injection, using Ofwat's notional gearing assumption of 55% as a constraint. Finally, we solve for the appropriate FFO/Net Debt using alternative input RCV run-off assumptions.[21] We define net equity injections as the remaining equity required to be injected net of base dividends generated. Effectively, this determines if the notional equity investor would receive a net positive payout in AMP8.

To achieve this, we apply a specific range of assumptions, as follows.

- ANH's estimated cost of equity of 6.25%;[22]
- ANH's estimated cost of debt of 3.71%;[23]
- No retail margin adjustment in arriving at the wholesale WACC;[24]
- All index-linked debt is linked to CPIH;[25]
- Gearing cap of 55% in each year of AMP8;[26]
- PR19 FD RCV run-off rates;[27] and
- All other assumptions consistent with Ofwat's FDs.

The results of this scenario are presented in Table 2.4. The analysis finds that both the AICR and FFO/Net Debt metrics sit within the required

[21] For this exercise, we define achieving financeability as recording an AICR of at least 1.7x, and FFO/Net Debt of at least 11%, consistent with our earlier detailed thresholds for Moody's and S&P.
[22] Derived from our report prepared for ANH, estimating its cost of equity for PR24. Oxera (2025), PR24 Cost of equity estimation, 21 March.
[23] Derived from KPMG's report prepared for ANH, estimating its cost of debt for PR24. See KPMG (2025), Estimating the cost of capital for PR24, March.
[24] Ibid.
[25] We consider this to be internally consistent for the notional company with an RCV entirely linked to CPIH-inflation. Ofwat's FD assumption of 90% of index-linked debt being RPI-linked, rather than CPIH-linked, materially understates the cash interest payments of the notional company. Whilst actual companies retain some RPI-linked debt, the RCV is CPIH-linked. This means that RPI-linked debt represents a risk to companies, as any fluctuations in the RPI-CPIH differential would impact companies' realised interest payments on debt. While this risk can be hedged away, Ofwat has not included an allowance for these costs, nor have they recognised the cost of derivatives that some companies have used to achieve this hedge.
[26] This assumption is valid as the wider regulatory construct, including the determination of the cost of capital, is done on a notional basis. In this context, we thus assume that the notional gearing assumption therefore applies.
[27] PR19 run-off rates are more aligned to ANH's natural run-off rate, rather than the reduced PR24 FD run-off rates.

range for a BBB+/Baa1 credit rating. Under these specifications no net equity injection would be required in AMP8, as equity injections of £1.22bn (nominal) would be covered by base dividends of £1.42bn (nominal), i.e. investors receive a net positive dividend £196m. While this is still a very low implied net dividend yield (of c. 0.7% p.a. averaged over AMP8), this is a significant improvement in the investment proposition over Ofwat's PR24 FD presented in Section 1 which implies a net dividend yield that is negative for investors in the notional ANH.

Table 2.4 ANH notional key financial ratios under Ofwat's FD model with adjusted specifications

Key financial ratios	2025-26	2026-27	2027-28	2028-29	2029-30	AMP8 average
Adjusted cash interest cover ratio (AICR)	1.76	1.76	1.76	1.76	1.76	1.76
Funds from operations / net debt (FFO/Net Debt)	11.52%	11.40%	11.34%	11.40%	11.65%	11.47%

Note: We assume an allowed cost of equity of 6.25%, cost of debt of 3.71%, no retail margin adjustment, PR19 FD run-off rates, all index-linked debt is CPIH-linked, and a gearing cap of 55% p.a. We then solve for the equity injection needed
Source: Oxera analysis.

In other words, our analysis in this section shows that **if the notional ANH is allowed its requested cost of equity and cost of debt, and if its RCV run-off rates were set at equivalent levels to PR19, the need for net equity injection, i.e. the need to inject equity on top of reinvesting dividends would be eliminated.** Instead, investors into the notional ANH would receive a net positive dividend, albeit a low one and investors would still have to forego almost all dividends in AMP8. At the same time, **the notional ANH would be able to achieve key financial ratios which are consistent with the thresholds for a BBB+/Baa1 rating, thus ensuring financeability.**

2.4 Conclusions

Our analysis in this section shows that even without any changes to Ofwat's PR24 FD, the notional company will not meet the credit metric thresholds for a BBB+/Baa1 rating. This follows recent adverse credit rating agency decisions to downgrade the England and Wales water sector and/or water companies, which have led to more stringent thresholds for the required rating of Baa1/ BBB+. This should be recognised in the first instance, as it signals how water sector

financeability continues to be pressured by Ofwat's policy decisions, and how this weakens investability further.

