S&P Global Ratings

Research

U.K. Water Regulatory Framework Support, Low Financial Flexibility In Coming Regulatory Period Drive Rating Actions

February 18, 2025

- Water companies in England and Wales will deliver their biggest investment programs since privatization, totaling £104 billion, in the upcoming five-year regulatory period (AMP8) starting April 2025. This follows the regulator's (Ofwat) publication of the final determination (FD) for each company on Dec. 19, 2024.
- While this indicates a much greater investment allowance from Ofwat versus AMP7 and a significant growth in future regulatory capital values, we also see significant execution risks associated with the massive capital investment increase. In particular, the sector experienced overspending against allowances in AMP7 and is now expecting greater scrutiny from the regulator regarding the delivery of business plans in AMP8.
- We expect the execution of these business plans will put additional strain on the water companies' balance sheets, which we already consider to have limited financial flexibility. We think that each company will require significant debt funding throughout the period and most may need additional equity funding. We expect negative free cash flow generation would limit the scope for deleveraging without equity injections.
- The sector will receive various forms of equity investments, demonstrating its ability to attract new capital during AMP8, and bolster financial metrics against otherwise tighter financial thresholds where relevant. However, we believe the current allowance for cost of equity compares unfavorably with other regulatory allowances. We anticipate that the amount of raised capital will fall short of Ofwat's assumptions, whose notional company gearing of 55% is expected to remain far from any actual company's gearing which is projected to be significantly above this over AMP8.
- Although we expect that substantially higher bills, as allowed under the FD, will enhance future cash flow generation and boost future credit metrics over AMP8, we consider that both Ofwat and some water companies will face major challenges over AMP8 to ensure customers' broad acceptance of these increases.
- We have revised our view of the preliminary regulatory advantage for water companies in England and Wales to strong/adequate from strong.
- We think that these risks are more pronounced for certain companies and result in different rating outcomes, as a result of both altered business risk assessments and rating thresholds at multiple rating levels.

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LONDON (S&P Global Ratings) Feb. 18, 2025--S&P Global Ratings today took rating actions on the following U.K. water utilities (for full details, please see the ratings list below):

- We affirmed our 'BBB+' rating on the class A debt instruments and our 'BBB-' rating on the class B debt instruments issued by Affinity Water Finance PLC, removed the ratings from CreditWatch negative, and assigned a negative outlook to both classes.
- We lowered by two notches our issue ratings on the senior secured debt issued by Anglian Water Services Financing PLC to 'BBB', and assigned stable outlooks.
- We lowered by one notch our issue ratings on the debt issued by DWR Cymru (Financing) UK PLC to 'BBB+' for class B debt and to 'BBB-' for class C debt, and assigned a negative outlook to both classes.
- We affirmed our 'BBB+' long-term ICR on Severn Trent Water Ltd. and 'BBB' long-term issuer credit rating (ICR) on Severn Trent PLC and maintained the stable outlooks.
- We lowered by one notch our issue ratings on the senior secured debt issued by South East Water (Finance) Ltd. to 'BBB-' and placed the rating on CreditWatch with negative implications.
- We affirmed our 'BBB-' long-term ICR on South Staffordshire PLC, 'BBB' long-term ICR on SSW Finance Ltd., 'BBB+' long-term ICR on South Staffordshire Water PLC,and revised the outlooks to stable from negative.
- We extended our CreditWatch with negative implications on the 'BBB-' rating for the bonds issued by SW (Finance) I PLC, the financing vehicle of Southern Water Services Ltd.
- We affirmed our 'BBB' long-term ICR on Sutton and East Surrey Water PLC, removed the ratings from CreditWatch negative, and assigned a stable outlook.
- We affirmed our 'BBB+' long-term ICR on United Utilities Water Ltd. and 'BBB' long-term ICR on United Utilities PLC and revised the outlooks to stable from negative.
- We lowered by one notch our issue ratings on the debt instruments issued by Yorkshire Water Services Finance Ltd. and Yorkshire Water Finance plc to 'BBB+' for class A debt and to 'BBB-' for class B debt, and assigned a stable outlook to both classes.
- When applicable, we affirmed our 'AA' issue credit ratings on the senior secured debt guaranteed by Assured Guaranty UK Ltd. (AA/Stable/--). The outlook on this debt is stable.

U.K. water companies summary of ratings and metrics

Company	Rating type	Rating/outlook	SACP	Business risk profile	Financial risk profile	Volatility table	FFO/Debt thresholds	Average FFO/Debt range over AMP8
Affinity Water Finance PLC	Class A	BBB+/Negative	bbb	Excellent	Highly leveraged	Medial	8%-11%	8%-9%
	Class B	BBB-/Negative	bbb-	Excellent	Highly leveraged	Medial	7%-10%	7%-8%
Anglian Water Services Financing PLC	Senior secured debt	BBB/Stable	bbb-	Excellent	Highly leveraged	Medial	6%-8%	6%-7%
DWR Cymru (Financing) UK PLC	Class B	BBB+/Negative	bbb	Excellent	Highly leveraged	Medial	8%-11%	7.5%-8.5%

U.K. water companies summary of ratings and metrics (cont.)

