South Staffs Water

# South Staffs Water
# PR14 Reconciliations
# July 2018

making water count

# 1. Introduction

This document provides detailed evidence to support South Staffs proposed reconciliation adjustments for the 2015-20 period, including how the Company has performed over the first three years and its expectations for the final two years.

As set out in Ofwat's letter to Regulatory Directors on 25 June 2018*, our submission covers the following relevant tables:

| **Data table** | **Content** |
|---|---|
| App5 | PR14 reconciliation – performance commitments |
| App6 | PR14 reconciliation – sub-measures |
| App27 | PR14 reconciliation – financial outcome delivery incentives summary |
| App23 | Inflation measures |
| App9 | Adjustments to RCV from disposals of interest in land |
| App25 | PR14 reconciliation adjustments summary |
| App31 | Past performance |
| WS13 | PR14 wholesale revenue forecast incentive mechanism for the water Service |
| WS15 | PR14 wholesale total expenditure outperformance sharing for the water service |
| WS17 | PR14 water trading incentive reconciliation |
| R9 | PR14 reconciliation of household retail revenue |
| R10 | PR14 service incentive mechanism |

*WWS13, WWS15 and Dmmy10 are not applicable.

We are not claiming any incentive payments under water trading therefore data table WS17 has not been completed.

We are also submitting the following models:

| |
|---|
| Totex menu PR14 reconciliation |
| WRFIM PR14 reconciliation |
| Residential (household) retail PR14 reconciliation |
| RCV adjustments feeder model |
| Revenue adjustments feeder model |

In summary, the value of the PR14 adjustments as set out in the submitted feeder models in 2017-18 CPIH prices are as follows:

| | Price Base | RCV £m | Revenue £m |
|---|---|---|---|
| 2010-15 reconciliation adjustments | 17-18 CPIH prices | 1.297 | (0.063) |
| CIS RCV inflation correction | 17-18 CPIH prices | (9.229) | |
| WRFIM (excluding developer contributions, including AMP 5 RCM) | 17-18 CPIH prices | | (1.883) |
| Totex | 17-18 CPIH prices | (0.148) | (0.362) |
| Residential retail | 17-18 CPIH prices | | 1.002 |
| ODIs | 17-18 CPIH prices | | 3.352 |
| SIM | 17-18 CPIH prices | | 2.439 |
| Land sales | 17-18 CPIH prices | (0.063) | |
| **Total** | | **(8.143)** | **4.485** |

The true-up for the 2010-15 reconciliations and the CIS RCV adjustment are in line with Ofwat's updated position document dated 18 December 2017.

The primary reasons for each of the other PR14 adjustments are as follows:

- The true up for WRFIM mainly relates to the 2014-15 Revenue Correction Mechanism (RCM) adjustment with its application deferred to AMP7 as agreed with Ofwat in our letter dated 4 November 2016. It excludes the variance on developer contributions which is explained in more detail in section 5 of this document.
- The true up on totex predominantly represents the financing adjustment from recovering expenditure in a different profile to that assumed in the Final Determination (FD).
- The true up for residential retail is as a result of lower demand from metered customers in 2016-17 and 2017-18 with the summers of 2016 and 2017 being cooler than normal.
- The true up on ODIs reflects the rewards accrued for the first three years which totalled £1.1m plus forecast rewards for 2018-19 and 2019-20 of £2.2m mainly relating to interruptions to supply.
- A SIM reward of 3% of household retail revenue has been included which is based on achieving upper quartile performance.

- A small adjustment for land sales because 2014-15 actual sales were higher than that assumed in the PR14 FD.

More detailed narrative on each of the reconciliations is set out in the rest of this document.

## 2. Assurance

In line with our overall PR19 assurance framework, we have used a three line approach to assure the information being submitted:

| Reviewer | Work undertaken |
|---|---|
| Executive Team Member review | Overall check that the tables are in line with expectation based on performance to date and the latest budgets. |
| Independent internal assurance | Detailed tick and tie of information to source and that numbers are consistent between tables and models.<br><br>Appendix A1 includes the assurance report provided by Jacobs. |
| Jacobs UK Limited | Assurance that the tables and models have been completed in line with the guidance and noting any exceptions (see below).<br><br>Appendix A2 includes the assurance report provided by Jacobs. |

In addition, a draft of this narrative was approved at a Board meeting on 28 June 2018.

We responded to Ofwat's pre-populated data tables on 1 June 2018 with a number of queries. Two of the queries were not resolved and following the guidance in a letter from Andy Duff to Regulation Directors dated 26 June 2018, and subsequent clarification by email we have amended the pre-populated data in line with the information above.

The specific wording we are following is:

**"We are not planning to re-issue the PR19 business plan data tables to address these outstanding issues. As set out in our letter to Regulatory Director's on 26 June from Andy Duff, Director Data and Modelling, companies are able to change pre-populated historic data, but this must be clearly highlighted and explained in the table commentaries. The letter provides further information on our expectations when restating historic data."**

These specific changes we have made are as follows:

**Table WS15 block C line 9 – Water: Actual totex**

For the 2015-16 report year, Ofwat linked table 4B line 6 in the data tables to line 21 of table 2B. However, table 2B line 17 (grants and contributions) excluded 'other' capital contributions shown in table 2E line 5. Ofwat corrected the RAGs for this as these contributions should be included (as set out in the first line of our commentary to table 4B in our 2016-17 APR). We have an e-mail from Rob Lee confirming this and confirming how we were asked to deal with it in our 2016-17 APR. The impact of this is a totex reduction in 2015/16 of **£0.561m** which we have adjusted in the table.

**Table WS15 block D line 11 - Water: Third party services (capex)**

The table has a prepopulated figure in 2015-16 of **£6.046m**. This should be zero and we have amended the table accordingly. This figure has been taken from table 2B line 15 and represents capital expenditure incurred in undertaking works for developers (as explained in the commentary to the table in our APR for that year). However, for the purposes of the totex menu reconciliation, these costs should not be adjusted out as they do not form part of the menu exclusions. The reconciliation of totex set out in table 4B of our APR has never included these costs within the menu exclusions so this has had no impact on customers and stakeholders in their understanding of our actual totex compared to that allowed.

Both of the above adjustments have also been made in the totex menu PR14 reconciliation model in order to ensure that the correct true up applies in the revenue and RCV feeder models.

**WRFIM feeder model – row 36 'recovered revenue - water'**

The feeder model for the WRFIM reconciliation excludes the variance to the FD on developer contributions and is therefore different to table WS13 line 23. Following extensive dialogue with Ofwat over the last six months, a letter from David Black to Tim Orange on 14 May 2018 (Appendix C) confirmed that this claim will be dealt with at PR19. The value of this claim is as per the total of line 26 (**£18.882m**) and is set out in full in section 5 of this document.

# 3. Wholesale total expenditure (totex) sharing

The Company has completed the reconciliation model for wholesale totex and a summary is set out below:

| | | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 | AMP 7 |
|---|---|---|---|---|---|---|---|
| Allowed Totex from final menu | 12-13 prices | 76.780 | 77.514 | 77.804 | 77.947 | 76.889 | 386.933 |
| Actual totex | 12-13 prices | 72.573 | 76.024 | 81.931 | 78.631 | 77.849 | 387.008 |
| Annual Variance | | -4.207 | -1.489 | 4.127 | 0.684 | 0.960 | 0.075 |
| Cumulative variance | | -4.207 | -5.696 | -1.569 | -0.885 | 0.075 | |
| Financing adjustment | | -0.639 | -0.167 | 0.302 | 0.025 | 0.000 | |
| Total annual variance (inc financing adjustments) | 12-13 prices | -4.846 | -1.656 | 4.429 | 0.709 | 0.960 | **-0.404** |
| Total annual variance (inc financing adjustments) | 17-18 CPIH prices | | | | | | **-0.509** |
| PAYG rate | | | | | | | **68.2%** |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Revenue adjustment | 17-18 CPIH prices | | | | | | **-0.362** |
| RCV adjustment | 17-18 CPIH prices | | | | | | **-0.148** |

## Actual totex for the three years to 2017-18

The cumulative position for the three years to 2017-18 shows totex of £1.6m (0.7%) below the FD with operating costs being £11.4m lower than the FD. In summary the variances are set out below:

| | **£m** |
|---|---|
| PAYG smoothing | (4.4) |
| IRE | (8.1) |
| Capex | 9.8 |
| Opex | 1.1 |
| Total | **(1.6)** |

Ofwat adjusted the Pay As You Go (PAYG) rate in the FD to smooth bills in the period to 2020. The impact was to have an FD PAYG rate of 73.9% in 2015-16 compared to the average in the FD of 68.2%, which was in line with the expected allocation between capital and operating expenditure. This smoothing accelerated £4.6m of fast money into the FD for 2015-16 from slow money, and adjusted subsequent years as an offset. The cumulative position for the three years to 2017-18 is an acceleration of £4.4m. IRE was £8.1m lower than the FD as a result of a temporary reduction in the level of mains renewals. This has been offset by an overspend on capital expenditure of £9.8m driven by an increase in expenditure on production assets to support water quality improvement. The remaining £1.1m

overspend in operating costs was predominantly related to the ongoing upward pressure on power costs driven by higher pass through charge rates which have continued albeit offset in this year by laboratory costs, cumulo rates and additional efficiencies in other areas.

Overall, ignoring the PAYG adjustment outlined above, there was an overspend of £1.7m of capital investment and infrastructure renewals expenditure which is expected to reduce in future years and a £1.1m overspend on operating costs.