We find that under the PR24 FDs, if all equity injections were removed, the notional ANH would not meet any of the applicable ratings thresholds. Even if no equity was injected and no dividends paid, the key financial ratios of the notional company would still be below the threshold ranges required by Moody's, Fitch, and S&P, indicating that underlying financeability is substantially weakened under Ofwat's FD package.

This illustrates the gap between Ofwat's assumptions in the FD, and what is practical or achievable in reality. It is not credible for Ofwat to 'assume away' financeability gaps arising from its own allowances by relying on 'equity solutions'—this is equivalent to seeking new equity investment to re-capitalise a company with weak financial resilience that has been caused by insufficient allowed returns. It cannot be likely that investors would inject equity capital into negative net present value (NPV) investments.

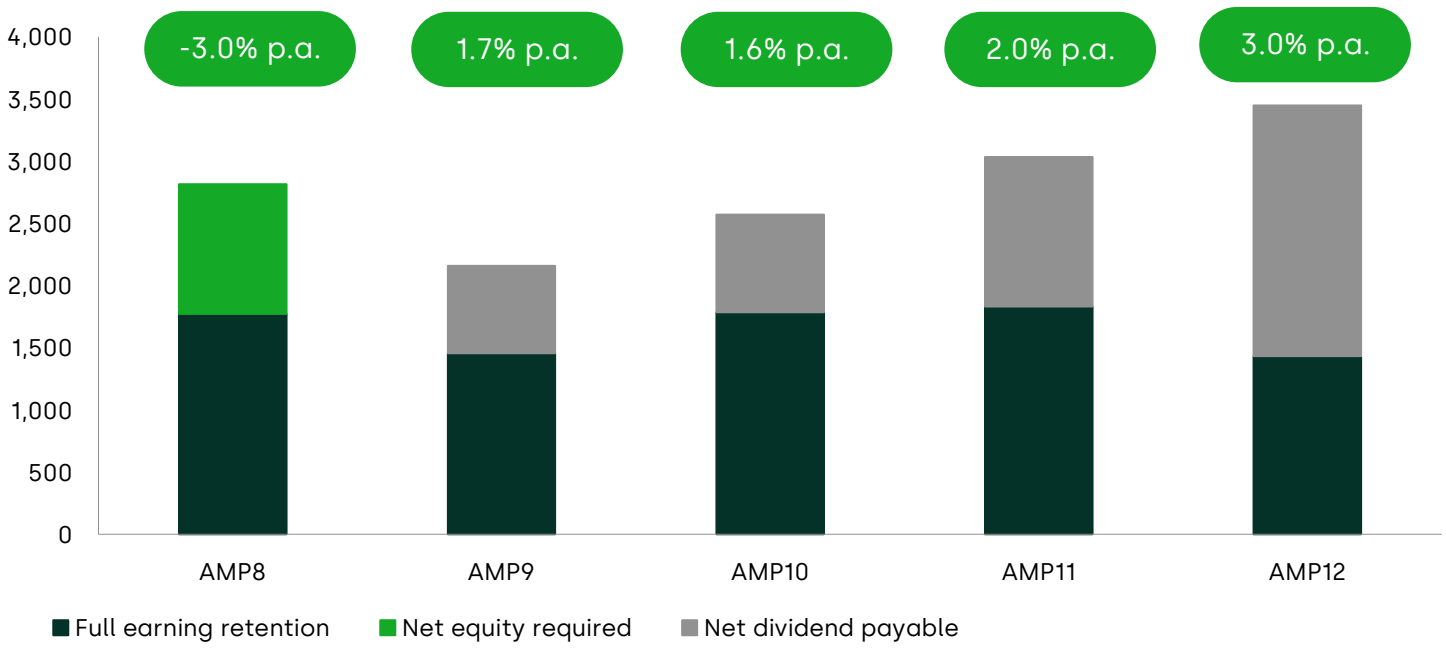
Instead, we consider that to resolve financeability, ANH's requested cost of equity and cost of debt should be allowed, while returning its RCV run-off rates to those in PR19, as detailed in Section 2.3. We find that this approach achieves a solution that is likely to be both financeable and investable.