Company	Rating type	Rating/outlook	SACP	Business risk profile	Financial risk profile	Volatility table	FFO/Debt thresholds	Average FFO/Debt range over AMP8
	Class C	BBB-/Negative	bbb-	Excellent	Highly leveraged	Medial	7%-10%	7%-8%
Severn Trent Water Ltd.	ICR	BBB+/Stable	bbb+	Excellent	Aggressive	Low	9%-12%	9%-10%
South East Water (Finance) Ltd.	Senior secured debt	BBB-/Watch Neg	bb+	Strong	Highly leveraged	Medial	7%-9%	7%-9%
South Staffordshire Water PLC	ICR	BBB+/Stable	bbb+	Excellent	Aggressive	Medial	11%- 14%	11%-12%
SW (Finance) I PLC	Senior secured debt	BBB-/Watch Neg	bb+	Strong	Highly leveraged	Medial	7%-9%	6%-8%
Sutton and East Surrey Water PLC	ICR	BBB/Stable	bbb	Excellent	Highly leveraged	Medial	9%-12%	9.5%-10.5%
United Utilities Water Ltd.	ICR	BBB+/Stable	bbb+	Excellent	Aggressive	Low	9%-12%	10%-11%
Yorkshire Water Services Finance Ltd.	Class A	BBB+/Stable	bbb	Excellent	Highly leveraged	Medial	8%-11%	8.5%-9.5%
	Class B	BBB-/Stable	bbb-	Excellent	Highly leveraged	Medial	7%-10%	8%-9%

SACP--Stand-alone credit profile. ICR--Issuer credit rating. Class A, Class B, and Class C debt refer to issue ratings.

Preliminary Regulatory Advantage Assessment

We now consider that U.K. water companies will operate in a less supportive regulatory environment. The changes in the current and upcoming regulatory periods that would indicate a heightened risk perception for the sector are no longer consistent with our strongest regulatory advantage assessment. Out of the four pillars that we use to assess the supportiveness of the preliminary regulatory advantage: regulatory stability; tariff-setting procedures and design; financial stability; and regulatory independence and insulation (see: "Sector-Specific Corporate Methodology," published April 4, 2024), we consider that the framework's supportiveness has weakened on regulatory and financial stability as well as regulatory independence and insulation.

Regulatory stability. We consider the regulator has shifted its focus from affordability and reducing bills in real terms during the previous price review in 2019 (PR19) to significant investment growth, in part funded by sizable increases in bills for the 2024 price review (PR24). Such a change in focus hinders regulatory stability due to the abrupt increase in capital investment requirements from one period to another, which will force the sector to accelerate its investment plans while maintaining a quality of service that is in line with operational requirements.

Financial stability. Our assessment of a framework's financial stability depends on the sector's ability to attract long-term capital, particularly when heavy investments are needed, while ensuring that financial leverage remains in check. Since the start of PR24, we have observed various equity commitments being made from respective shareholders, with the momentum growing after the publication of the FD, leading to stronger financial metrics sometimes offsetting our tighter guidance. While this demonstrates that the sector can attract equity, we consider that the risk-return trade-off is less favorable for U.K. water companies than their counterparts in the U.K. regulated energy sector. For instance, Ofgem, the regulator for energy companies, provided in December 2024 its early view on cost of equity, for which the midpoint of 5.05% (in real terms adjusted for the Consumer Prices Index including owner occupiers' housing costs, assuming an equivalent 55% gearing level for electricity transmission networks) is broadly similar to that of Ofwat's FD (5.03%, early view of 4.14%). We consider the water sector riskier than electricity transmission networks, owing to a deterioration in public and political perception and weaker financial resilience across the sector, exemplified by the ongoing financial stress facing Thames Water, the largest company in the sector.

As a result, we anticipate that the amount of raised equity over AMP8 will likely fall short of the regulator's assumptions, whose notional company gearing of 55% will remain far below any actual company's gearing. The regulatory framework is designed for the notional capital structure, which sets assumptions regarding gearing, cost of financing, types of financing instruments, and expenditure allowances that will lead to outcomes that are materially different to those under the companies' actual capital structures.

