SSC04j – PR24 data table commentary - Past Delivery

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1.1 Introduction

We have submitted the following feeder models and data tables with our Business Plan submission:

Reconciliation models	Past delivery data tables
	PD1 – Inflation
	PD11 – RCV midnight adjustment
	PD12 – PR19 reconciliation adjustments
Cost reconciliations	PD7/7a – Green Recovery, PD8 – Totex analysis, PD9 – Totex performance,
ODI performance model	
Residential retail reconciliation model	
Revenue forecasting incentive model	PD5 – Revenue reconciliation - wholesale
Developer services revenue adjustment model	
Bilateral entry adjustment	
Cost of new debt reconciliation model	
Gearing outperformance sharing mechanism	
Tax reconciliation	PD10 – Capital allowance super deductions
RPI-CPIH wedge reconciliation model	
WINEP/NEP reconciliation model	
Land sales	PD4 – Land sales
Strategic regional water resources	
RCV feeder model	
Revenue adjustments feeder model	

The e-mail from Marc Hannis on the 4 March 2023 confirmed that the Ofwat innovation fund will not be subject to the reconciliation process and so the associated feeder model has not been submitted.

We also not submitted the PR19 water trading incentive model as we have no trades that will qualify for this incentive.

We submitted our PR19 totex reconciliation in July. There was only one minor change we have made following feedback from Ofwat. This does not materially change the reconciliation and so our narrative is unchanged. For ease of reference, we have included the key elements of our narrative in section 1.3 below.

Each of the reconciliations is covered in the following sections.

1.2 Assurance

In line with the overall PR24 assurance framework, the data tables and models have been assured using the following process:

Reviewer	Work undertaken
First line peer review	A first line peer review to check that the table outputs are in line with expectation based on latest in-house budgets and modelling
Jacobs UK Limited	Assurance that key tables and models have been completed in line with the guidance and noting any exceptions, in particular the totex reconciliation (assured in July), the RFI model and the residential revenue reconciliation along with associated tables. Appendix SSC21 includes the assurance report in respect of past delivery.

1.3 Cost reconciliations and tables PD7/7a, PD8 and PD9

The cost reconciliation tables and feeder models are as per our early submission in July 2023 except for the opex/capex split profiles. This was highlighted in the feedback from Ofwat on the 8 August. As instructed, we have used the splits set out in the financial flows data set. We repeat the key elements of our original narrative below for ease of reference.

1.3.1 Inflation and earnings assumptions

Actual CPIH is taken from the Office of National Statistics (ONS) published data. For the two forecast years of the period we have considered various independent forecasts including HM Treasury and the Bank of England monetary policy report. We have assumed average CPIH of 5.2% for 2023/24 and 2.2% for 2024/25.

For average earnings, we have used the published ASHE indices table 4.1a gross mean pay for 2019/20 to 2021/22.

At the time of submission, the index for 2022/23 had not been published. We have therefore used the annual change from the Average weekly earnings of Great Britain also published by the ONS of 7.0%: (https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/averageweeklyearningsingreatbritain/june2023)

For the last two years of the period we have used the average earnings projections from Table M6 of the May 2023 HM Treasury forecast of 5.2% for 2023/24 and 3.4% for 2024/25. (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1157160/_Independent_Forecasts_for_the_UK_Economy__May_2023.pdf)

1.3.2 Rates and abstraction charges

We are projecting to underspend our allowances by £2.3m. Business rates are projected to be £3.3m lower for the period. The 2023 revaluation has resulted in a reduction in our rateable value for the final two years of the period.

This has been partly offset by an increase in abstraction charges of £1m. The EA have brought in a completely new charging mechanism following a review of abstraction licence charging. This means that charges are now based on the type of abstractor (e.g. water company, agriculture etc), the volume of water abstracted and the status of the waterbody the water is being abstracted from. As a result, our abstraction charges have been updated and the higher costs reflect the large abstraction at Hampton Loade off the River Severn, plus the status of the waterbodies in the Cambridge region.

1.3.3 WINEP

At PR19 we had a number of Amber WINEP schemes amounting to £1.7m. There is an uncertainty mechanism to adjust for each Amber scheme, if the scheme is confirmed as not required for the period 2020-25.

The EA agreed to alter these schemes from amber to green on the 5 January 2021. This was set out in our response to the PR19 WINEP reconciliation model check request from Ofwat which we responded to on the 20 July 2023.