3 Appendix

3.1 Equity profile and implied net dividend yield analysis—alternative specifications

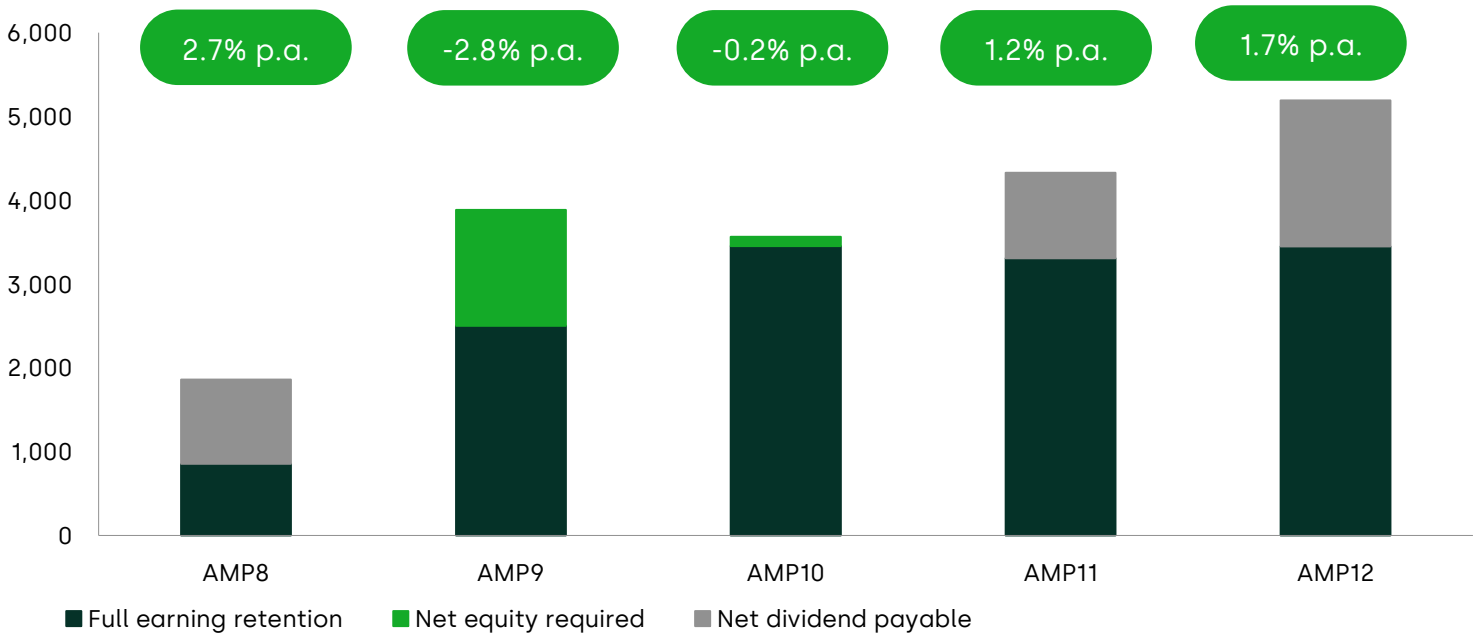
We present below results from our analysis studying the implied net dividends for Severn Trent (SVT) and United Utilities (UU), as being among the top performers in the sector. We find that the implied net dividend profile for both of these show a marked difference to that of the wider sector—SVT is able to generate implied net dividends from AMP9, and both are able to pay net dividends of in excess of the sector average.

Figure 3.1 SVT equity profile and implied net dividends, no de-gearing (£m, real)



Note: Callouts show the average implied net dividend on a per annum basis, for each year of the respective AMP. We assume no de-gearing of the notional company in this scenario.
Source: Oxera analysis.