## Forecast totex for 2018-19 and 2019-20

Totex for the remaining two years of the price control is forecast to bring the five year position in line with the FD with operating cost efficiencies achieved in 2017-18 expected to continue and reduce the current overspend to a level broadly in line with that allowed.

# 4. Wholesale revenue forecasting incentive mechanism (WRFIM)

The Company has completed the reconciliation model for WRFIM and a summary is set out below

| £ms | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 | AMP 7 |
|---|---|---|---|---|---|---|
| Wholesale revenue allowed per Final Determination | 101.991 | 102.185 | 103.968 | 106.265 | 109.256 | 523.665 |
| Under recovery from two years previously (before financing adjustments) | | | (0.200) | 0.886 | (0.190) | |
| Adjusted wholesale allowed revenue | 101.991 | 102.185 | 103.768 | 107.151 | 109.066 | 523.665 |
| Actual revenue recovered | 102.191 | 101.300 | 103.958 | 106.952 | 109.066 | 523.467 |
| Under/(over) recovery | (0.200) | 0.886 | (0.190) | 0.199 | (0.001) | 0.198 |
| **Under recovery to be applied to AMP7 (including financing costs and inflation in outturn prices)** | | | | | | **0.291** |
| **AMP5 RCM adjustment to be applied at PR19 (Outturn price base)** | | | | | | **-2.203** |
| **Total Under recovery to be applied to AMP7 (17-18 CPIH prices)** | | | | | | **-1.883** |

The true-up for the 2014-15 Revenue Correction Mechanism (RCM) has been included in the populated model with its application deferred to AMP7 as agreed with Ofwat in our letter dated 4 November 2016.

This table has been completed excluding the variance on developer contributions. Following extensive dialogue with Ofwat, it was confirmed that the variance on developer contributions will be dealt with at PR19 (see Appendix C)

In November last year, and in line with the PR14 guidance to engage on a case by case basis, the Company submitted a paper regarding the scale of variation in developer contributions in the first two years of AMP 6.

Following subsequent detailed and open discussions with Ofwat, the decision was made to resolve this claim as part of the PR19 business plan. In section 5 we set out our original claim but have extended it to include the actual position for 2017-18 and our estimate of the likely position for 2018-19 and 2019-20.

In Appendix B, we have also included the additional information we provided in response to questions raised by Ofwat following our claim.

## Actual WRFIM position excluding developer contributions for the three years to 2017/18

In 2015-16, wholesale revenues were very close to those allowed, being £0.2m (or 0.2%) higher. This over recovery was deducted from the allowed revenue in 2017-18 when setting charges.

In 2016-17, wholesale revenues were £0.9m lower than allowed due to lower than expected demand from metered customers with the summer of 2016 being cooler than normal. This variance was still only 0.9% of the allowed revenue and within the penalty threshold of 2%. This under recovery was included in the allowed revenue in 2018-19.

In 2017-18, wholesale revenues were only £0.2m higher (0.22%), predominantly driven by higher business customer demand.

## Forecast WRFIM position excluding developer contributions for 2018-19 and 2019-20

The forecast wholesale revenue for 2018-19 is expected to be in line with that allowed in the FD after adjusting for the £0.9m under recovery of revenues in 2016-17.

Similarly, the small over recovery of £0.2m will be adjusted when setting wholesale charges for 2019-20.

# 5. Developer contributions claim

## Executive summary

In the 2014 Final Determination, company wholesale allowed revenues included contributions from connection charges and infrastructure charges; this was irrespective of whether companies treated these items as income or as capital.

When setting charges, the amount of allowed wholesale revenue to recover from water customers is the allowed revenue after deducting these developer charges. The Company treats these developer receipts as a capital contribution and therefore offsets any gross cost incurred within capital expenditure.

As set out in our Annual Performance Report (APR) the South Staffs level of developer contributions for the first three years of the current price control period exceeds that forecast in the Final Determination by £11.225m.

Detailed investigation has identified a number of drivers for this variation; broadly they fall into three components:

- A higher volume of new connections undertaken by the Company (excluding self-lay connections) than anticipated. For the first three years of the period, there have been 9,905 connections compared to 4,070 assumed in the PR14 Business Plan.

- More complex new connections than anticipated:
    - Our Business Plan forecast the delivery of primarily new connections in green-field sites (for example we were expecting new large developments in Burton and Sutton Coldfield in line with local planning). For the first two years of the period, there has been a higher proportion of connections in the footpath and highway and a significant proportion of non-standard activity (for example developments on brownfield sites and in-fill of small numbers of properties).
    - These connections have cost more to deliver, and therefore more cost has been passed on to the developer. Compared to the Business Plan costs have increased which offsets the additional income, this is not recognised in the “single till” mechanism which is essentially one-sided.

- Using a reasonable interpretation of the line definition, our Business Plan did not include mains requisition charges of £0.5m per annum in the wholesale revenue projections table W9, although it was taken into account in totex; this has subsequently been clarified as not being in line with Ofwat expectations.

The Company has forecast the level of developer contributions for the final two years of the price control period based on the first three years and predicts these to total £7.658m above the Final Determination, taking the total difference to £18.882m.

A summary of the variances to the Final Determination for the five years is set out below:

| **Summary of variances - Outturn Prices** | | **2015-16** | **2016-17** | **2017-18** | **2018-19** | **2019-20** | **5 year Total** |
|---|---|---|---|---|---|---|---|
| Variance in connection charges due to number of connections undertaken by the Company | £m | 0.609 | 0.440 | 1.532 | 1.147 | 1.239 | 4.967 |
| Variance in the unit price per connection | £m | 1.368 | 1.776 | 1.082 | 1.630 | 1.580 | 7.436 |
| Variance in infrastructure charges | £m | 0.230 | 0.163 | 0.931 | 0.000 | 0.000 | 1.324 |
| Variance in mains requisitions due to increase in volume and not included in revenue | £m | 0.679 | 1.746 | 0.668 | 1.031 | 1.031 | 5.156 |
| **Total Variance as reported in APR** | **£m** | **2.886** | **4.125** | **4.214** | **3.808** | **3.850** | **18.882** |

The PR14 final methodology published in July 2013 and more recently the new connections charging consultation in April 2016 state that variances to contributions from justifiable situations are an area to be discussed with Ofwat on a "case by case" basis.

**"If a company increased revenue by unduly reducing connection charges we may take corrective action to ensure that companies returned these monies (with financing costs) to customers. Similarly, although we have decided not to allow automatic adjustments to allowed revenues for demand variations in wholesale controls, if demand for connections is unexpectedly high then we would nevertheless consider allowing extra revenue to compensate for the loss of price control revenue on a case-by-case basis."**

South Staffs Water has seen no benefit from increased mains requisition and connection charges; additional income is offset by additional costs with the extra charges passed on to developers for connections. Mains requisitions represent costs legitimately incurred in the delivery of the services required.

The rest of this section sets out in more detail the background and analysis of South Staffs developer contributions and in particular looks to demonstrate that the assumptions and forecasts included in our PR14 Business Plan were reasonable and that the actual costs are efficiently incurred.

## PR14 assumptions

In the Company's June 2014 Business Plan submission, the following assumptions on costs, contributions and new properties were included:

| *2012-13 prices* | Table Ref | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---|---|---|---|---|---|---|
| Total number of new connections | Table W4 Line 20 | 3.780 | 3.968 | 4.168 | 4.324 | 4.471 |
| Number of self-lay connections included above | | 2.305 | 2.616 | 2.979 | 3.263 | 3.531 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Capital expenditure | Table W3 Line 9 | £3.535m | £2.659m | £2.728m | £2.811m | £2.883m |
| Contributions | Table W3 Lines 33 and 34 | £2.408m | £2.408m | £2.408m | £2.408m | £2.408m |

The number of new connections was based on the Company's Water Resources Management Plan (WRMP), a similar approach will be taken going forward as these numbers are evidenced by Local Plans; unfortunately such predictions are frequently revised and do quickly become out of date particularly in high growth areas.

## Variance due to the number of connections

In the first three years of the current price control period, the number of new connections undertaken by the Company was higher than that assumed in the Final Determination. As well as the absolute number of new properties built being higher, we have also seen the proportion of connections undertaken by Self Lay Organisations (SLOs) being lower than was assumed in the Business Plan. This is set out below:

| **2015-16** | **Unit** | **Final Determination** | **Actual** | **Variance** |
|---|---|---|---|---|
| Number of connections | # | 3.780 | 4.176 | 0.396 |
| Number of connections by the Company (i.e. not self-lay) | # | 1.475 | 2.904 | 1.429 |
| Proportion of connections done by Company | % | 39.0% | 69.5% | 30.5% |
| Contribution per connection in Company Business Plan (Outturn prices) | £ | | | £426 |
| Variance in connection charges due to number of connections undertaken by the Company (Outturn Prices) | £m | | | 0.609 |

| 2016-17 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Number of connections | # | 3.968 | 4.258 | 0.290 |
| Number of connections by the Company (i.e not self-lay) | # | 1.352 | 2.364 | 1.012 |
| Proportion of connections done by Company | % | 34.1% | 55.5% | 21.4% |
| Contribution per connection in Company Business Plan (Outturn prices) | £ | | | £435 |
| Variance in connection charges due to number of connections undertaken by the Company (Outturn Prices) | £m | | | 0.440 |

| 2017-18 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Number of connections | # | 4.168 | 6.892 | 2.724 |
| Number of connections by the Company (i.e not self-lay) | # | 1.242 | 4.637 | 3.395 |
| Proportion of connections done by Company | % | 29.8% | 67.3% | 37.5% |
| Contribution per connection in Company Business Plan (Outturn prices) | £ | | | £451 |
| Variance in connection charges due to number of connections undertaken by the Company (Outturn Prices) | £m | | | 1.532 |

Historically in the South Staffs region, the level of self lay connections has been low compared to the level in the Cambridge region. There was a legitimate expectation that the level of self-lay connections would increase significantly in the current AMP bringing the two regions roughly in line as a result of the increase in new developments in green field sites (see below). These types of connections are straightforward and are popular with SLOs due to the number of properties on each development.