Regulatory independence and insulation. We continue to view positively the strong legal backing for the regulatory framework for England and Wales since its privatization in 1989. Still, we consider that Ofwat has been subject to continuous scrutiny and political pressure in recent years. This is also against the backdrop of increasing public scrutiny of environmental issues related to the sector, with low public confidence that water and sewerage companies (WaSCs) are fulfilling their duty. Consumers and other stakeholders are not only expecting a high quality of service, but also greater protection of the environment. WaSCs must comply with the EA's obligations regarding wastewater treatment and overflows of untreated sewage, which can pose litigation and reputational risks.

A substantial reform agenda was initiated in Autumn 2024, the most prominent of which being the Independent Commission chaired by Sir Jon Cunliffe, which will likely result in significant changes to the U.K. privatized regulated model. Although we think this would not necessarily result in a worse outcome for the England and Wales water sector, we expect a period of uncertainty in the regulatory environment.

The FD saw improvements across the industry compared with the draft determination (DD) published in July 2024, signaling a more compromised approach from Ofwat. We see that total expenditure (totex) allowances were set more or less in line with what most companies asked in their business plan representations, with the industry receiving on average a 7% challenge from Ofwat. Changes to the energy and business rates allowances largely benefited companies across the board in terms of base expenditure, with some companies having a slightly larger allowed base expenditure than what they had asked and reopeners for new costs that arise during the period. Most cuts came from enhancement expenditure; however, the introduction of gated allowances for investments totaling £2.3 billion will also support companies' ability to carry out long-term investment projects.

We also see Ofwat intending to rebalance rewards and penalties between the stronger and weaker performers. The introduction of sharing and adjustment mechanisms to totex and outcome delivery incentives (ODIs) and a higher proportion of overspend that can be passed onto customers will reduce the extreme levels of over- and underperformance throughout the AMP. It will also contribute somewhat to lower cash flow volatility, contrary to what we have seen during AMP7.

We think that these risks are more pronounced for certain companies and lead to different rating outcomes, as a result of both different business risks and different rating threshold calibrations at various rating levels. Although we maintain the majority of the sector in the excellent business risk profile category, we consider that the use of the medial volatility table (see:"Corporate Methodology," published Jan. 7, 2024) better reflects our risk perception for most companies in the sector. Companies that are in this category would typically have their business plans assessed as standard by the regulator and with a mixed track-record on a variety of elements, positioning each company more or less equally against its peers in terms of regulatory advantage. These elements would typically include, for example, quality of service assessments by the regulator, profitability levels, and past and expected levels of operational and financial performance. We would also consider gearing levels relative to regulatory assumptions in assessing their business risk.

We consider that few companies can create a sustainable competitive advantage through their regulatory strategy and ability to manage the regulatory process effectively. We continue to use the low volatility table for Severn Trent Water Ltd. and United Utilities Water Ltd. These companies would typically display a track record of strong operational and financial performance over AMP7 and a relatively favorable FD, marked by our expectation that management will be able to deliver a business plan in line with its allowances while exceeding its performance commitments. We would also typically expect gearing levels to be closer to the notional company's expectation from the regulator.

Conversely, we consider that for some companies, the higher risk is reflective of the overall final determination package for AMP8.

There are uncertainties associated with the execution of their business plans under such conditions, and they usually had a track record of below average operational performance during AMP7--and in some cases significant fines. For these companies we also note material funding requirements not only to finance their respective capital programs but also to avoid liquidity pressures in the short term.

We are observing a gradual decoupling within the sector in light of increasing discrepancies between companies that consistently lead and those that lag behind the sector on a variety of operational and financial indicators. We believe that these dynamics are reflected in our recalibration of the credit metrics for most U.K. water companies.

Water Companies Face Multiple Challenges During AMP8

AMP8 will, in our view, be a pivotal regulatory period for the sector, which will face many challenges in the upcoming five years. An all-time high capital program creates significant execution risks and will further constrain the sector's balance sheets. The FD package comes as a large front-loaded increase (+77% in real terms) in allowances by the regulator versus the previous regulatory period, and +18% over the DD in July 2024, signaling a compromise approach from the regulator. For some companies, the gap remains sizable between allowances and business plan requests, well above the 7% sector average. The whole sector will have to execute a much bigger capital program than in the past. This poses a significant execution risk to ensure the program can be delivered in due course and within the allowances, considering a track record of overspending in AMP7. Though part of this would be in anticipation of AMP8 and to a significant extent, due to inflationary pressures on energy and chemicals for which there are new protection mechanisms in place. Each company will face significant pressure to secure its supply chain and financing accordingly and management to ensure the right execution of the plan in a timely fashion and within budget. Furthermore, they will face additional scrutiny from the regulator in AMP8 with the inclusion of price control deliverables, resulting in expanded oversight of delivery through increased reporting and the application of time-based incentives. Some companies remain markedly below the allowances requested in their business plan resubmissions, resulting in additional efficiency challenges and contingent allowances, based on additional evidence being provided to the regulator.

