

July 2019

Trust in water

PR19 draft determinations

Affinity Water – Cost efficiency draft determination appendix

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1. Wholesale water activities

1.1 Enhancement

The tables below summarise the adjustments we make to set the efficient level of enhancement totex for the water resources and network plus water price controls. Where appropriate, we reallocate enhancement expenditure between enhancement activities. In the table, we present the company requested cost for each activity where we made a material challenge, after any reallocation that we may have done. Our disallowances to company enhancement proposals include a challenge on the need to invest, on the efficiency of the proposals or on the classification of the expenditure as enhancement (in which case we consider that the expenditure is covered by our base allowance). For draft determinations we make an adjustment to the enhancement allowances to account for an implicit allowance for enhancement opex included within our base models. We set out our method of estimating the opex implicit allowance in 'Securing cost efficiency technical appendix'. Costs for new developments, new connections and addressing low pressure are now considered within wholesale water base ("totex plus") econometric models. We show details of specific areas of material disallowance or efficiency challenge in the table below and we provide details in our published feeder models.

Table 1: Material disallowances of and efficiency challenges to enhancement costs for the water resources price control 2020-25 (£ million of 2017-18)

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All enhancement totex	156.3	153.5	132.1
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
Supply and demand side enhancements: Totals	28.2	14.0	
WINEP / NEP ~ Water Framework Directive measures	83.7	79.5	

Note 1: Our allowance for enhancement totex is net of an implicit allowance for enhancement opex. We have not netted off an implicit allowance for enhancement opex from our allowances for the individual lines.

Note 2: During our QA process we identified a non-material error in the favour of the company in the allowance for WINEP/NEP Investigations. We provide details in the relevant feeder model and we will make the adjustment at final determination..

Table 2: Material disallowances of and efficiency challenges to enhancement costs for the water network plus price control 2020-25 (£ million of 2017-18).

Area of enhancement	Company requested totex	Ofwat view of requested totex after reallocations	Our allowance
All Enhancement totex	179.5	182.2	121.8
Material areas of disallowance and efficiency challenge in enhancement totex (£ million)	Ofwat view of requested totex after reallocations	Our allowance	
Supply and demand side enhancements: Total	98.0	48.7	
Resilience	15.5	13.6	
Metering (excluding new connections) for meters requested by optants, customers and businesses	47.0	45.7	

Note: Our allowance for enhancement totex is net of an implicit allowance for enhancement opex. We have not netted off an implicit allowance for enhancement opex from our allowances for the individual lines.

1.2 Transition expenditure

Affinity Water does not request any expenditure under the transition programme.

2. Cost adjustment claims

Table 3 summarises our consideration and allowances for the cost adjustment claims submitted by the company. We give further details in our published cost adjustment claim feeder model for Affinity Water. In its resubmitted plan Affinity Water withdrew two of its cost adjustment claims from its original plan. The remaining two claims are for base expenditure for the residential retail and wholesale water network price control.

Table 3: Cost adjustment claims and our allowed totex adjustments, 2020-25 (£ million of 2017-18)¹

Description of Claim	Value of company claim	Our allowed adjustment	Rationale for decision
Population transience – regional operating circumstances	7.8	0.0	Although we accept that transience may increase costs, we reject the claim because it is already fully accounted for by the total migration variable in our residential retail cost models.
Regional wages – regional operating circumstances	12.5	0.0	The cost claim (based on the wage premium) fails to account for (a) the off-setting benefits in regions of high labour costs, such as higher labour productivity and economies of density related to the supply chain, and (b) wage savings due to factors that are under management control. We also note that Thames Water and SES Water, which are exposed to even higher regional wages, have not submitted a similar claim.

Note 1: The value of the cost claim for the residential retail price control (ie population transience) is in nominal terms.

3. WINEP uncertainty mechanism

Our totex allowance for companies includes an allowance for environmental obligations set out in the Water Industry National Environment Programme (WINEP). Some of the requirements in WINEP are not expected to be confirmed until December 2021 at the earliest, which is after we make our final determinations in December 2019. Unconfirmed requirements in WINEP are known as ‘amber’ schemes.

Where we make an allowance for amber schemes, we use a mechanism to adjust our totex for schemes which are later confirmed as not required.

Table 4 sets out the adjustments we will make for each scheme in Affinity Water’s WINEP programme that is currently unconfirmed, if the scheme is confirmed as not required for the period 2020-25. We will make the adjustments at the end of the control period. Our adjustments are based on the company’s totex estimates as adjusted by our company specific efficiency factor. Though not listed in WINEP as a scheme having Amber status, the Environment Agency has identified the possibility of the requirement before 2025 of a sustainability change in the Brett region, the impact of which would exceed the surplus of the water resource zone. Accordingly, Table 4 also sets out the adjustment we will make for further sustainability reductions up to 20MI/d of deployable output in the Brett region should this be required by the Environment Agency during 2020-25. Licence changes that have an impact on deployable output and therefore the supply-demand balance are usually addressed through supply-demand balance enhancement investment consistent with the water resources management plan.

Table 4: WINEP uncertainty mechanism – cost adjustments for unconfirmed WINEP schemes included in our draft determination (£ million in 2017-18 prices)

Unique ID	Scheme category / name	Company's totex unit rate	Our allowed totex unit rate
WINEP/NEP ~ Ecological improvements at abstractions			
7AF100131, 7AF100132, 7AF100133, 7AF110002, 7AF10008, 7AF100032, 7AF100034	Various (Each Unique ID accounts for 4no. projects)	£0.331m per project	£0.311m per project
WINEP/NEP ~ Water Framework Directive measures			
7AF10008	Higham Bridge / Lattinford Bridge/ Shelley Hall/ Stoke by Nayland - 1 & 2 Stratford St Mary(Woodhouse Farm), Dedham P.S.,Lawford P.S.	£3.260m per MI/d of deployable output	£3.086m per MI/d of deployable output
7AF100116,	ALMA ROAD PUMPING STATION	£0.042m per MI/d of deployable output	£0.044m per MI/d of deployable output
7AF100119	CHARTRIDGE PUMPING STATION		
Additional sustainability reduction for the Brett region should it be required to be delivered by the Environment Agency during AMP7. The unit rate of £1.20 million per MI/d is the same as used for supply-demand balance enhancement, which this activity falls under, and is capped by the maximum deficit that the zone will be in under the maximum licence reduction scenario.			
n/a	Sustainability reduction in Brett region not in WINEP (from 2.6 MI/d to 4.6 MI/d)	£3.260m per MI/d of deployable output	£1.20m per MI/d of deployable output (up to a maximum of 11.21MI/d)
n/a	Sustainability reduction in Brett region not in WINEP (from 4.6 MI/d to 20 MI/d)	£6.67m per MI/d of deployable output	£1.20m per MI/d of deployable output (up to a maximum of 11.21MI/d)

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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July 2019

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