We have therefore left the WINEP reconciliation lines blank for the totex reconciliation submission.

1.3.4 Green Recovery

We have published a summary of our progress on Green Recovery on our website https://www.south-staffs-water.co.uk/media/4305/green-recovery-appendix-2022-23.pdf .

Below is an update on our latest forecast:

1.3.4.1 Milestones for Hampton Loade

The key milestones for the Hampton Loade treatment upgrade is set out below (17/18 prices):

	Date	**Cumulative total project cost (£m)**	**Green recovery element (£m)**
Design completion	Oct-22	15.598	4.980
Main building completion	Jul-23	42.171	13.465
Off-site assemblies complete	Dec-23	51.473	16.435
Commissioning starts	Apr-24	54.211	17.309
50% plant in use	Aug-24	56.729	18.113
100% plant in use	Feb-25	58.261	18.602

1.3.4.2 Forecast delivery programme

The following table is in 2017/18 prices:

Programme 17-18 prices	Metric	Unit	2021-22	2022-23	2023-24	2024-25	Total
Total Project expenditure (PR19 and GER)	Totex	£m, 3dps	6.036	23.963	21.959	6.303	58.261
Total Project expenditure (PR19 and GER) - South Staffs contribution	Totex	£m, 3dps	4.024	15.975	14.640	4.202	38.841
Total Project expenditure (PR19 and GER) - Severn Trent contribution	Totex	£m, 3dps	2.012	7.988	7.320	2.101	19.420
Project expenditure - GER element	Totex	£m, 3dps	1.927	7.651	7.011	2.012	18.602
Project expenditure - GER element - South Staffs contribution	Totex	£m, 3dps	1.060	4.268	4.044	0.972	10.343
Project expenditure - GER element - Severn Trent contribution	Totex	£m, 3dps	0.868	3.383	2.968	1.041	8.259

The projected spend on delivery of the green recovery scheme of £10.343m compares to our original allowance of £9.684m, an overspend of £0.659m or 6.8% as a result of the current inflationary pressures on delivery costs.

1.4 ODI performance model

We have completed the ODI performance models for both 2023/24 and 2024/25.

We have evaluated our forecast PC performance for 2023/24 and 2024/25 for completion of the two ODI performance models for those years. For each year, we have looked at our performance in the AMP to date, and reflected also on the current (year to September 2023) performance.

For 2023/24, there are two notable penalty expectations. These are CRI, where we have experienced compliance failures attributed to Hampton Loade in the first part of year which is likely to push CRI performance above the penalty collar. The second is for PCC, where we remain considerably higher than target due to the residual effects following Covid-19. We have assumed we continue to perform well, earning outperformance payments, on supply interruptions, unplanned outage and customer contacts.

For 2024/25, again PCC penalties are expected based on the current targets and degree of residual impact post Covid. On outperformance, we have continued to assume outperformance payments on supply interruptions, unplanned outage and customer contacts.

For the majority of other PCs we are forecasting broadly neutral or small value outperformance/underperformance incentives.

For the reputational PCs on table 3E we have also completed these based on the performance in the years to date. These do not have incentives attached.

Table 3F, 3F.1 and 3F.2 have been completed with the required normalisers.

The models include the full PCC penalty based on the PR19 PC targets of £13.371m for the 2020-25 period. For the purposes of the revenue feeder model we have included £0.543m based on our view of the level of appropriate penalty. This is set out in detail in appendix SSC18.

1.5 Residential retail reconciliation model

We are projecting a small over recovery for the period of £0.276m. This represents the position for the three years to March 2023. We are projecting to be in line with our allowances for the remaining two years of the period.

1.6 Revenue forecasting incentive model

We are projecting to recover our revenues in line with our allowances by the end of the period so that the reconciliation is zero. We are not expecting to defer revenues when setting charges for 2024-25 and we will set charges to recover our allowances adjusted for previous under/over recovery of revenues and the in-period ODIs.

The model includes a penalty adjustment £0.290m in 2022-23 as a result of being 6% below our allowed revenue. When we set charges for 2022-23 we decided to limit our bill increase to support customers by deferring £2.3m of revenue into future years. This was set out in our end-user assurance statement that we published.