The lower adoption of SLO delivery by developers was against expected trends and could not have been realistically anticipated by the Company; therefore we believe the extra volume at the expected charge should be allowed by Ofwat as this income has been offset by the extra cost of undertaking the work.

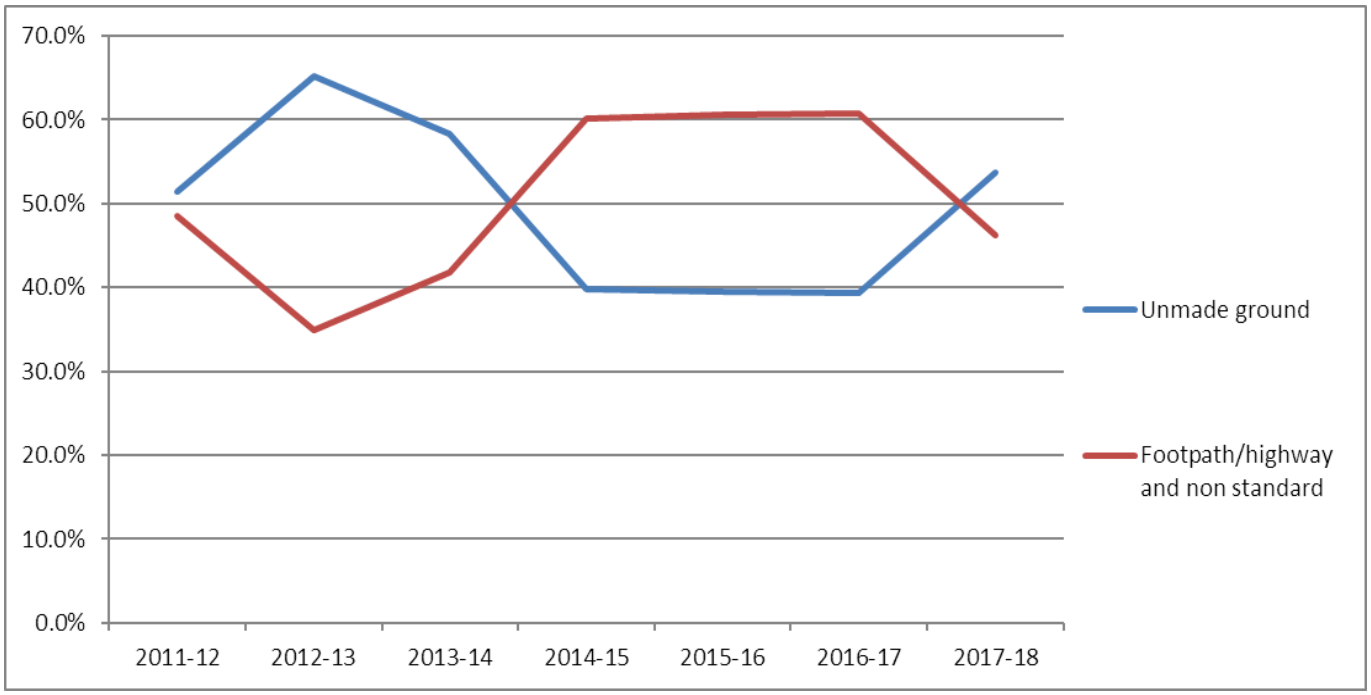
## Variance due to the type of the connection

At the time of the Business Plan submission, Local Plans in the South Staffs region pointed to a significant number of new green field developments that would support the housing availability in the areas of Burton and Sutton Coldfield.

Based on this, the Company assumed that the majority of new connections undertaken would be standard and in unmade ground.

However, during the first two years of the current price control period, the Company has seen a significant number of non-standard connections and in-fill developments on brownfield sites. These connections are particularly expensive and can involve extra costs such as traffic management.

Analysis shows that the level of non-standard connections in the South Staffs region has increased over a four year period from 2013-14, falling back in 2017-18 as set out in the graph below:




The average cost of a footpath/highway/non-standard connection in the first three years of the current period was £1,505 which is over £1,000 higher than the standard connection assumed in the Company's Business Plan.

The summary below sets out the overall impact from the higher average cost per connection compared to the Final Determination for the first three years of the period:

| 2015-16 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Number of connections | # | 3.780 | 4.176 | 0.396 |
| Number of connections by the Company (i.e not self-lay) | # | 1.475 | 2.904 | 1.429 |
| Proportion of connections done by Company | % | 39.0% | 69.5% | 30.5% |
| Average contribution per connection (Outturn prices) | £ | £426 | £897 | £471 |
| Variance in connection charges due to unit price of connections undertaken by the Company Outturn prices) | £m | | | 1.368 |

| 2016-17 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Number of connections | # | 3.968 | 4.258 | 0.290 |
| Number of connections by the Company (i.e not self-lay) | # | 1.352 | 2.364 | 1.012 |
| Proportion of connections done by Company | % | 34.1% | 55.5% | 21.4% |
| Average contribution per connection (Outturn prices) | £ | £435 | £1,186 | £751 |
| Variance in connection charges due to unit price of connections undertaken by the Company Outturn prices) | £m | | | 1.776 |

| 2017-18 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Number of connections | # | 4.168 | 6.892 | 2.724 |
| Number of connections by the Company (i.e not self-lay) | # | 1.242 | 4.637 | 3.395 |
| Proportion of connections done by Company | % | 29.8% | 67.3% | 37.5% |
| Average contribution per connection (Outturn prices) | £ | £451 | £685 | £233 |
| Variance in connection charges due to unit price of connections undertaken by the Company Outturn prices) | £m | | | 1.082 |

The change in the nature of developments from that anticipated in Local Plans is beyond the control of the Company, and was not predictable. The Business Plan was based on the best available information at the time. Therefore we believe that the extra cost per connection should also be recoverable from developers at it has been legitimately incurred and that no adjustment should be made through the Wholesale Revenue Forecasting Incentive Mechanism (WRFIM).

We also believe that this extra cost could not have been expected on any unanticipated volume (as set out above) resulting from the shift in the SLO percentage, and that this variance should also be allowed by Ofwat.

Both of the above components are included in the tables within this section.

## Variance in infrastructure charges

As the infrastructure charge is a fixed charge per property for domestic connections and a multiple of the charge for non-household properties with connections greater than 32mm, the level recovered is directly linked to the number of properties connected in the year.

As outlined above, the Company has experienced a higher number of connections than anticipated and hence recovered more infrastructure charges. This is summarised below:

| **2015-16** | **Unit** | **Final Determination** | **Actual** | **Variance** |
|---|---|---|---|---|
| Number of connections | # | 3.780 | 4.176 | 0.396 |
| Standard Infrastructure charge (*outturn prices*) | £ | £354 | £354 | 0.000 |
| Infrastructure charge receipts *(Outturn prices)* | £m | 1.338 | 1.568 | 0.230 |

| **2016-17** | **Unit** | **Final Determination** | **Actual** | **Variance** |
|---|---|---|---|---|
| Number of connections | # | 3.968 | 4.258 | 0.290 |
| Standard Infrastructure charge (*outturn prices*) | £ | £358 | £358 | 0.000 |
| Infrastructure charge receipts *(Outturn prices)* | £m | 1.421 | 1.583 | 0.163 |

| 2017-18 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Number of connections | # | 4.168 | 6.892 | 2.724 |
| Standard Infrastructure charge (*outturn prices*) | £ | £365 | £365 | 0.000 |
| Infrastructure charge receipts *(Outturn prices)* | £m | 1.523 | 2.454 | 0.931 |

*Note: The actual infrastructure charge receipts do not equate to the number of connections multiplied by the unit charge due to infrastructure credits.*

## Mains requisitions

The level of wholesale contributions included in the Company's Final Determination was taken from the Business Plan table W9, revenue projections. Line 14 was defined as:

**"Connection and infrastructure charges (including requisitions and self-lay) treated as a capital contribution in statutory accounts"**

In completing the table, this was reasonably interpreted as being all connection charges and infrastructure charges for both requisitioning by the Company and for self-lay (as below).

| | | | | | | |
|---|---|---|---|---|---|---|
| Connection and infrastructure charges | Table W9 Line 14 | £1.855m | £1.855m | £1.855m | £1.855m | £1.855m |

Following the Final Determination, it has been clarified by Ofwat that this line should also have included mains requisition charges.

The difference between the contributions included in table W3 and the connection and infrastructure charges in table W9 (£0.553m per annum) relates to the missing mains requisition charges. Therefore, a sum equal to mains requisition charges is not included in the Company's final allowed Wholesale revenues.