Most companies in the sector currently have relatively constrained balance sheets, with funds from operations (FFO) to debt metrics projected to remain below 10% for the majority of the sector. Many companies are subject to Ofwat's concerns about financial resilience. Given the significant increase in capital intensity expected during AMP8, we anticipate companies will not only continue but also markedly increase the amount of negative free cash flow generation over the period. These investments add to the companies' regulatory capital value and contribute to enhancing future returns through regulatory depreciation. The funding gap is however sizable and will have to be covered by a marked increase in debt and equity levels--despite a noticeable increase in bills in real terms.

The U.K. water sector will need to restore confidence from all stakeholders to ensure it can justify steep bill increases. We consider that the U.K. water sector currently experiences a fairly low level of public support, with both politicians and consumers expressing dissatisfaction--further exacerbated by severe financial stress facing Thames Water. We believe that water companies will have to make decisive efforts to improve this sentiment, notably in delivering better performance and improving quality of service. They will face substantial challenges to justify the major bill increases in the interim. We expect public sentiment toward the sector could further deteriorate when the magnitude of the price rise starts affecting customers in 2025. Water companies are also facing the risk of higher levels of arrears, considering existing levels already average 8% for household customer (as of March 2024) before a 36% average bill increase throughout the period. Despite the increase in social tariffs for eligible consumers that companies have promised to deliver in AMP8, we still consider an increase in arrears a significant risk.

Some water companies have asked Ofwat to refer their FD to the Competition and Markets Authority (CMA). If accepted, the CMA would then commence an independent price review process, and its redetermination would apply to the companies that have appealed. We note that an appeal may not lead to meaningful improvements in our perception of a company's creditworthiness. Should a company appeal, it would still have to deliver its business plan for at least the first year of the next regulatory period in line with the parameters as described in Ofwat's FD.

Other than the communication of the rationale for the appeal and the uncertainty this creates for management in terms of delivering their biggest capital programs in history, we would be particularly focused on the company's approach toward managing liquidity risk while expecting for its redetermination. Our liquidity assessment would still consider a 12-month window in terms of sources over uses.

Structurally Enhanced Debt Issue Ratings

We could increase the number of notches differential between instruments for structurally enhanced debt transactions (SEDs) with senior secured and subordinated debt issuances. We believe the deferral risk for subordinated debt in SEDs could rise more rapidly as the senior debt is lowered to the 'BBB' category. We would likely widen the rating gap between the senior debt and subordinated debt to more than two notches to reflect this risk if the subordinated stand-alone credit profile (SACP) were to fall toward 'bb+' or lower.

We continue to see protection provided for structurally enhanced debt transactions as providing credit support to senior creditors and continue to apply a one-notch uplift to senior debt issue credit ratings from the senior debt SACP as long as they meet our criteria for this uplift.

Affinity Water Finance PLC

Primary analyst: Julien Bernu

Outlook

The negative outlook reflects our view of the currently limited headroom on our key credit metrics for Affinity Water during the next regulatory period, that is S&P Global Ratings-adjusted FFO to debt of 8% for its class A (senior secured) debt and 7% for consolidated debt. This includes our expectation that the group will receive a £150 million equity injection by March 2026 enhancing its financial metrics and maintain the current ratings despite otherwise tighter thresholds. We also assume in our base case that the group's liquidity position will remain adequate with liquidity sources covering uses by more than 1.1x on any prospective 12-month period. This assumes a timely refinancing of its July 2026 maturities (£250 million bond and about £91 million of accretion payable on inflation-linked swaps) ahead of a significant ramp-up in its capital expenditure program. Although we currently anticipate some efficiency challenges for the group based on the comparison with its FD and its submitted business plan, we believe it will be able to execute its plan broadly in line with its allowances with a mostly neutral ODI position.

Downside: We would lower the rating on Affinity Water's senior secured and consolidated debt if we believed that shareholders would not provide equity support to the group for the execution of its business plan by March 2026, or if the group is unable to maintain its liquidity position as adequate ahead of a significant increase in funding needs for 2026.

Additionally, we would lower the rating if we consider that the group is unlikely to post credit metrics commensurate with the rating thresholds, at the current rating level, which could be the result of significant financial or operational setbacks during the execution of the AMP8 business plan.

A downgrade of the senior debt would likely result in more than one notch downgrade of the subordinated debt, given we would see a higher deferral risk.

Upside: We could revise the outlook to stable if Affinity Water demonstrates its commitment to deleveraging via the drawdown of a £150 million equity commitment by fiscal 2026, bolster its liquidity profile with the refinancing of its July 2026 maturity by the end of fiscal 2025. The ratings could also stabilize if there is sufficient visibility on the group's ability to maintain a comfortable and sustainable buffer above our current rating threshold for its class A and B debt throughout AMP8.