Figure 3.2 UU equity profile and implied net dividends, no de-gearing (£m, real)



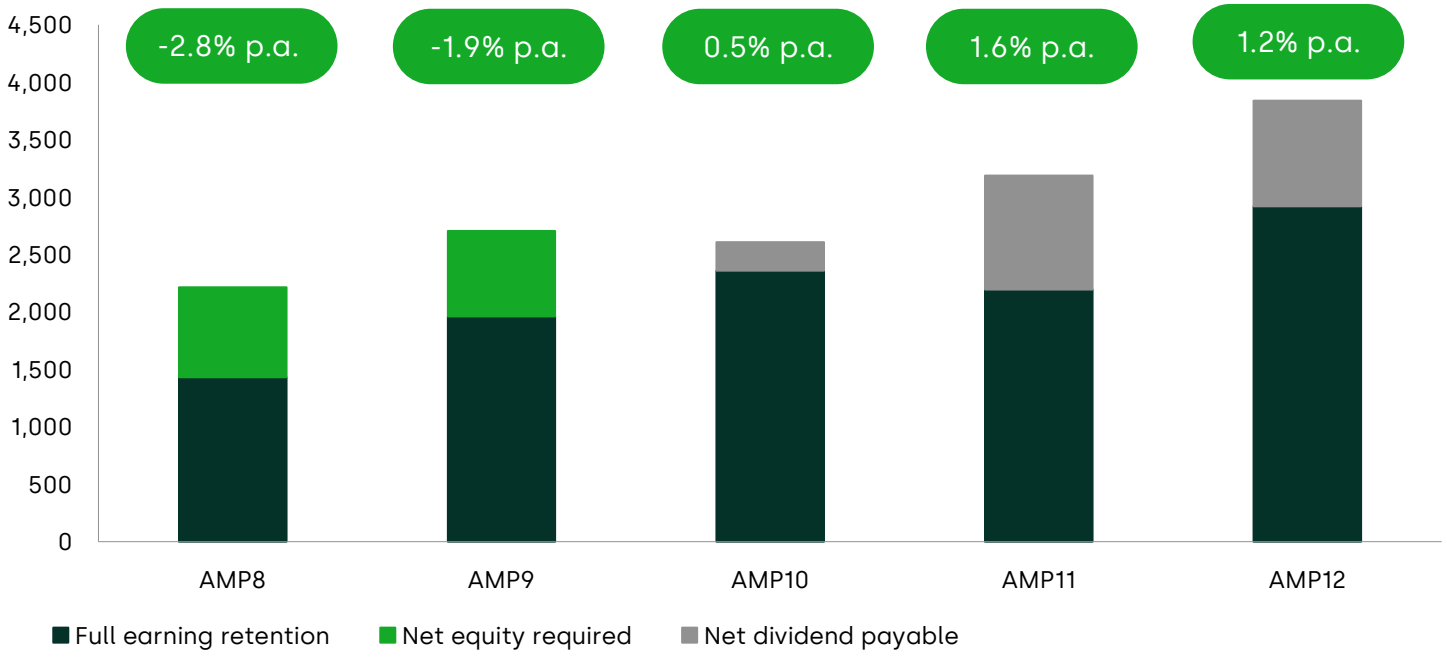
Note: Callouts show the average implied net dividend on a per annum basis, for each year of the respective AMP. We assume no de-gearing of the notional company in this scenario.
Source: Oxera analysis.

As explained in Section 1, our analysis of the net cash flow or net dividend to investors is based upon deducting the required equity financing from base returns. The data used in this analysis is derived from the AMP8 FD, and from LTDS data from AMP9 onwards.

The amount of required equity is influenced by Ofwat's modelled injections in its PR24 FD, and the anticipated level of spend from both the PR24 FD and company LTDS submissions. In addition to this, given Ofwat's assumption of starting notional gearing of 55% in AMP8 (from 60% in AMP7 previously), this hypothetical de-gearing would thus drive further the amount of equity required to be injected.