The assumed level of mains requisition charges included in the net totex was £0.533m (2012-13 prices) which in outturn prices is set out below:

| ***Outturn prices*** | **Unit** | **2015-16** | **2016-17** | **2017-18** |
|---|---|---|---|---|
| Mains Requsitions included in the FD but excluded from Table W3 (Outturn Prices) | £m | 0.587 | 0.599 | 0.622 |

In actual terms this has generated a difference to the Wholesale allowed revenue as follows:

| 2015-16 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Contributions received from mains requisitioning charges (*Outturn Prices)* | £m | 0 | 0.679 | 0.679 |

| 2016-17 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Contributions received from mains requisitioning charges (*Outturn Prices)* | £m | 0 | 1.746 | 1.746 |

| 2017-18 | Unit | Final Determination | Actual | Variance |
|---|---|---|---|---|
| Contributions received from mains requisitioning charges (*Outturn Prices)* | £m | 0 | 0.668 | 0.668 |

As this additional developer income results from increased cost that has again been legitimately incurred, it is proposed that all mains requisition charges recovered from developers is allowed by Ofwat.

## Efficiently incurred costs

It is important to demonstrate that the costs incurred by the Company are efficient and that the variance in the unit cost of connection compared to that assumed in the Determination is due to the type of connection rather than an increase in costs.

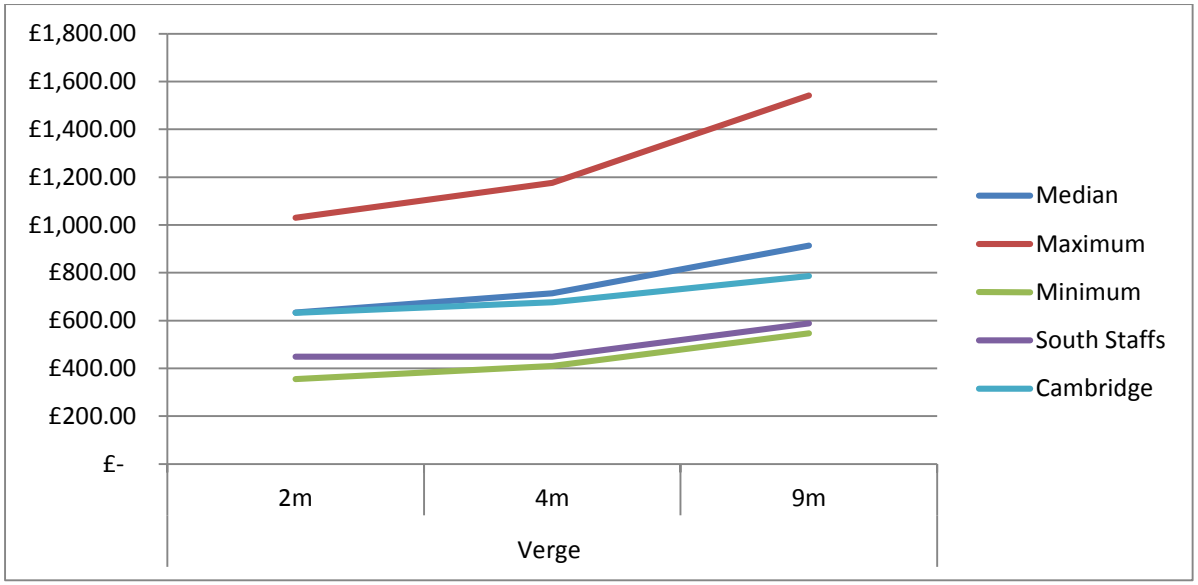
Ofwat published an independent comparison of monopoly water companies' new water supply connection costs (IN 17/02) in February 2017. This set out the range of maximum, minimum and median charges for different connection scenarios. The analysis is set out below along with the charges for South Staffs and Cambridge regions (as set out in our 2016-17 charges scheme):

| | Verge[1] | | | Footway | | | Carriageway | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2m | 4m | 9m | 2m | 4m | 9m | 2m | 4m | 9m |
| Median | £ 633.42 | £ 713.35 | £ 913.19 | £ 773.84 | £1,009.06 | £1,597.10 | £ 779.34 | £1,020.67 | £1,623.99 |
| Maximum | £1,029.41 | £1,175.82 | £1,541.85 | £1,144.98 | £1,419.20 | £2,104.75 | £1,188.50 | £1,510.86 | £2,316.74 |
| Minimum | £ 354.52 | £ 409.34 | £ 546.40 | £ 458.47 | £ 627.11 | £1,048.73 | £ 468.73 | £ 648.60 | £1,098.28 |
| South Staffs | £ 449.00 | £ 449.00 | £ 588.00 | £ 737.00 | £ 737.00 | Quote[2] | £ 877.00 | £ 877.00 | £1,228.00 |
| Cambridge | £ 632.00 | £ 676.00 | £ 786.00 | £ 925.00 | £1,099.00 | £1,534.00 | £ 925.00 | £1,099.00 | £1,534.00 |

[1] *The Company has assumed that the reported costs for 'verge' are equivalent to unmade or site ground.*

[2] *South Staffs Region only publishes standard charges up to 4m for footway. Longer services would be quoted separately.*

This analysis demonstrates that the South Staffs region is generally near the minimum charges in the industry and that the Cambridge region is around the median. This is set out graphically for each type of connection below.


£1,800.00
£1,600.00
£1,400.00
£1,200.00
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£800.00
£600.00
£400.00
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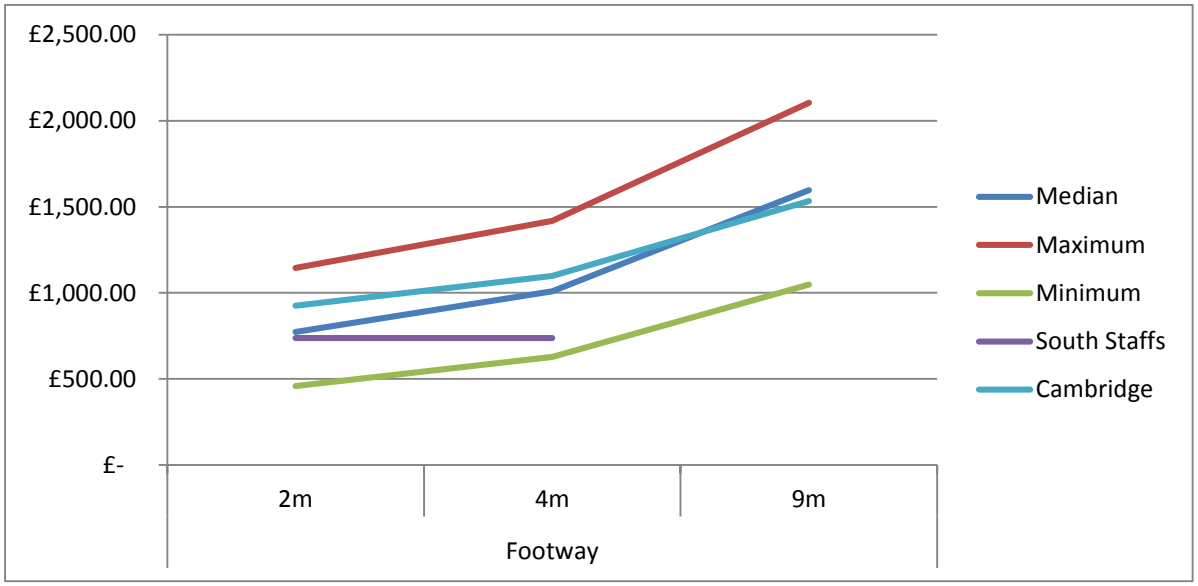
2m
4m
9m
Verge
Median
Maximum
Minimum
South Staffs
Cambridge


£2,500.00
£2,000.00
£1,500.00
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£500.00
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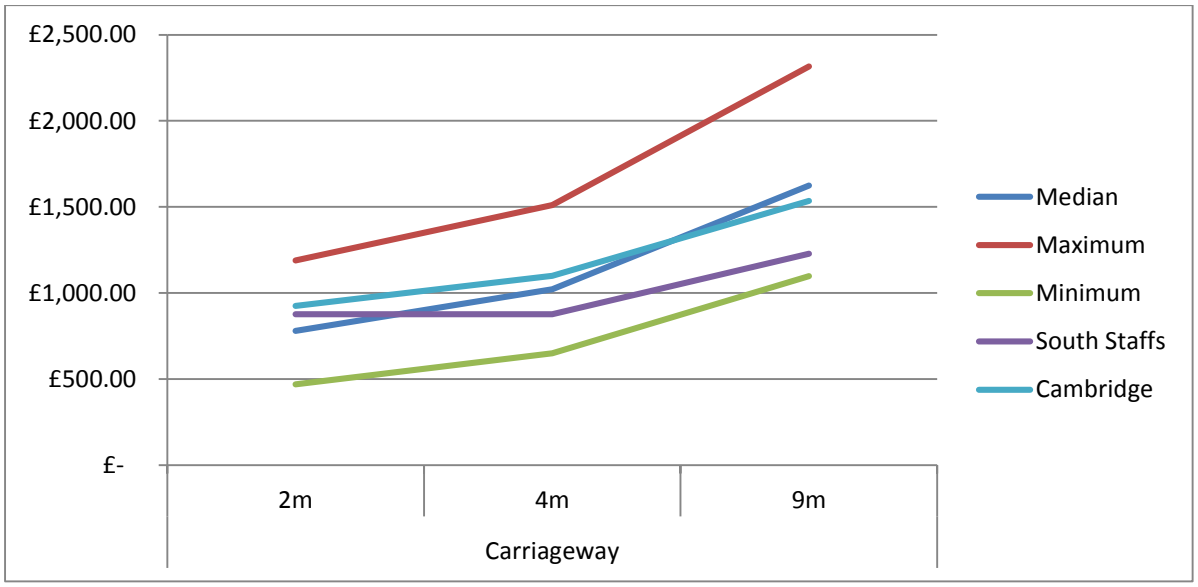
2m
4m
9m
Footway
Median
Maximum
Minimum
South Staffs
Cambridge


£2,500.00
£2,000.00
£1,500.00
£1,000.00
£500.00
£-
2m
4m
9m
Carriageway
Median
Maximum
Minimum
South Staffs
Cambridge

The Company has also had no disputes with developers with regard to its connection charges.