Anglian Water Services Financing PLC (AWS)

Primary analyst: Andres Dascoli

Outlook

The stable outlook is based on AWS' FD outcome, characterized by a sizable capital program. We believe the company will achieve credit metrics around 7% for AMP8. AWS received a totex allowance of £11 billion, which represents a 2% cut to the company's business plan representation, with all cuts being on base expenditure. We estimate AWS' capex to average £1.6 billion yearly during AMP8, weighing on the company's credit metrics. We expect AWS to operate with ongoing ODI penalties during AMP8, putting further pressure on financial metrics.

Downside: We could lower the rating on AWS' debt if the group faces difficulty delivering its business plan. This could be due to either significant cost underperformance or larger than expected ODI penalties, leading to adjusted FFO to debt falling sustainably below 6%.

Upside: We currently see limited upside potential for AMP8 based on the significant uptick in the group's capital program over the period. We could consider raising the ratings if the group's adjusted FFO to debt exceeded 8% on a sustainable basis. This could happen if AWS demonstrated higher-than-expected operational performance during AMP8, the company were able to achieve certain totex outperformance, and shareholders were to commit to a higher rating at the operating company through equity injections.

Dwr Cymru (Financing) UK PLC (DWR)

Primary analyst: Gustav Rydevik

Outlook

The negative outlook reflects our view that the FD outcome for DWR will provide limited headroom to the 8% FFO-to-debt threshold on senior credit metrics and 7% based on its consolidated credit metrics. Although the company received almost all its requested £6 billion totex allowance for the period, we believe past performance leading to ODI penalties for the company may persist during AMP8 due to the regulatory performance targets it has received.

Downside: We could downgrade DWR if it does not deliver on its business plan leading to significant levels of penalties on its ODI targets. A negative rating action could also be linked to a significant negative financial or reputational impact on the group linked to the ongoing investigation from Ofwat and the EA into how the company manages its wastewater treatment works.

We could also downgrade DWR if we see signs of a weakening liquidity position or if its FFO is eroded by the high interest resulting from refinancing of its upcoming maturities.

A downgrade of the senior debt would likely result in a greater than one-notch downgrade of the subordinated debt, given we would see a higher deferral risk.

Upside: We could revise the outlook to stable if the upcoming maturities are successfully refinanced at interest rates that do not have a material detrimental effect on the company's FFO to debt. We would revise the outlook to stable if DWR sustainably maintains FFO to debt above 8% for senior debt and 7% on a consolidated basis.

Severn Trent PLC (SVT); Severn Trent Water Ltd. (STW)

Primary analyst: Julien Bernu

Outlook

The stable outlook is based on STW's strong operational record and credit metrics, currently projected to remain above our 9% threshold at the current 'BBB+' rating over AMP8. STW in our view benefits from a sustainable competitive advantage compared with the majority of its peers in the U.K. water sector with regard to its strong operational and financial track record over AMP7 and positioning ahead of AMP8. Although we currently anticipate some efficiency challenges for the group based on the comparison with its FD and its submitted business plan, and a limited level of financial headroom at the current level, we believe that STW will be able to execute its business plan in line with allowances and post credit metrics commensurate with our current 'BBB+' rating on STW.

Downside: We could lower the 'BBB' rating on SVT and 'BBB+' rating on STW if we were to consider that the group's delivery of its AMP8 business plan were to be more challenging than anticipated, with either significant cost underperformance or ODI penalties, suggesting that our perception of the group's ability to take advantage of its regulatory settlement has weakened. If this were to be the case, we would likely revise our rating thresholds upward, which could result in a downgrade should the group not benefit from any headroom at that level.

Absent any of these elements, a downgrade could also occur if we believe that adjusted FFO to debt would not remain sustainably and comfortably above a 9% average over AMP8.

A negative rating action could also be linked to a significant negative financial or reputational impact on the group due to the ongoing investigations by Ofwat and the EA into how the company manages its wastewater treatment works and networks.

Upside: We currently see limited upside potential on the ratings for AMP8 based on the significant uptick in the group's capital program over AMP8 and the resulting relatively modest level of headroom at the current rating level. We would consider raising the ratings if the group's adjusted FFO to debt exceeded 12% on a sustainable basis and STW demonstrated sector-leading operational performance during the current regulatory period, while committing to a higher rating.

South East Water (Finance) Ltd. (SEW)

Primary analyst: Andres Dascoli

CreditWatch

The CreditWatch negative placement reflects our view that the company faces persistent financing needs that will continue to create liquidity challenges. In December 2024, the group received a loan extension until June 2026, that together with a £75 million equity injection eased liquidity pressures. We could lower the rating on the debt issued by South East Water (Finance) Ltd. by one notch if there is no shareholder support by end of May 2025 that would allow the group to maintain adequate liquidity for the 12 months prior to the loan's maturity and to finance its capital program for the rest of AMP8.