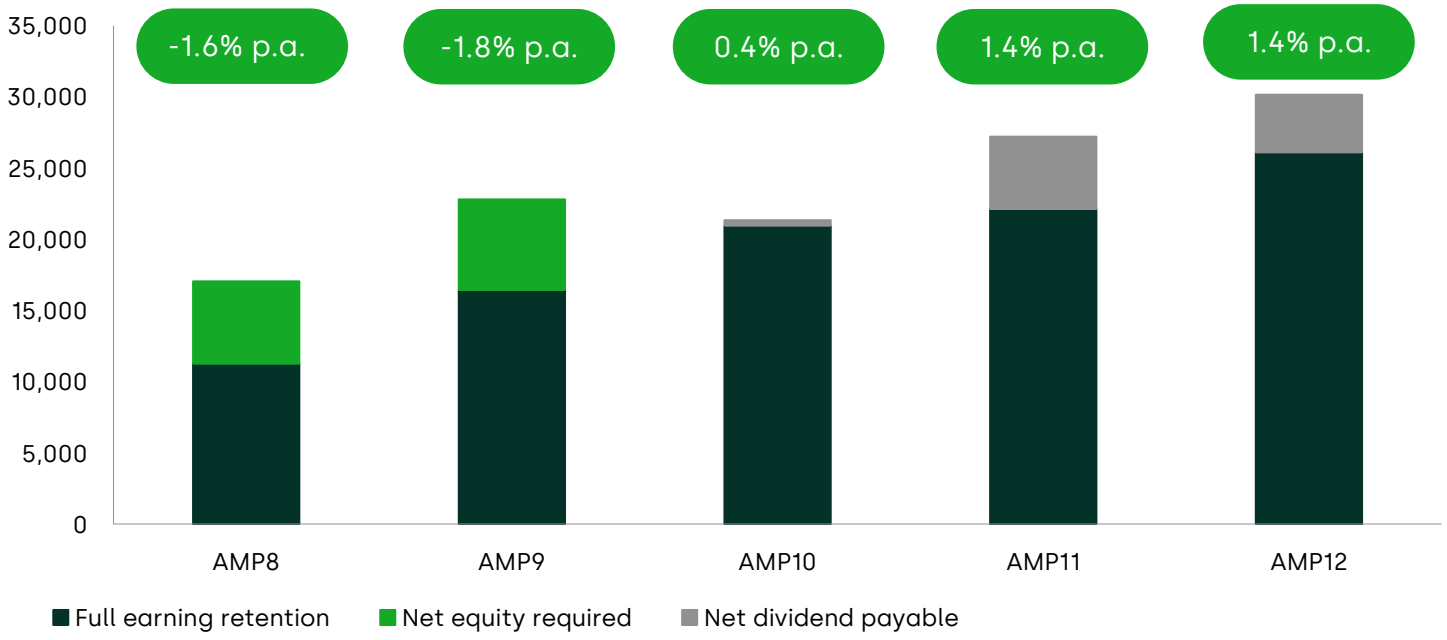
We present the various results of our analysis by de-gearing scenario below.

Figure 3.3 ANH equity profile and implied net dividends, notional de-gearing over AMP8 (£m, real)



Note: Callouts show the average implied net dividend on a per annum basis, for each year of the respective AMP.
Source: Oxera analysis.

Figure 3.4 Sector equity and implied net dividends, notional de-gearing over AMP8 (£m, real)



Note: Callouts show the average implied net dividend on a per annum basis, for each year of the respective AMP. Sector refers to WaSCs only.
Source: Oxera analysis.

3.2 Financeability analysis of PR24 FD model—alternative specifications

Table 3.1 ANH notional key financial ratios under Ofwat's FD model, with cost of debt market update to cut-off

Key financial ratios	2025-26	2026-27	2027-28	2028-29	2029-30	AMP8 average
Adjusted cash interest cover ratio (Ofwat)	1.69	1.68	1.69	1.69	1.69	1.69
Funds from operations / net debt (Ofwat)	10.22%	10.30%	10.30%	10.33%	10.48%	10.33%

Note: Assumes that the cost of debt and corresponding Ofwat allowance is updated to reflect cost of debt as of 31 January 2025 (following Ofwat's FD methodology).
Source: Oxera analysis.

Table 3.2 ANH notional key financial ratios under Ofwat's FD model, assuming no equity injections

Key financial ratios	2025-26	2026-27	2027-28	2028-29	2029-30	AMP8 average
Adjusted cash interest cover ratio (Ofwat)	1.71	1.65	1.59	1.52	1.45	1.57
Funds from operations / net debt (Ofwat)	10.23%	9.68%	9.10%	8.57%	8.20%	9.02%

Source: Oxera analysis.

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