We therefore believe that our charges are efficiently incurred compared to the rest of the industry and that the variations identified above are not due to inefficiency.

## 2018-19 and 2019-20 forecast years

The Company has projected the level of developer contributions for the final two years of the price control period and this is set out below:

## Number of connections

This forecast of Company connections has used the average of the final quarter of 2017-18 and the first two months of 2018-19, which has then been annualised. This has then been grossed up using the three year average % of Company connections to arrive at a total number of connections including self lay. This is set out below:

| | Jan-18 | Feb-18 | Mar-18 | Apr-18 | May-18 | 5 month average | 12 month projection |
|---|---|---|---|---|---|---|---|
| No of connections by the Company | 283 | 303 | 256 | 196 | 451 | 298 | 3,574 |
| 3 year average % undertaken by the Company | | | | | | | 64% |
| Forecast number of total connections | | | | | | | 5,574 |

## Forecast costs

From 2018-19, infrastructure charges are reconciled as part of the new developer charging rules and companies are required to balance their costs with revenues received, as far as is reasonably possible over a rolling 5-year cumulative period. Therefore any variance projected for the last two years of the period has been excluded.

The connection charge is calculated as the average unit connection charge seen in the first three years of the period. This is set out below:

| £s | 2015-16 | 2016-17 | 2017-18 | Average |
|---|---|---|---|---|
| Average unit connection cost | £897 | £1,186 | £685 | £923 |

Although the average connection charge for 2017-18 is lower than the previous two years, driven by a lower proportion of footpath and non-standard connections, there is no evidence that this will be a continuing trend and therefore the three year average is viewed to be the most sensible.

This average unit cost is multiplied by the number of Company connections of 3,574 to give a total cost and hence contribution of £3.298m.

The forecast for mains requisitions is calculated as the three year average of contributions received in the period as shown below:

| £m | 2015-16 | 2016-17 | 2017-18 | Average |
|---|---|---|---|---|
| Mains requistions contributions | 0.679 | 1.746 | 0.668 | 1.031 |

Therefore the forecast mains requisition contribution is £1.031m

Overall, for 2018 -19 and 2019-20, the forecast contributions are:

| £m | 2018-19 | 2019-20 |
|---|---|---|
| Connection charges | 3.298 | 3.298 |
| Infrastructure charges | 1.634 | 1.740 |
| Mains requisitions contributions | 1.031 | 1.031 |
| **Total developer contributions** | **5.962** | **6.069** |

*Infrastructure charges included for consistency and completeness with table WS13, line 23.

## Conclusion

Based on the information set out above, we believe that the costs incurred and subsequently charged to developers as connection charges, infrastructure charges and mains requisition charges are legitimately incurred. These variations from our Final Determination arise as a result of demand variations where the Company has incurred additional cost, and therefore their recovery from developers is justified. It is therefore proposed that there is no adjustment through WRFIM for this additional revenue.

# 6. Residential retail

The Company has completed the reconciliation model for residential retail and a summary is set out below.

| £ms | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 | AMP 7 |
|---|---|---|---|---|---|---|
| Expected retail revenue | 14.938 | 15.156 | 15.794 | 16.782 | 17.256 | 79.926 |
| Actual / forecast retail revenue | 14.934 | 14.679 | 15.218 | 16.782 | 17.256 | 78.869 |
| Under/(over) recovery | 0.004 | 0.477 | 0.576 | 0.000 | 0.000 | 1.057 |

Overall, residential retail revenue for the five year period is forecast to be within 1.3% of expectation.

## Actual customer numbers for the three years to 2017-18

The actual number of customers for the first three years of the period has been marginally above that assumed at PR14 being 5,006 (0.8%) higher in 2015-16 2,040 (0.3%) higher in 2016-17 and 8,709 (1.3%) higher in 2017-18.

Part of the driver for the higher number of customers is a reduction in void properties in the South Staffs region. The Company has also seen new connections above that assumed in the PR14 Final Determination (3,630 additional for the first three years of the period).

## Actual retail revenues compared to expectation for the three years to 2017-18

In 2015-16, the overall difference between actual revenue compared to that expected from the actual customer numbers was small, being £0.004m higher.

In 2016-17 and 2017-18, there was a £0.477m (3.0%) and £0.576m (3.7%) shortfall in revenue respectively driven by lower demand from metered customers with the summer of 2016 and 2017 being cooler than normal.

The split of residential retail revenues recovered between unmetered and metered customers is different to that assumed in the PR14 determination. This is because charges have been set to be cost reflective.

The allowed cost to serve, based on the whole industry average, for metered customers is approximately £5 per customer higher than an unmetered customer. This predominantly reflects the additional cost of metering. However, South Staffs unit cost of bad debt for an unmetered customer is significantly more than that for a metered customer (£6.57 compared to £2.70 in 2017-18) therefore this £5 differential is mostly offset. Using data in the Company's APR for 2017-18, the difference in average cost to serve (before depreciation) is as follows:

| | | | Unmeasured | Measured |
|---|---|---|---|---|
| Total operating expenditure | Table 4F line 8 | £m | 6.361 | 5.222 |
| Number of customers | Table 2F col G | £000's | 380.905 | 289.756 |
| Average cost | | £ | 16.70 | 18.02 |

This shows that the difference is only £1.32 on a cost reflective basis and this has been factored in when setting retail charges for metered and unmetered customers.

## Forecast retail revenues compared to expectation for 2018-19 and 2019-20

The retail revenues for 2018-19 and 2019-20 are expected to be in line the Final Determination with charges being set to recover the allowed retail revenue

# 7. ODIs and SIM

ODI and SIM performance for the first three years of the price review period is set out in our Annual performance Report which can be found at the link below:

https://www.south-staffs-water.co.uk/publications/annual-reports

The true up on ODIs is set out below showing rewards or penalties for the first three years of the period and forecast rewards for the final two years:

| Performance commitment | Three year actual performance (£m) | Two year forecast performance (£m) | Five year forecast performance (£m) |
|---|---|---|---|
| | £m | £m | £m |
| 1.1: Mean zonal compliance (MZC, combined company) | (0.200) | 0.000 | (0.200) |
| 1.2: Acceptability of water to customers (combined company) | (0.499) | 0.000 | (0.499) |
| 2.1: Interruptions to supply (combined company) | 2.024 | 1.812 | 3.836 |
| 4.2: Leakage (Cambridge operating region) | (0.217) | 0.000 | (0.217) |
| **Total (12-13 prices)** | **1.109** | **1.812** | **2.921** |

The forecast performance levels for all performance commitments have been assured by Jacobs.

The expectation is that a maximum reward is achieved in 2018-19 and 2019-20 for supply interruptions and that all other performance commitments in that period neither earn a reward nor incur a penalty.

For the first two years of the period (2015-16 and 2016-17), maximum rewards were achieved for supply interruptions. 2017-18 performance is considered an exception as it was impacted by a small number of events through the year (although a reward was still earned). It is therefore expected that maximum rewards will be achieved in the final two years of the period.

We are working hard to ensure that where there has been a small underperformance in previous years on MZC, acceptability of water and leakage in Cambridge that this does not happen in the next two years.

South Staffs has always targeted SIM performance in the upper quartile for the industry. We are forecasting a SIM reward equal to 3% of retail household revenue earning a reward of £2.4m (£16m*3%*5).

Significant progress has been made in certain service delivery areas such as complaints. A key area of focus throughout 2017-18 was to reduce the volumes of complaints we received, especially within our Cambridge region. A series of initiatives were completed including improving our debt recovery letters, process improvements to our measured customer journey, changes to our MyAccount system and setting up our Cambridge First contact centre team. These changes combined with investment in customer service training across the business for field teams and contact centre staff ensured we delivered a 37% reduction in complaints, with our South Staffs region at our lowest ever recorded level. We are committed to reduce complaints even further and this is reflected in our forecast complaint levels shown in table App31.

We have also started to work on improving transactional interactions such as home moves and making payments, this has seen positive increases to our quarterly SIM scores and we will continue to work on this throughout the following year.

We have completed table R10 with our projected SIM scores. SIM will not be reported in 2019-20, being replaced with a shadow version of C-Mex. However we have populated the year for completeness.