SEW's business risk profile is now assessed as strong from excellent. The higher risk is reflective of the overall final determination package for AMP8 coupled with the uncertainties associated with the execution of its business plan under such conditions and a track record of weak supply interruptions performance during AMP7.

While a significant improvement from the draft determination, SEW received meaningful cuts to its business plan, corresponding to 13% of totex and bill increase compared to its business plan re-submission. Most cuts were on its proposed enhancement costs, 25% less versus its proposal, suggesting lower RCV growth during the period. Regarding bills, despite the cut, it was allowed a 25% increase compared to the AMP7 average.

We believe that recent liquidity pressures significantly increase the risk profile of SEW compared to most of its peers in the water sector, considering the large increase in capex the group will have to execute over AMP8.

South Staffordshire Water PLC (SSW), South Staffordshire PLC (SSPLC), SSW Finance Ltd. (SSF)

Primary analyst: Gustav Rydevik

Outlook

The stable outlook is based on SSW's strong operational record and we expect the company will achieve S&P Global Ratings-adjusted FFO to debt above our 11% threshold for AMP8. We expect the shareholders will continue to provide support to the group, including equity injections and revise the dividend payout strategy to preserve the cash within the group.

Downside: We could lower the ratings on SSW, SSF, and SSPLC if we were to consider that the group's delivery of its AMP8 business plan were to be more challenging than anticipated, with either significant cost underperformance or ODI penalties. A downgrade could occur if FFO to debt falls below 11% on average over AMP8, even after any mitigating actions.

We could consider a downgrade if the EBITDA contribution from unregulated activities exceeds 25% compared with 22% currently.

We could also lower the ratings if refinancing is not made in a timely manner, and we see deterioration of liquidity sources over uses to below 1.1x over any 12-month period.

Upside: We currently see limited upside potential on the rating for AMP8 based on the significant uptick in the group's capital program over the period. We could consider raising the ratings if the group's adjusted FFO to debt exceeded 14% on a sustainable basis, and SSW demonstrated continued good operational performance during the remainder of AMP7, while committing to a higher rating.

SW (Finance) I PLC

Primary analyst: Julien Bernu

CreditWatch

The extension of our CreditWatch with negative implications indicates that we would lower the rating on the debt issued by SW (Finance) I Plc, the financing vehicle of Southern Water Services (SWS), possibly by multiple notches, if we were to consider that the group's liquidity position will no longer remain adequate by the end of March 2025. A less-than adequate position would correspond to liquidity sources not covering uses by more than 1.1x, for the 12-month period starting March 2025.

Ahead of about £810 maturing in March-end 2026, we believe that, to meet this threshold, SWS would be required to:

- Draw a significant portion of the £900 million equity that we expect will be committed by its majority shareholder (funds managed by Macquarie Asset Management) by June 2025;
- Secure, by end of March 2025, additional funding sources to refinance its A4 £350 million bond maturing 31st March 2026;
- Extend, or secure funding sources to repay (or combination thereof), by end of March 2025, the £455 million accretion paydown on inflation-linked swaps due in March 2026; and about £175 million (notional value) of mandatory breaks due in November 2025.

While SWS also has the option to defer parts of its capital investment program to bolster its liquidity position, we consider this solution as only temporary. This is because of the group's significant regulatory requirements and capex run-rate (£1.4 billion per annum on average) over AMP8.

We understand that the company and its shareholders have started these processes and would expect these to be facilitated by MAM's indication of its commitment to remain a long-term shareholder of the group following the announcement of another equity injection (adding to £1.65 billion injected since 2021 and dividend forgone since then and until at least the end of AMP8). For the group's liquidity to be credited with the benefits of the equity injection, we would look for confirmation that any commitment to inject the £900 million into Southern Water is legally binding and unconditional. We would expect to receive additional information on the development of these processes and likelihood of realization before the end of March. By that time, we believe we would be in a better position to assess the sustainability of the company's liquidity position ahead of its maturities due in March 2026.

Separately, we would also lower the rating if we were convinced that the group would not be able to post S&P Global Ratings-adjusted FFO to debt sustainably above 7% over AMP8. We expect metrics to be above this threshold for the first two years of AMP8 benefitting from the proceeds of the equity injection, but consider that capital intensity and negative free cash flow generation would likely pressure the metrics toward the end of the period.

If we were to lower our rating on the debt issued by SW (Finance) I PLC to below 'BBB-', we would likely cease to consider the transaction as benefiting from a one-notch uplift above its SACP as a structurally enhanced debt transaction and would instead align both the issue ratings and SACP. This would be because SWS' large swap portfolio, with a negative mark-to-market position of about £1.5 billion to date, is super senior in the company's claims and would rank ahead of the senior secured class A debt. We believe this would significantly affect creditors' prospects of recovery.

