

south east water

New Appointments and Variations
Pricing
August 2018

Pure knowh₂ow

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1. Background

Ofwat issued new bulk supply price guidance for new appointments and variations (NAVs) in May 2018. Following this publication we have reviewed our NAV bulk supply price calculation methodology to account for the changes between Ofwat's current and previous guidance.

Upon external independent review with Frontier Economics we identified that the only change required in our methodology was to account for unbilled leakage/water loss between the bulk supply meter and customer meters.

The following section sets out our revised approach.

2. Our revised approach

The underlying principles and our general approach in calculating the bulk supply price for a NAV site are as follows:

The bulk supply price is the cost per cubic metre that the NAV Company will pay for the water they receive at the bulk supply connection point(s) from us.

Where the NAV site is primarily made up of residential dwellings, our starting point for the bulk supply price is the wholesale household standard measured tariff. This is the base price as per Ofwat's guidance.

Where the site includes significant non-household use as well as residential dwellings we will use both the wholesale household and wholesale non-household measured tariffs, to calculate the bulk supply price for the household and non-household use respectively.

To this base price we will apply a discount to reflect the costs that we will avoid and the NAV Company will incur because we no longer operate and maintain a part of our network.

As per Ofwat's May 2018 guidance the discount is calculated by looking at:

1. Avoided operational cost primarily relating to the "last mile" infrastructure and activity.

2. Leakage after the bulk supply meter but before the customer meters

Weighted Average Cost of Capital and depreciation have been identified by Ofwat as components to consider when calculating the discount. However, upon review and looking at the current period, April 2018 up to April 2020 there are no avoided costs as Ofwat in November 2017 required Incumbents to pay NAV's the discounted asset value in the same way as we do for Self-lay.

2.1 The approach we have followed in calculating the discount is:

2.1.1 Avoided operational costs – last mile activity

The avoided costs are primarily operational and maintenance costs including customer contact and incident management costs relating to the “last mile” infrastructure and activity.

We calculated the avoided costs by using average costs across the company for each activity deemed to have been avoided.

As key cost drivers change over time we will review the bulk supply price discount at the start of each five yearly price review period.

Avoided operational costs have been calculated as £0.0437 per cubic metre and this is deducted from the wholesale household measured tariff for the relevant charging region and year.

2.1.2 Leakage

SEW average household distribution leakage %, excluding customer side leakage, is 14.56%. This average reflects leakage over the assumed 100 life of the SEW pipework.

Applying the 100 year average from day one to a NAV site does not reflect reasonable accounting of leakage on similar pipework.

Therefore we will use average leakage over 10 year periods to calculate the leakage % to apply to the NAV discount, assuming a linear relationship between pipe age and leakage %.

The average leakage % in the first ten years of a site is calculated as 1.445%.

This % is applied to the wholesale household measured tariff for the relevant year and charging region after the £0.0437 avoided operational costs have first been deducted. This ensures that we do not double count avoided costs.

This leakage % for the first 10 years will be applied from day one of the site up to year ten at which point the average leakage % for a 20 year old site will be applied for the next 10 years. This process will repeat at every ten year point.

As key cost drivers change over time we will review the bulk supply price discount at the start of each five yearly price review period.

Wholesale leak allowances are discretionary and excluded from our regulated price so they are not included as an avoided cost.

2.1.3 Example calculation

We will calculate the bulk supply volumetric rate as follows:

$$(VR - D1) - ((VR - D1) \times L1)$$

Where:

- VR is the published wholesale household volumetric rate for relevant region and charging year.
- D1 is the avoided operational costs per cubic metre.
- L1 is the average leakage % for pipework between 0 and 10 years old

For 2018/19 where the bulk supply price relates to a residential site only, VR will be £1.2878 per cubic metre in our western region and £1.6996 per cubic metre in our eastern region. D1 is £0.0437 and L1 is 1.445%.

On this basis the NAV bulk supply price per cubic metre for a new site in 2018/19 would be £1.6318 in our eastern region and £1.2260 in our western region.

An annual standing charge will also be added to the bulk supply cost based on the bulk supply meter size. No discount is applied to the annual standing charge.

Please see the attached NAV Bulk Supply Price Calculator. This shows the calculation of a NAV bulk supply price for 2018/19 for both eastern and western regions.

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