## Table APP5 Financial measures

The following general points apply to all of our performance commitments:

- All of our financial incentives operate as per the automatic application defined in our PR14 final determination. We have not deviated from this automatic application.
- None of our reported performance is due to methodological improvements. We have kept methodologies the same for all measures since they were defined in PR14 and we have maintained separation between measures which are live and those which are being reported as shadow, using new methodologies, in this period.
- We have not applied any mitigating factors (e.g. for weather or exceptional events) to our forecasts.
- We do not consider there to be any ambiguity in our performance commitment definitions. In the first three years of the reporting period, no ambiguity issues have been detected either from our assurance processes or from external stakeholders.
- All performance commitments are allocated fully to network plus with the exception of SIM, which is allocated to residential retail.

| 1.1 Mean Zonal Compliance (MZC, combined company) | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | 100% | 100% |
| Forecast performance | 99.970% | 99.970% |
| PC level met? | No | No |
| Penalty deadband | 99.950% | 99.950% |
| Commentary | • Our historical performance has tended to fluctuate around the 99.97% level over the last 7 years. We have incurred an underperformance penalty in this price control period to date.<br>• Whilst we strive to achieve our target of 100% compliance through a wide range of proactive activity in our network and ensuring our treatment works are operating correctly, it is likely that we will experience a small number of sample failures each year as this is the likely outcome of a random compliance sample programme. In the majority of cases, resamples do not fail and all failures are thoroughly investigated and reported to the DWI.<br>• Our forecast performance level is within the penalty deadband and therefore we do not forecast underperformance penalties in the final two years. | |

| 1.2 Acceptability of water to customers (combined company) | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | 1.23 | 1.23 |
| Forecast performance | 1.23 | 1.23 |
| PC level met? | Yes | Yes |
| Commentary | • We have made strong year on year improvements to this performance commitment, delivering a 15% improvement in 2016/17 and a further 14% improvement in 2017/18. In the current year the hot summer has caused a slight increase in contacts however we are putting in place actions to mitigate this and expect to recover the position, meeting our | |

| | |
|---|---|
| | performance commitment by year end. We will continue these improvements into the final year of the AMP where we will also begin preparing for our significant capital investment that we need to deliver further improvements in performance. Therefore we are also forecasting meeting our performance commitment in 2019/20.<br>• There are no deadbands to this performance commitment, so slight variation from our target will result in penalty or reward.<br>• As we are forecasting to hit our performance commitment we do not expect any further financial incentives. |

| **2.1 Interruptions to supply (combined company)** | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | 10 | 10 |
| Forecast performance | 7 | 7 |
| PC level met? | Yes | Yes |
| Reward deadband | 9 | 9 |
| Reward cap | 7 | 7 |
| Outperformance payment rate | £0.453m per minute | £0.453m per minute |
| Commentary | • This performance commitment can experience volatility due to unplanned events. Following good performance in 2015/16 and 2016/17, we experienced unplanned events in 2017/18 which resulted in a deterioration in performance.<br>• Subject to no extreme events occurring, we expect to be able to achieve maximum outperformance payment for each of the remaining two years of the period. We have forecast 7 minutes for the remaining two years as we know volatility can have an impact on performance. Whilst we will work hard to ensure any events have minimal consequences to customers, it is prudent to include an allowance for volatility in our forecast. | |

| | |
|---|---|
| | • The outperformance payments calculation is:<br>  ○ 9 (deadband) – 7 (forecast) x £0.453m<br>  ○ Cap is at 7 minutes, so incentive does not go higher if performance is better than expected. |

| **2.2 Serviceability infrastructure (combined company)** | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | Stable | Stable |
| Forecast performance | Stable | Stable |
| PC level met? | Yes | Yes |
| Commentary | • This performance commitment is a combination of sub measures reported in table APP6. Please see the APP6 section of this commentary for further information on the sub measures.<br>• We published our asset health methodology on our website in 2015 and this remains unchanged.<br>• Using this methodology our infrastructure serviceability is stable and no financial incentive is expected to be incurred. | |

| **2.2 Serviceability non-infrastructure (combined company)** | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | Stable | Stable |
| Forecast performance | Stable | Stable |
| PC level met? | Yes | Yes |
| Commentary | • This performance commitment is a combination of sub measures reported in table APP6. Please see the APP6 section of this commentary for further information on the sub measures.<br>• We published our asset health methodology on our website in 2015 and this remains unchanged.<br>• Using this methodology our non-infrastructure serviceability is stable and no financial incentive is expected to be incurred. | |

| **4.1 Leakage South Staffs region** | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | 70.5 Ml/d | 70.5 Ml/d |
| Forecast performance | 70.5 Ml/d | 70.5 Ml/d |
| PC level met? | Yes | Yes |
| Commentary | • We slightly outperformed our leakage target in 2015/16 and 2016/17 but slightly underperformed it in 2017/18 due to the late impact of the cold winter. In all three years the performance variance was not sufficient to trigger a financial incentive.<br>• We are aiming to hit our performance commitment for the final two years of the period and so no future financial incentive is expected to be incurred. | |

| **4.1 Leakage Cambridge region** | | |
|---|---|---|
| Forecast year | 2018/19 | 2019/20 |
| PC level | 13.5 Ml/d | 13.5 Ml/d |
| Forecast performance | 13.5 Ml/d | 13.5 Ml/d |
| PC level met? | Yes | Yes |
| Commentary | • We have incurred an underperformance penalty for leakage in the Cambridge region in 2016/17 and 2017/18 and are working to bring the performance back on track. We have already increased the level of resource to detect and repair leaks in the Cambridge region for 2018/19.<br>• We are aiming to hit our performance commitment for the final two years of the period and so no future financial incentive is expected to be incurred. | |

## Table APP6

Table APP6 reports sub measures which combine to form an assessment of asset health (serviceability) for infrastructure and non-infrastructure assets. Our methodology for how the sub measures are combined, which includes their weighting factors, is published on our website at the following link:

https://www.south-staffs-water.co.uk/media/1937/asset-health-odi-methodology.pdf

The asset health sub measures are not incentivised individually, but at the combined level.

### Serviceability infrastructure

| | |
|---|---|
| Mains bursts: | We have taken the five year average of our performance to derive the forecast for the two future years. This is because there is natural variability to burst numbers which can depend on the weather and other external effects such as third parties. We have made no direct alteration to account for these effects but by taking a 5 year average we are implicitly allowing for them. We forecast our future performance to be within the existing reference level. |
| Interruptions > 12 hours: | We met our reference level in 2015/16 but did not meet it in 2016/17 and 2017/18. This was due to unplanned events which caused a small number of properties to experience a longer supply interruption. We work extremely hard to ensure that supplies are restored quickly during an event however this metric can be volatile,. We have taken a five year average of performance to implicitly allow for the volatility. |
| Low pressure: | We have one persistent low pressure property in the Cambridge region which is a property requiring its own boosted supply. We are currently investigating the engineering options available to us and we expect to resolve this by 2019/20. During the reporting year we rectify many low pressure issues for customers and they therefore do not become persistent. |
| Discolouration contacts: | Discolouration contact has been reducing in line with the main ODI for acceptability of water to customers. We have assumed that the latest year's performance is broadly what we will achieve in the final two years, reflecting the improvements we have made, which meets the reference level. |
| TIM index: | Turbidity, iron and manganese (TIM) compliance samples are sub components of the regulatory sample programme and also included in MZC. As with MZC, there is a degree |

of random noise associated, although we work hard, through flushing programmes and ensuring that our treatment works are operating correctly, to minimise the risk of water quality issues. We have taken a five year average to derive the forecast.

**Serviceability non-infrastructure**

WTW coliforms: As with MZC and TIM index, these water quality parameters can experience a small amount of random noise, often unrepeatable on resampling. We think the best approach to allow for this is to base our future forecast on a 5 year average. This meets our reference level for this sub measure.

Service reservoir coliforms: Our historic performance on this sub measure is full compliance (zero failures) therefore our future forecast is unchanged from this. This meets our reference level.

WTW turbidity: Our historic performance on this sub measure is full compliance (zero failures) therefore our future forecast is unchanged from this. This meets our reference level.

Enforcement actions: We do not expect any enforcement actions for microbiological parameters within the next two years. This meets our reference level.

Unplanned maintenance: There is natural variability to the amount of asset reliability events (trips, unplanned failures) that we get, and therefore the most sensible approach is to take a five year average of our past performance. This meets our reference level for this sub measure.

## Table APP5 Reputational measures

We have provided forecasts for all of our reputational measures, using the following rationale:

Water efficiency (PCC): We experienced a higher than expected PCC in 2017/18 due to the effect of the cold winter. In 2018/19 and 2019/20 we are forecasting to hit our performance commitments however the current period of hot weather is likely to have an upwards pressure on PCC for this year. It is too early in the year to project the impact this might have on the final outturn value.

Biodiversity: As of 2017/18 we have achieved our performance commitment for the price control period however we plan to continue delivering improvements as we lead in to AMP7. We are projecting a further 10 Hectares per annum in each of the remaining years.

Carbon emmissions: We have not achieved our performance commitments on this measure. Our original PR14 target was inclusive of renewable energy plans, however these became less economic to undertake following changes to government incentives early in the period. We are continuing to deliver energy efficiency improvements but the impact is less than if we had been able to deliver the original renewable energy proposals. We are forecasting to deliver the same improvement in the remaining two years as we have delivered in 2017/18.

Value for money and affordability surveys: We have met our performance commitment in the first three years of the period. As a survey measure, it can experience natural fluctuations therefore we have taken an average of our three years performance to derive the forecast for the remaining two years.

Support for customers in debt: Our extensive marketing of our social tariff along with our proactive efforts to reach out to vulnerable customers have meant we have exceeded our performance commitments on this measure to date. We expect to achieve our 2019/20 performance commitment in 2018/19 and will continue to grow our offering, outperforming our performance commitment in the final year.

SIM We have not met our original PR14 target which was based on the previous SIM methodology however we have continued to work hard to achieve our aspiration of an upper quartile performing company. We have addressed issues in 2016/17 that caused our SIM and complaints performance to deteriorate and as result have seen our score improve in 2017/18. We will continue to work hard to ensure we don't deteriorate from this level so are forecasting 88.1 for the remaining two years.

