

South East Water: Direct procurement for customers detailed actions

In South East Water’s business plan “2020-2025 Business Plan” South East Water identified four potential schemes that met the cost threshold for Direct Procurement for Customers (DPC). We have reviewed South East Water’s assessments and during our review we identified a number of schemes which were rejected by South East Water that could be suitable for DPC. Due to a lack of information in South East Water’s business plan submission, we were unable to review the detail for each of these schemes and their suitability for DPC. The schemes that we identified were:

- Bewl Darwell Transfer
- Aylesford Newsprint WTW

We require South East Water to supply us with the following information on these schemes as follows:

Scheme	Action	Action reference
Bewl Darwell Transfer	<ul style="list-style-type: none"> • A summary of the key elements of the Bewl Darwell Transfer scheme. This should include all of the relevant scheme information including but not limited to the key deliverables. • A summary of the projected scheme costs clearly identifying the costs for each phase of the scheme by year. These should clearly identify the incremental costs to South East Water. • An economic analysis of the scheme including a Net Present Value analysis using the standardised assumptions provided in Table A. This analysis should clearly identify any additional benefit to customers of progressing this scheme outside of DPC. 	SEW.CMI.A2
Aylesford Newsprint WTW	<ul style="list-style-type: none"> • A summary of the key elements of the Aylesford Newsprint WTW scheme. This should include all of the relevant scheme information including but not limited to the key deliverables. • A summary of the projected scheme costs clearly identifying the costs for each phase of the scheme by year. These should clearly identify the incremental costs to South East Water. • An economic analysis of the scheme including a Net Present Value analysis using the standardised assumptions provided in Table A. This analysis should clearly identify any additional benefit to customers of progressing this scheme outside of DPC. 	SEW.CMI.A3

Table A – Standard assumptions for the NPV analysis of Direct Procurement for Customer schemes

The business case submissions from the water companies as part of the Price Review 2019 had thirteen economic assessments of schemes that were considered technically suitable for Direct Procurement for Customers (DPC). There were significant differences in the assumptions used to identify the NPV differential for the DPC case (factual) and in-house (counterfactual). The table below sets out a set of assumptions and range of sensitivities that should be used in the event that companies do not have any specific market information for the relevant scheme.

Area	Item	DPC (Factual) Assumptions	In-house (Counterfactual) Assumptions
Customer Payments	Value	Determined by CAP contract payments and Appointee costs	Determined by Allowed Revenues from PR framework
	Timing	From first payment by customers which would usually be expected after asset completion. If improved contractual terms are identified with earlier payments then these should be considered.	From first payment by customers which would usually be when the appointee starts collecting from customers as per its business plan 'allowed revenue' profile.
Contract period	Length	Mid-case 25 years, Lower-case 20 years, Upper-case 50 years	Not needed
PV Calculation	Period	From the start of the customer payments until the end of the asset life (or until there is no difference in asset value, maintenance and finance costs).	

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Area	Item	DPC (Factual) Assumptions	In-house (Counterfactual) Assumptions
	Discount rate	Discount rate of 3.5% real decreasing overtime (Based on HM Treasury Green Book Supplementary Guidance: discounting (3.5% 0-30 years, 3.0% 31-75 years, 2.5% 76-125 years)	
Indexation		CPIH	CPIH
Asset Depreciation	Method	Straight line or as per companies policy for asset type, the treatment should be consistent between DPC and in-house deliver.	
	Depreciation Rate	Mid-case - As per company policy for this asset type Lowercase +25% faster company policy rate	As per company policy for this asset type
Financing Costs	Cost of debt	Construction: forward Libor 6m swap + 220bsp –240bsp Operation: forward Gilt / Libor 6m swap + 120bsp –140bsp RCV bullet repayment: forward Gilt / Libor 6m swap + 120bsp –140bsp	As per company business plan
	Cost of equity	Equity IRR (Real) 8% (Upper case 7%, lower case 10%)	As per company business plan
	Gearing	Mid case 85% (Upper case 90%, lower case 80%) after asset completion.	As per company business plan or Ofwat notional of 60%.
	Assumptions	Given the ranges available above, please provide explanation justifying your selections made	N/A

Area	Item	DPC (Factual) Assumptions	In-house (Counterfactual) Assumptions
Cost differentials	Capex efficiency saving	Mid case 10% (Uppercase +15%, lowercase 5%)	In-house is base case
	Opex efficiency saving	Mid case 10% (Uppercase +15%, lowercase 5%)	In-house is base case
	Additional Bidder Costs	Additional bidder costs of 2% of capital spend, (Upper case 1%, lowercase 3%)	In-house is base case
	Procurement	Procurement costs of 1% of capital spend, (Uppercase 0.5%, Lowercase 2%)	In-house is base case
	Management	Contract management costs £150k per annum. (Lowercase £300k per annum for high operational interaction schemes)	In-house is base case
Terminal Value	Assumptions	Please disclose clearly any assumptions about terminal value	N/A