

south east water

New Appointments and Variations
Pricing 2020/21

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1. Background

This document outlines our new appointments and variations (NAVs) bulk supply price calculation methodology. This approach has been reviewed by an independent third party organisation and is in line with Ofwat's latest bulk supply price guidance for NAVs issued May 2018.

2. Changes to the income offset on 1 April 2020 - impact on NAV Charges

2.1 Impact on NAV of the changes implemented on 1 April 2020

The charges scheme rules (as amended) introduce additional changes from 1 April 2020 in relation to requisition charges and the income offset.

Ofwat has explained the reasons for these changes in “New connections charges rules from April 2020 – England: Decision Document” and in “charging rules for new connections and new developments for English companies from April 2020 – decision document”.

The latest change from 1 April 2020 is that the income offset will no longer be applied to requisition charges but will be applied instead to infrastructure charges. Consequently, an asset payment will no longer be paid to self-lay providers and a payment equivalent to the income offset will no longer be paid to New Appointees. Instead, the income offset will be applied to the amount of infrastructure charges that the New Appointee is required to remit to us under the bulk supply agreement in respect of the service connections made on the NAV site.

There will be no change to the way bulk supply charges are calculated.

You can find more details on infrastructure charges and the income offset from 1 April 2020 in our “Infrastructure charges and miscellaneous services charges scheme 2020-21”.

2.2 Transitional arrangements

We explain below when old and new charges apply in the context of the changes described above.

2.2.1 Bulk supply agreement concluded before 1 April 2020

If the bulk supply agreement was signed before 1 April 2020, a payment equivalent to the asset payment is made to the New Appointee. It is calculated using the method that applied before 1 April 2020. (Please refer to your quotation or for additional information on the calculation of the asset payment/income offset from 1 April 2018 to 31 March 2020 to our charging arrangements for new connection services 2020-21 and our infrastructure charges and miscellaneous services charges scheme 2020-21.)

2.2.2 Bulk supply agreement concluded on or after 1 April 2020

If the bulk supply agreement was signed on or after 1 April 2020, no payment equivalent to the asset payment is made to the New Appointee but the income offset is applied to the infrastructure charges that the New Appointee is required to remit to us under the bulk supply agreement in respect of the service connections made on the NAV site.

3. NAV Bulk Supply Charges

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 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 guidance the discount is calculated by looking at:

- a. Avoided operational cost primarily relating to the "last mile" infrastructure and activity.
- b. Leakage after the bulk supply meter but before the customer meters.
- c. Weighted Average Cost of Capital and depreciation.

3.1 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 actual costs from 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.

3.2 Leakage

Our average household distribution leakage %, excluding customer side leakage, is 14.56%. This average reflects leakage over the assumed 100 year life of our 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 1.456%.

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.

3.3 Weighted Average Cost of Capital and depreciation

Weighted average cost of capital and depreciation have been identified by Ofwat as components to consider when calculating the discount. With the changes to income offset payments as set out in section 2 above, we have reviewed this pre and post 1 April 2020.

For the period 1 April 2018 up to 31 March 2020 there are no avoided costs as Ofwat in November 2017 required Incumbents to pay NAV's the discounted asset value.

From 1 April 2020 there are no avoided costs as the income offset value is still paid to the NAV upfront but via the deduction from the infrastructure charge.

4. Example calculation and price

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 2020/21 where the bulk supply price relates to a residential site only, VR will be £1.4079 per cubic metre in our western region and £1.8582 per cubic metre in our eastern region. D1 is £0.0437 and L1 is 1.456%.

On this basis the NAV bulk supply price per cubic metre for a site in 2020/21 would be £1.3443 in our western region and £1.7881 in our eastern 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. The annual standing charge for each meter size can be found in our Wholesale Charges Schedule 2020/21. <https://wholesale.southeastwater.co.uk/about-us/our-charges>

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