

December 2019

PR19 final determinations

**Affinity Water – Accounting for past delivery
additional information appendix**

PR19 final determinations: Affinity Water - Accounting for past delivery additional information

Wholesale revenue forecasting incentive mechanism additional revenue

1 Our draft determinations

In our draft determination we proposed to exclude the whole of Affinity Water's claim for additional revenue in the wholesale revenue forecasting incentive mechanism (WRFIM). The claim relates to unexpectedly high demand for connections during the 2015-20 period which is within the reconciliation mechanism's scope, however the company had not provided sufficient evidence to support the claim.

Affinity Water had been able to demonstrate that there was a significant increase in new connections to individual properties fed off a large supply (e.g. a block of flats) compared to its forecasts, but it had not yet provided:

- sufficient explanation to support the level of its PR14 forecasts;
- the reasons why these types of connections have increased so significantly from forecast; and
- an explanation of the process that the company went through to assess its forecasts at PR14 and how it took account of these types of connections in its assessment.

We also excluded the proportion of the claim that relates to infrastructure charges for 2018-20, as, under the new 'Charges scheme rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991', the company has the ability to smooth infrastructure charges over a five year period to recover its costs.

We intervened to reduce the aggregate value of the revenue claim reflected in the wholesale revenue forecasting incentive mechanism from £23.936 million to £0 million (nominal prices).

Our intervention for the draft determination decreased the total WRFIM adjustment at the end of the 2015-20 period from £8.212 million in the company's business plan to - £15.669 million (2017-18 FYA CPIH deflated price base).

2 Stakeholder representations

In its representation on our draft determination, Affinity Water provides additional information linking the increase in new connections to individual properties fed off a

large supply (e.g. blocks of flats) to the Mayor of London housing zones, help to buy and stimulus for affordable housing in London. The company also updates its 2019-20 forecast for grants and contributions downwards, reflecting the most recent information available. The updated forecast reduces the revenue claim by £1.460 million.

The company has also reduced the infrastructure charges component of its claim by £4.639 million in the interests of closing the gap. The total revised claim is for £16.558 million (nominal prices) of additional revenue.

In response to our queries, and following engagement with Affinity Water, the company provides further evidence that shows:

- The Mayor of London housing zones disproportionately affect Affinity Water's area as the company's area includes 25% of the Mayor of London housing zone properties, while the company serves 13% of London's households; Essex and Suffolk Water are the next most affected with 10% of zone properties and 6% of London's households served. Thames Water covers 62% of zone properties and serves 77% of London's households.
- Due to the timing of announcements on the Mayor of London housing zones none of the additional growth resulting from these could have been foreseen in the company's PR14 business plan.
- For help to buy scheme driven growth, only scheme driven connections in 2015-16 could have been reflected in the PR14 business plan (the company acknowledges these were not included). Help to buy driven growth for 2016-20 in the company's area could not have been foreseen, at least for the draft determinations. The company argues that its enhanced status disadvantaged them in this regard, as they had less time available to submit updated forecasts ahead of draft determinations (although they could have provided representations on the draft determinations).
- The timing of decisions on help to buy, and London specific changes means that the company's business plan could not have reflected all of the changes caused by these schemes, and the company's status as enhanced exacerbated this.
- The company also provides more information to support its revised forecasts for 2019-20.

Using its average connection costs, Affinity Water calculates that the new connections driven by the Mayor of London housing zones and help to buy schemes that it could not reasonably have predicted, would have resulted in additional grants and contributions received of £10.831 million. The remainder of the revenue claim

relates to other volume variance that has not been explained and infrastructure charges.

We received no other representations in relation to the intervention on Affinity Water's wholesale revenue forecasting incentive mechanism.

3 Our assessment and reasons

The WRFIM mechanism allows for representations from companies regarding the application of the revenue adjustment, namely when demand for connections is unexpectedly high (subject to companies demonstrating the reasons for the variance were unexpected and beyond the company's control). Our principles for assessing claims for additional revenue under the wholesale revenue forecasting incentive mechanism are set out on pages 42 to 44 of the '[PR14 reconciliation rulebook](#)'.

Having reviewed the information and actively considered all issues raised in the company's representation, we are changing our view in relation to some elements of the claim for additional revenue in the wholesale revenue forecasting incentive mechanism.

- We are including the element of the claim relating to the increase in connections due to the Mayor of London housing zones and help to buy schemes calculated using the company's average cost of connection. The company provides sufficient and convincing evidence that it could not take full account of the significant impact of these schemes in its area in its PR14 forecasts. This reflects connection charges for the five years and infrastructure charges for 2015-18.
- We are excluding the remainder of the claim relating to the increase in new connections, as the company does not provide sufficient and convincing evidence that the variance is not as a result of poor forecasting.
- We now exclude only the proportion of the claim that relates to infrastructure charges for 2018-20, as under the new charging rules, the company has the ability to smooth infrastructure charges over a rolling five year period (spanning price control periods) to recover its costs. We consider this to be under the company's control.

4 Our final decision

We are including £10.831 million of the company's revised claim for £16.558 million additional revenue in the wholesale revenue forecasting incentive mechanism as

Affinity Water provides sufficient evidence that this arises from unexpectedly high demand for connections driven by the Mayor of London housing zones, help to buy and stimulus for affordable housing in London schemes that it could not have reasonably been expected to forecast. However we are excluding the additional revenue claimed in relation to the remainder of the increase in new connections and infrastructure charges.

Our intervention for the final determination reduces the total WRFIM adjustment at the end of the 2015-20 period from £12.792 million in the company's 15 July 2019 submission to £0.537 million (2017-18 FYA CPIH deflated price base).

Table 4.1: Claim for additional revenue and the WRFIM adjustment (£ million)

	April 2019 revised business plan	Draft determination	15 July 2019 past delivery submission	30 August 2019 representation	Final determination
Additional revenue claim (Nominal prices)					
Total	21.870	0.000	22.657 ¹	16.558	10.831
WRFIM adjustment (2017-18 prices)					
Wholesale revenue forecasting incentive mechanism adjustment	8.212	-15.669	12.792	9.980	0.537

Note 1: This is the figure quoted in the company's representation as a "minor amendment to the 15 July [2019] submission". The 15 July 2019 submission states a figure of £22.698 million.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

December 2019

© Crown copyright 2019

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gov.uk.