Customer satisfaction: We have met our performance commitment in the two of the first three years of the period. As a survey measure, it can experience natural fluctuations therefore we have taken an average of our three years performance to derive the forecast for the remaining two years.

| | |
|---|---|
| Community engagement: | For the first two years we did not meet our performance commitment. In 2017/18 we improved our strategy and also brought in additional resources, and we have achieved our performance commitment. We plan to continue with this level of activity for the remainder of the period and will continue to promote the benefits of the community activity we undertake. |

# Table App31

## Block A: Complaints

A key area of focus throughout 2017-18 year was to reduce the volumes of complaints we received, especially within our Cambridge region.

A series of initiatives were completed including improving our debt recovery letters, process improvements to our customer journey, changes to our MyAccount system and setting up our Cambridge First contact centre team. These changes combined with investment in customer service training across the business for field teams and contact centre staff ensured we delivered a 37% reduction in complaints, with the levels in our South Staffs region at our lowest recorded level.

We are striving to reduce complaints further for 2018-19 and 2019-20. Towards the end of 2017-18 year we have started to work on improving transactional interactions such as home moves and making payments, this has seen positive increases to our quarterly SIM scores. We will continue to work on this throughout the following year.

As well as launching the Alexa Skill, we have also developed our digital contact channels and have added both Twitter and Facebook which are proving to be useful service channels and a great way of communicating quickly with some of our customers, especially if we have a supply issue.

We continue to find ways to better listen to our customers and respond to what we hear from them. More in-depth, regular research has been put in place to better understand customers' current and future needs as well as their views of our services. The research has been targeted on specific customer groups, including those in vulnerable circumstances and non-bill payers, to enable us to better understand how we can offer the right level of service and support. This additional research combined with our ongoing customer dialogue and information obtained from customer contacts and complaints is creating insights that are being used to inform business decisions to match what customers have told us they value. We have also altered our approach to how we engage with customers to give them a greater say in shaping the future of their water services. This is all part of how we are putting customers at the heart of our business.

We have had a very low number of investigations opened by CCW; details are set out below:

**2015/16**

| Case Ref | Date Application Rec'd | Date of SSW Response | Outcome Date | Decision |
|---|---|---|---|---|
| WAT/SSW/0050 | 15/019/15 | 17/09/2015 | 23/09/2015 | Claim withdrawn as not applicable |
| WAT/SSW/0125 | 03/11/2015 | 10/11/2015 | | This was settled and held in customer's favour |
| **2016/2017** | | | | |
| **Case Ref** | **Date Application Rec'd** | **Date of SSW Response** | **Outcome Date** | **Decision** |
| WAT/SSW/0379 | 07/09/2016 | 13/09/2016 | | Found to be in company's favour |
| WAT/SSW/0391 | 06/10/2016 | 10/10/2016 | | Found to be in company's favour |
| WAT/SSW/0407 | 31/10/2016 | 07/11/2016 | | Found to be in company's favour |
| **2017/2018** | | | | |
| **Case Ref** | **Date Application Rec'd** | **Date of SSW Response** | **Outcome Date** | **Decision** |
| WAT/SSW/0550 | 17/07/2017 | | 11/08/2017 | Found to be in company's favour |
| WAT/SSW/0589 | 28/09/2017 | | 26/10/2017 | This was settled and held in customer's favour – customer declined settlement |

## Block B: Major Incidents

We have had no major incidents over the past three years.

## Block C: Compliance with Environment Agency/National Resources Wales statutory requirements

As per the table guidance, water only companies are not required to complete this block.

## Block D: Compliance with DWI statutory requirements

We have had no cautions or prosecutions over the last three years.

## Block E: Compliance with Ofwat regulatory requirements

We have had no enforcement action taken by Ofwat over the last three years.

# Appendix A1

## SOUTH STAFFORDSHIRE PLC – INTERNAL AUDIT

### Subject Matter: PR14 Reconciliations

Group Internal Audit was requested to carry out an independent review of information contained within the PR14 Reconciliation statements being submitted to Ofwat.
This review entailed checking the inputs to supporting documentation and obtaining explanations behind the numbers reported within the following tables:

- WS13 –wholesale revenue forecast incentive mechanism (WRFIM)
- WS15 – wholesale total expenditure outperformance
- R9 – reconciliation of household revenue
- R10 – service incentive mechanism
- App5 – performance commitments (ODI's)

Figures from these feeder models were then checked through to the summary of PR14 adjustments (this work included specific testing of the accuracy of the price base).
From work undertaken Internal Audit is satisfied that the figures being reported are in line with supporting internal documentation.

Glyn Palmer BA (Hons) FCA

Group Internal Audit Manager
July 2018

# Appendix A2

Reconciling for Past Performance - South Staffs Water plc

## Letter of Assurance

**For the attention of the Audit Committee** **13 July 2018**

### Reconciling for past performance

Part of the 2019 price review (PR19) will be the calculation of adjustments to take account of AMP6 performance and incentive mechanisms. This is particularly important given the potential materiality of the adjustments and the fact that the way adjustments are calculated can be complex and often open to different interpretations.

Ofwat has helpfully produced the PR14 reconciliation rulebook which describes the way that it will reconcile companies' 2015-20 performance against the PR14 final determinations at PR19. This includes the following mechanisms:

- Outcome delivery incentives (ODIs), which provide companies with rewards for achieving stretching performance targets and compensate customers if performance is below performance targets,
- Wholesale total expenditure (totex) sharing, where company over- and underperformance is shared with customers,
- Wholesale revenue forecasting incentive mechanism (WRFIM), which provides financial incentives for companies to provide accurate forecasts, and ensures under- and over-recovery is reconciled,
- PR09 reconciliation (blind year adjustments); and
- Household retail, where the total revenue allowance is adjusted for actual customer numbers.

You engaged us to conduct a risk based review of your submissions relating to the Reconciliation Rule Book – Feeder Models. Our assurance focused on your interpretation of the guidance for the PR14 reconciliation rulebook and subsequent application via the feeder models.

The risks identified do not reflect the robustness of the data relating to actual costs that input to the feeder models as these are subject to separate assurance.

When reviewing your models, our risk based sampling approach assessed the completeness of the data and your interpretation of the process. We have assigned an overall grade of A, B, C or D.

**Overall, for the Reconciliation Rule Book and Feeder models we consider:**

- **your team has good understanding of the data required to populate the feeder models, consistent with PR19 tables,**
- **your team has good understanding of your processes required to populate the feeder models, in line with Ofwat guidance; and,**
- **your team has good understanding of how the outputs of the feeder models provide data required for the financial model and associated PR19 data tables.**

#### Observations

Within our scope we completed a reviews covering a range of data tables and feeder models as per table 1. Due to the volume of tables and models we note that our review was risk based and we focussed on your interpretation of the guidance and completed sample checking of input data and outputs to data tables.

**Table 1**

| Data table | Content | Calculation Models | Financial model feeders |
|---|---|---|---|
| App5 | PR14 reconciliation – performance commitments | | |
| App6 | PR14 reconciliation – sub-measures | | |
| App27 | PR14 reconciliation – financial outcome delivery incentives summary | | Revenue adjustments feeder model<br>RCV adjustments feeder model |
| App23 | Inflation measures | All models | All models |
| App9 | Adjustments to RCV from disposals of interest in land | | RCV adjustments feeder model |
| App25 | PR14 reconciliation adjustments summary | This is an output from the other models and tables | |
| App31 | Past performance | This is a statement of operational performance with no impact | |
| WS13 | PR14 wholesale revenue forecast incentive mechanism for the water service | WRFIM PR14 reconciliation | RCV adjustments feeder model |
| WS15 | PR14 wholesale total expenditure outperformance sharing for the water service | Totex menu PR14 reconciliation | RCV adjustments feeder model<br>Revenue adjustments feeder model |
| WS17 | PR14 water trading incentive reconciliation | | Revenue adjustments feeder model |
| R9 | PR14 reconciliation of household retail revenue | Residential (household) retail PR14 reconciliation | Revenue adjustments feeder model |
| R10 | PR14 service incentive mechanism | | Revenue adjustments feeder model |

Based on our review we note the following general observations:

- You have explained that due to the prescription and automation of the feeder models supplied by Ofwat and Rule book, you have not prepared Individual methodology statements for each feeder model and associated tables. However, you have produced a paper that contextualizes and summarises the processes, levels of internal assurance and the resulting data.

- Through our assurance we have observed that there remains some scope to further reduce reporting risk. We observed that you are reliant on a small team to populate the feeder models. However, the team demonstrated clear ownership of this element of the Business Plan.

- We note that this is a complex element of the business plan and that the Ofwat models have been subject to a number of updates. This means that there is risk that either the company has misinterpreted part of the guidance or Ofwats models might not prove to be as fit for purpose as Ofwat originally intended

We have provided more detailed observations on our findings and areas to improve in separate feedback.

## Conclusion

Overall, we consider that we have worked constructively to identify key reporting risks and issues associated with the inputs to, and outputs from, the feeder models. We have been helped by the open, co-operative and committed attitude of your teams.

As noted the PR14 reconciliation rule book in complex and we note that the models have been subject to a number of updates. Your team has demonstrated that it is committed to owning this process and addressing any issues that Ofwat has identified to date and might subsequently identify as a result of its review of this relatively early submission.

Based on the findings of our risk based approach, as set out in this report, we see no reason why you should not submit the required models and associated tables to Ofwat.

Andrew McGeoghan

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# Appendix B

## South Staffs Water responses to Ofwat questions on developer contributions sent on the 7 December 2017

### 1. Explanation of movement in developer contributions in table W9 from original to revised business plan

The level of developer contributions shown on line 14 of table W9 reduced from £3.009m to £1.855m per annum between the original and revised Business Plan.