Under the Southern Water Group's finance documentation, it is an event of default if the underlying credit rating on the company's bonds, in each case as ascribed by any two rating agencies, is less than the minimum required for an investment-grade credit rating ('BBB-' or higher). The group would then enter its credit remedy period (sometimes referred to as a standstill period), during which creditors would suspend their enforcement claims, apart from the right to sell the shares in the operating subsidiary, but debt service would be uninterrupted because payments due would be made from the dedicated liquidity facility. The credit remedy period provides time for the financing group to implement measures to strengthen its credit quality.

Sutton and East Surrey Water PLC (SES Water)

Primary analyst: Andres Dascoli

Outlook

The stable outlook is based on SES Water's strong operational record for the last years of AMP7, coupled with the ongoing support from its parent company. We believe that SES Water's access to funding sources benefits from being part of the Pennon Group, both in terms of equity and debt. We expect SES Water to maintain FFO to debt above our 9% threshold throughout AMP8.

Downside: A downgrade could occur if SES Water's FFO to debt falls below 9% on average over AMP8. This could happen if the company's delivery of its AMP8 business plan were to be more challenging than anticipated, with either significant overspend or ODI penalties. We could also lower the rating if our view of Pennon Group's credit quality deteriorates.

Upside: We currently see limited upside potential. We could consider raising the ratings depending on our view of Pennon Group's credit quality and if SES Water's adjusted FFO to debt exceeded 12% on a sustainable basis.

United Utilities PLC (UU); United Utilities Water Ltd. (UUW)

Primary analyst: Gustav Rydevik

Outlook

The stable outlook is based on UUW's strong operational record and that the company will achieve credit metrics above our 9% threshold for AMP8. UU received a totex allowance of £13.3 billion, which represents a 5% cut to the company's business plan representation. With the cuts mainly being made on enhancement expenditure, we expect UU to achieve some totex efficiency to operate in line with the totex allowance. We also believe the company will continue to achieve solid operating performance and will execute its business plan, with expectations of achieving some ODI rewards despite the tougher targets.

Downside: We could lower the ratings on UU and UUW if we see the group's delivery of its AMP8 business plan as more challenging than anticipated, with either significant cost underperformance or ODI penalties. If this were the case, we would likely revise our rating thresholds upward to reflect the increased risk perception for the U.K. water sector, which could result in a downgrade should the group not achieve credit metric headroom at that level.

We could also downgrade the company if we believe that FFO to debt would not remain sustainably above 9% on average over AMP8.

A negative rating action could also be linked to a significant negative financial or reputational impact on the group due to the ongoing investigation by Ofwat and the EA into how the company manages its wastewater treatment works.

Upside: We currently see limited upside potential for AMP8 based on the significant increase in the group's investment program over the period. We could consider raising the ratings if the group's adjusted FFO to debt exceeded 12% on a sustainable basis, and UUW demonstrated continued sector-leading operational performance during the remainder of AMP7 and were also committed to maintaining a higher rating level.

Yorkshire Water Services (Finance) (YWS)

Primary analyst: Gustav Rydevik

Outlook

The stable outlook is based on YWS' FD outcome, strong shareholder support and operational record, as well as our view that the company will achieve credit metrics above our 8% threshold for AMP8. We expect the shareholders will continue to provide support to the group, including their commitment to repay a legacy intercompany loan valued at around £600 million, including accrued interest before March 2027 and dividend payments below Ofwat's base dividend yield guidance.

Downside: We could lower the rating on YWS if we were to consider that the group's delivery of its AMP8 business plan would be more challenging than anticipated, with either significant cost underperformance or ODI penalties. A downgrade could occur if we thought that FFO to debt would not remain sustainably above 8% on average over AMP8, even after any mitigating actions.

A downgrade of the senior debt would likely result in a greater than one notch downgrade of the subordinated debt, given we would see a higher deferral risk.

Upside: We currently see limited upside potential for AMP8 based on the significant uptick in the group's capital program over the period. We could consider raising the ratings if the group's adjusted FFO to debt exceeded 11% on a sustainable basis, and YWS demonstrated higher operational performance than expected during AMP8.