If we had not deferred this revenue, our revenue imbalance would have been 4.4% resulting in a penalty of £0.209m. We therefore request that the penalty applied is reduced by £0.081m.

1.7 Developer services revenue adjustment

We are forecasting 27,032 new connected properties for the period compared to 20,333 included in our PR19 Final Determination. The first two years of the period were impacted by Covid which led to a reduction in the expected level of housebuilding. 2022-23 showed an increase in connections as the sector returned back to normal levels of activity.

Historically, we have delivered 65-69% of local plans excluding covid year. We are forecasting to deliver 70% of local plans by the end of the period, and 75% in AMP8. This ensures phasing is consistent with WRMP plans but with realistic delivery expectations applied.

Therefore, we are forecasting a small increase in average connections for future forecasts vs historically. We have applied 97% to the total connections forecast to reflect residential connections based on average splits in actual figures within recent years.

We have included NAV connections in our actuals and projections to be consistent with how we believe our PR19 FD was set.

1.8 Bilateral Entry Adjustment

Our Final Determination included a potential bilateral entry adjustment in 2024-25. As of August 2023, we are not expecting any bilateral market entry and so there is no revenue adjustment.

1.9 Cost of new debt reconciliation model

We have populated the cost of new debt reconciliation model with annual data provided by Ofwat in an e-mail dated 8 September 2023. This set out the historic iBoxx A/BBB 10+ average data from 2020-21. We have assumed that the iBoxx rate in 2023-24 continues through to March 2025.

1.10 Gearing Outperformance sharing mechanism

We are not projecting any adjustment with this mechanism. Our gearing for the first three years has been below the threshold to trigger a penalty. Although our gearing increases in the last two years of the period as we deliver our capital programme, we are targeting to still be below the trigger threshold of 70% by 2025.

1.11 Tax reconciliation

We have completed this reconciliation using the PR19 FD financial model and the updated FD model published by Ofwat which incorporates changes to tax super deductions.

Table PD10 sets out the estimate of the proportion of expenditure qualifying for super deductions.

The 2021/22 Qualifying Expenditure Schedule (QES) and the draft 2022/23 QES were used to calculate a split between expenditure qualifying for super deductions and expenditure qualifying for normal allowances (Plant and Machinery and Special Rate). This was then used to populate table PD10. We engaged with ChandlersKBS to support us in this work and there is assurance report can be found in appendix SSC30.

We have also updated the cost of debt in the updated FD model to align to the cost of debt reconciliation model. To do this, we have updated row 734 of the 'InpOverride' tab using the average for the period.

1.12 RPI-CPIH wedge reconciliation model

We have populated this model with actual and projected inflation consistent with table PD1.

1.13 WINEP/NEP reconciliation model

We have used the WINEP model that we submitted to Ofwat on the 20 July 2023 confirming the WINEP schemes covered by the WINEP uncertainty mechanism.

We are expecting to deliver on all but one of our Amber WINEP schemes. One scheme (WMD00105) is no longer required and so will not go ahead. The value of this scheme is £0.25m

1.14 Land Sales

We have not had any land sales in the first three years in the period and are not currently projecting that any land sales will be completed by March 2025. The model output is therefore zero along with table PD4.

1.15 Strategic regional water resources

We understand that an updated version of the Strategic Water Resources (SRO) feeder model is set to be published at the end of September. This is after the cut-off for the completion of our plan and so we have populated the version of the feeder model published on the Ofwat website as at the 11 September.

We are seeking to recover of £17.421m plus financing costs for AMP7 in relation to our share of costs for Fens Reservoir and following the funding allowances set out in gate 2 of the RAPID process published in June 2023 and the current forecast of progress to March 2025:

	Gate one	Gate two	Gate three	Gate four	Total
Fens Reservoir gated allowance	N/A	£4.09m	£23.82m	£10.91m	£38.82m
Comment	Some work funded from existing allowances.		Allowance has been revised and capped.	We will review gate four expenditure as part of gate three assessment or PR24.	Updated to reflect revised gate three expenditure cap.
Previous Allowance	N/A	£4.09m	£9.55m	£10.91m	£24.55m
Change from Previous Allowance	£0.00m	£0.00m	£14.27m	£0.00m	£14.27m

Our current projected spend for AMP 7 is as follows (Cambridge water share only)