As a result of a number of key members of staff leaving the business since the Business Plan was submitted, the precise details of the change have not been available. However, with the information available it has been possible to conclude that the largest and most significant change was due to the assumption around the level of self-lay connections which increased from 13% to 71%. This increase is from the expectation that a large proportion of housing development would be in greenfield sites compared to the historic proportion which had been used for the December plan. Based on experience from the Cambridge region these type of developments had been popular with SLOs. An example at the time was a significant Barratt development called ‘Trumpington Meadows’ which was entirely a self-lay site via Energetics.

Although the precise breakdown of this change is not available, by analysing the local plans that were used as the basis for the level of connections, it is possible to demonstrate why the proportion of self-lay connections changed.

Overleaf sets out the most significant greenfield site developments and how this increased the assumed proportion of self-lay. Section 2 below provides more detail on specific sites which were included in local plans at the time. This includes a reference to the relevant pages from each of the local plans which have also been provided.

| | Original plan (2015-20) | | Cambridge NW | NIAB 1 | Clay farm | Trumpington Meadows | Burton | Lichfield | Sutton Coldfield | Other smaller greenfield sites in East Staffs | Revised Plan | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Company connections | 19.149 | *87%* | (2.625) | (1.780) | (1.125) | (0.600) | (2.500) | (1.743) | (1.500) | (0.840) | 6.436 | *29%* |
| Self-lay connections | 2.776 | *13%* | 2.625 | 1.780 | 1.125 | 0.600 | 2.500 | 1.743 | 1.500 | 0.840 | 15.489 | *71%* |
| Total level of connections | 21.925 | | | | | | | | | | 21.925 | |
| *Back up file reference* | | | *CamNW* | *CAM DP* | *CAM DP* | *CAM DP* | *East Staffs DP* | *Lichfield DP* | *Birmingham DP* | *East Staffs DP* | | |
| Detail and assumptions | | | Plan to build 5,000 dwellings. Assumed to be 525 built each year based on local plan assumption that 1.050 would be built in the first two years | Plan states 1,780 to be built and planning already given so assumed completed over the five years | Plan states 2,250 to be built. Assumed to completed over a ten year period to 2025 | c600 homes now built | Land at Branston for 2,500 homes. Application for planning was in 2012. Assumed build starts 2015 over five years. | Local plan includes 64% of development being greenfield and rural. Assumed delivered over the life of the local development plan. Calculated as 64% of 10,892 homes over 20 years | Local plan assumed 6,000 homes over the life of the local plan. Calculated as 6,000 homes over 20 years so 1,500 built in 2015-20 | There are a number of smaller developments in both regions on greenfield sites in East Staffs district. Assume built over the 20 year life of the plan. | | |

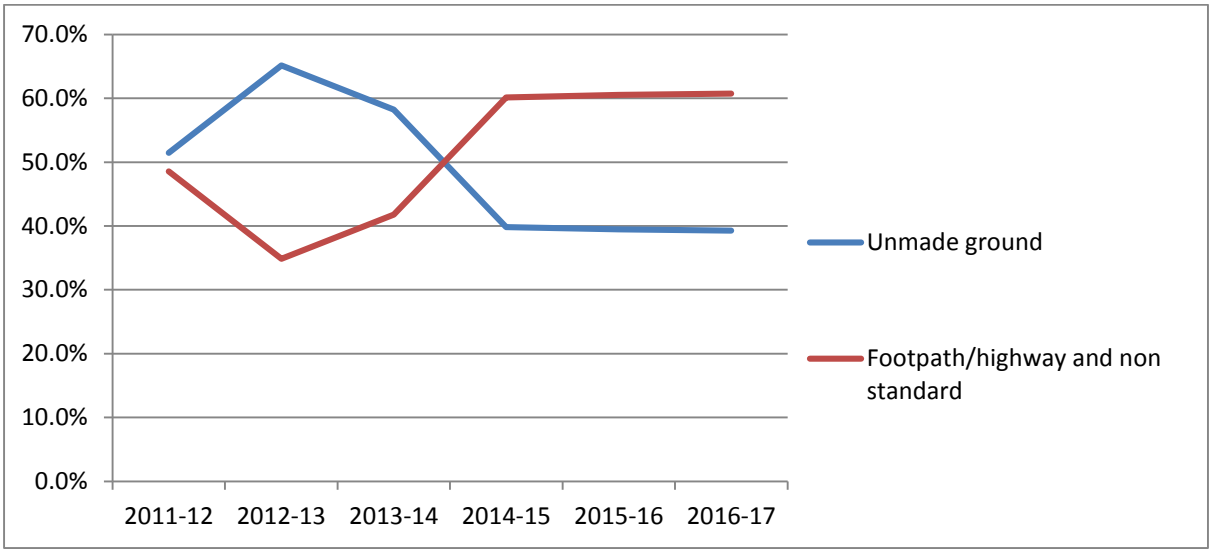
## 2. Evidence of local plans at the time of the Business Plan submission

Following on from section 1, the assumptions included in the June revised Business Plan were built up from local development plans which assumed a significant proportion of development on greenfield sites. The most significant of these are set out below and enclosed are the relevant pages from the plans for your information.

- Cambridge North-West development (*see CAM NW file*). This released greenbelt land for Cambridge University to build 3,000 homes and 2,000 student dwellings. Over 1,000 homes were expected to be built by 2016; however the development has run behind this expected timeline.
- NIAB 1 development (*see CAM DP file*). This was land at an agricultural research centre that was granted outline planning permission for 1,780 homes. To date, only the first phase has been delivered.
- Clay Farm development (*see CAM DP file*). Approval has been granted for up to 2,250 dwellings and development is progressing.
- Trumpington Meadows (*see CAM DP file*). The early phases of this development are complete (600 homes) and land is allocated for future phases.
- Burton development at Branston Locks (*see East Staffs DP file*). This land had original planning submitted in 2012 for 2,500 homes. However, final planning consent was not given until 2015. The land is currently being sold off to developers and it is estimated that work will commence in the spring of 2018.
- Other greenfield developments in the East Staffordshire District (*see East Staffs DP file*). There are several other smaller greenfield developments expected over the period to 2031. This totals 3,360 homes to be built over the period which would equate to approximately 840 in the period to 2025 if the phasing is assumed flat.
- Lichfield Development Plan (*see Lichfield DP file*) which shows that outside of Lichfield City, which accounts for 36% of all developments over the plan period, the remaining development is predominantly expected to be in rural areas on greenfield sites.
- Draft Birmingham Development Plan which covers the Langley sustainable development in Sutton Coldfield (*see Birmingham DP file*). There was subsequent delay as a result of local resident petitions and this was only formally adopted in November 2016 following approval by the housing minister.

## 3. Split of type of connection

Below is a graph of the split of connections between unmade ground and footpath/highway/non-standard for South Staffs region extended back to 2011-12. It has not been possible in the time available to analyse for earlier years as the Company's works management system was replaced and data from the old system is not readily accessible.




## 4. Number of connections split between type

In relation to efficiently incurred cost, the number of connections by different type for 2016-17 is as follows:

| | |
|---|---|
| **South Staffs Region** | |
| Verge | 518 |
| Footway/Carriageway | 321 |
| Non-standard/separately quoted | 479 |
| | |
| **Cambridge Region** | |
| Verge | 596 |
| Footway/carriageway/separately quoted | 450 |
| | |
| **Total connections by the Company in 2016-17** | 2,364 |

*Note that the numbers in the Cambridge region are estimates and have not been subject to assurance in the timescales available.*

## 5. Infrastructure charges

In the initial meeting on 1 December, there was a question of how to deal with the over recovery of infrastructure charges; it was not expected that this should be corrected because the new developer charging regime starts on 1 April 2018.

The infrastructure charge for 2018-19 will be set based on the future expected off-site re-enforcement over a five year period. Initial work suggests that this will lead to a reduction in the infrastructure charge from the current level of £365 and that it is likely that as a result we will under recover on these charges compared to the Final Determination. We therefore believe that the over recovery in the first two years of this period will naturally reverse out over the remaining period.

# Appendix C

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14 May 2018

Dear Christopher

## South Staffs Water developer contributions

Thank you for your letter dated 6 March 2018, which sets out your concern and disappointment that the issues concerning your developer contributions have not been resolved.

I am aware that you have had detailed discussions with Andrew Chesworth and Gayle Webb in late 2017. They brought these issues to my attention and I discussed the issues with them. While I appreciate your concern and your desire to address issue, I would like to be clear that our understanding is that our position not to address the issue in advance of the final methodology (and for you to address in your business plan) was made clear to you in these discussions. I am sorry for any misunderstanding on your expectations for how we would address this issue.

The PR19 methodology sets out that we will consider these issues on a case by case basis. You will understand that the importance of treating each company on a fair and consistent basis. We will assess the quality of the plan and evidence provided in respect of such claims when we carry out our initial assessment of business plans and implement our decision on the claims in the draft determination.

I do not propose that we meet with you to discuss the issue at this point, our approach is set out in the PR19 methodology and the PR14 final determinations. I am sure you will appreciate the importance of common information is supplied to all companies in the run up to finalising business plans. Finally, I would like to thank you for the detailed information supplied to Ofwat on the issue and your earlier engagement with us, as this has enabled us to better understand your position and the issues facing South Staffordshire Water on connection charges.

Yours sincerely

**David Black**

**Senior Director, Water 2020**