Related Criteria

- Criteria | Corporates | General: Sector-Specific Corporate Methodology, April 4, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Corporates | Utilities: Rating Structurally Enhanced Debt Issued By Regulated Utilities And Transportation Infrastructure Businesses, Feb. 24, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Southern Water Services Ltd.'s Debt Downgraded To 'BBB-' On Challenging Financing Conditions, Remains On Watch Negative, Oct. 31, 2024
- Research Update: Anglian Water Services Debt Ratings Placed On CreditWatch Negative On Potential Revision To Regulatory Framework Support, Nov. 6, 2024
- Various Rating Actions Taken On Eight U.K. Water Companies On Potential Revision To Regulatory Framework Support, Nov. 12, 2024
- S&P Global Ratings Definitions, Dec. 2, 2024
- Thames Water Utilities Finance PLC's Class A Debt Rating Lowered To 'CC', Class B To 'C' On Proposed Restructuring, Oct. 28, 2024
- Thames Water Utilities Ltd. Rated 'CC' Pending Restructuring; Outlook Negative, Dec. 17, 2024

- Industry Credit Outlook 2025: EMEA Utilities, Jan. 14, 2025
- U.K. Economic Outlook 2025: Monetary Policy And Trade To Offset Fiscal Impetus, Nov. 26, 2024
- Water Investments In England And Wales Poised To Nearly Double Over 2025-2030, Oct. 5, 2023

Ratings List

*** * * * * * * * * * * * Affinity Water Finance PLC * * * * * * * * * * * ***		
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Affinity Water Finance PLC		
Senior Secured	BBB+/Negative	BBB+/Watch Neg
Subordinated	BBB-/Negative	BBB-/Watch Neg
*** * * * * * * * * * * * Anglian Water Services Ltd. * * * * * * * * * * ***		
Downgraded; CreditWatch/Outlook Action		
	To	**From**
Anglian Water Services Financing PLC		
Senior Secured	BBB/Stable	A-/Watch Neg
Ratings Affirmed		
Senior Secured	AA/Stable	
*** * * * * * * * * * * * DWR Cymru (Financing) UK PLC * * * * * * * * * * ***		
Downgraded; CreditWatch/Outlook Action		
	To	**From**
DWR Cymru (Financing) UK PLC		
Senior Secured	BBB+/Negative	A-/Watch Neg
Subordinated	BBB-/Negative	BBB/Watch Neg
Ratings Affirmed		
Senior Secured	AA/Stable	
*** * * * * * * * * * * * * Sutton and East Surrey Water PLC * * * * * * * * * * * ***		
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
Sutton and East Surrey Water PLC		
Issuer Credit Rating	BBB/Stable/--	BBB/Watch Neg/--
Senior Secured (S&P Published Underlying Rating)	BBB/Stable	BBB/Watch Neg
Senior Secured	AA/Stable	
Downgraded; CreditWatch/Outlook Action		
	To	**From**
Yorkshire Water Services Finance Ltd.		
Senior Secured	BBB+/Stable	A-/Watch Neg

YW Services Ltd.		
Senior Secured	BBB+/Stable	A-/Watch Neg
Yorkshire Water Finance PLC		
Senior Secured	BBB+/Stable	A-/Watch Neg
Subordinated	BBB-/Stable	BBB/Watch Neg
Ratings Affirmed		
Yorkshire Water Services Finance Ltd.		
Senior Secured	AA/Stable	
*** * * * * * * * * * * * * * * Severn Trent PLC * * * * * * * * * * * * * ***		
Ratings Affirmed		
Severn Trent Water Ltd.		
Severn Trent PLC		
Issuer Credit Rating	BBB/Stable/A-2	
Senior Unsecured	BBB-	
Severn Trent Water Ltd.		
Senior Secured	BBB+	
Severn Trent Utilities Finance PLC		
Senior Unsecured	BBB+	
*** * * * * * * * * * * * * South East Water (Finance) Ltd. * * * * * * * * * * * * ***		
Downgraded		
	To	**From**
South East Water (Finance) Ltd.		
Senior Secured	BBB-/Watch Neg	BBB/Watch Neg
*** * * * * * * * * * * * * South Staffordshire PLC * * * * * * * * * * * ***		
Ratings Affirmed		
South Staffordshire Water PLC		
Senior Unsecured	BBB+	
SSW Finance Ltd.		
Senior Secured	BBB-	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
South Staffordshire Water PLC		
Issuer Credit Rating	BBB+/Stable/A-2	BBB+/Negative/A-2
SSW Finance Ltd.		
Issuer Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2
South Staffordshire PLC		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3

*** * * * * * * * * * * * * * United Utilities PLC * * * * * * * * * * * * ***

Ratings Affirmed		
United Utilities PLC		
Senior Unsecured	BBB-	
United Utilities Water Ltd.		
United Utilities Water Finance PLC		
Senior Unsecured	BBB+	
Ratings Affirmed; CreditWatch/Outlook Action		
	To	**From**
United Utilities PLC		
Issuer Credit Rating	BBB/Stable	BBB/Negative
United Utilities Water Ltd.		
Issuer Credit Rating	BBB+/Stable	BBB+/Negative
* * * * * * * * * * * * * * Southern Water Services Ltd.* * * * * * * * * * * * *		
Ratings Affirmed		
SW (Finance) I PLC		
Senior Secured	AA/Stable	
Senior Secured	BBB-/Watch Neg	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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