Fens Reservoir projected spend (Cambridge share)	2020-21	2021-22	2022-23	2023-24	2024-25	Total
Capex (£m) 17/18 prices	-	0.814	1.781	7.158	7.669	17.421

The current thinking is that SIPR is the preferred route for delivery and an outline of the key work that is being progressed through to March 2025 is set in the table below:

Key activity	Commentary
Developing the delivery model	Work with third parties to consider the best delivery solution; in-house, DPC or SIPR
Optioneering	Predominantly site considerations including for the reservoir, abstraction point, treatment works and pipelines
Development Consent Order (DCO)	This includes : • Environmental surveys • Topographical surveys, • Site investigations - criticality of ground conditions, planning applications • Planning application - what does the site look like, what are the additional benefits, for example jobs, amenities and public access)

	• Feasibility of design – Size, height, access etc
Procurement	Process of contract tendering to have in place in advance of main works and can be novated to an IP
IP organisational design	Set up of organisational design that can migrate the IP, for example Board structure and governance

Please refer to appendix SSC03 for the overall approach we take on the plans for Fens Reservoir in AMP 8 and beyond.

1.16 Table PD1 Inflation assumptions

Our inflation assumptions for 2023-24 and 2024-25 use the Bank of England MPC CPI inflation projections published in August (https://www.bankofengland.co.uk/monetary-policy-report/2023/august-2023).

We apply a CPI-CPIH wedge of 0.4%, consistent with August 2023. For RPI, we assume that the wedge to CPIH remains the same proportion of the July level of 2.6% so as CPIH falls, so does the wedge. This means that the wedge returns to the longer-term level of around 1% by December 2024.

For the 2025-30 period, we have assumed that CPIH is 2%, consistent with the Bank of England target.

1.17 Table PD11 – RCV adjustment

This table has been populated from the various PR19 feeder models set out above.

1.18 Table PD12 – PR19 reconciliation adjustments summary

We have used line PD12.35 to include missing costs from our PR19 in relation to HS2 of £11.4m (17/18 prices) which are to be adjusted at PR24 as set out in the letter dated 17 December 2020 between Aileen Armstrong and Andrew McGeoghan set out overleaf.

Centre City Tower, 7 Hill Street, Birmingham B5 4UA
21 Bloomsbury Street, London WC1B 3HF

By email

Andrew McGeoghan
South Staffordshire Water plc
Green Lane
Walsall
West Midlands
WS2 7PD

17 December 2020

Dear Andrew,

Adjustment to 2020-25 revenue at the 2024 price review

This letter sets out our proposal for how we will correct an error that has been identified in our final determination.

During the post final determinations query process you questioned whether we had double counted the contributions from Severn Trent Water for Hampton Loade Treatment Works by recognising them in both price control and non-price control categories. We were clear that we had included the Severn Trent Water contributions only once, as a price control contribution. However, we have identified that the error is actually an omission of the costs associated with HS2.

In our final determinations we included your forecast grants and contributions of £10.3 million towards the work on HS2. We did not however, include the corresponding costs of £11.4 million in your totex allowance. You included these costs in your totex business plan tables but not in response to the developer services information request. We used this response as inputs to our models. We expected the response to this request to be consistent with the business plan as the purpose of the request was to seek further granularity and it was not intended as an opportunity for companies to change their projections. Indeed there was no reason for you to change the values from the business plan as we understand that although there had been some uncertainty as to whether HS2 would go ahead, when you resubmitted your developer services information request in October 2019 HS2 had been confirmed.

Aileen Armstrong, Senior Director t. 0121 644 7702 m. 07595 471 933
e. aileen.armstrong@ofwat.gov.uk

You should note that it has taken a considerable amount of resource to re-examine your business plan and other submissions in order to ascertain the position you took. This was hampered by inadequate commentaries in your business plan. In spite of this, we are now clear that the costs relating to HS2 were included in your business plan table WS1 but then subsequently excluded from the information request. As this is therefore an unambiguous error we are able to make a correction to your allowed revenue.

We intend to make a revenue adjustment at PR24 to retrospectively correct this error. There is no impact on the cost sharing reconciliation since both the costs and grants and contributions related to HS2 are excluded.

I attach tables 3.2 and 4.1 from your final determination and have shown the corrected calculations as an additional column in order to highlight the impact of the error.

Yours sincerely

Aileen Armstrong
Senior Director, Performance and outcomes