

PR19 Customer Challenge Group

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Title: Financial overview - investment expenditure

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Printing: This document does not contain any graphs or pictures and therefore does not require you to print in colour.

What is this paper about:	This paper provides the CCG with an overview of the business expenditure for the next 5 years.
What is the context of this paper:	The planned total expenditure (Totex) for the next 5 year split into capital expenditure (Capex) and Operational expenditure (Opex).
Action needed from the CCG:	This paper is for information.

Total expenditure (Totex) Business Plan overview

DD Month YYYY

How we have built up our plan costs

- The Unit Cost Database (UCDB)
- Developed by South East Water in 2009 and now industry leading
- Used for successive price reviews – means we can quickly and accurately cost the investment we want to include in our business plan
- How? Contains actual costs for many types of schemes and projects (e.g mains replacement) which we've already delivered over the last 15+ years
- Improved it for this price review process by looking at `whole life' total expenditure across much longer planning horizons e.g. 25-40 years
- That clarity of long-term cost improves our assessment of different investment options and gives greater accuracy about their long-term costs – both critical for determining impact on today's and tomorrow's bills.

Base expenditure and enhanced expenditure

- The total expenditure in our business plan is split into:
 - Base – expenditure to ensure we keep delivering **current levels of service** to customers
 - Enhanced – expenditure we need to deliver **improved levels of service** to customers
- The majority of our base expenditure is worked out from a computer model which simulates how our assets perform over time and shows when that performance is compromised i.e. it gets worse
- The model chooses the optimal time for an intervention – at minimal cost – to ensure current levels of service are maintained, The model looks to solve targets for Burst Mains, Water Quality, Leakage and Interruptions to supply e.g. we need to carry out maintenance or replace something
- The base expenditure is further refined via SEW operations and consultant expertise - we don't just blindly follow the computer model
- Our Base Operational costs are derived from our existing plant and running costs e.g. Energy, Personnel, Chemicals, these costs are continually challenged to improve efficiency and performance and have been further challenged for this plan.
- The investment needed to enhance our services is driven by a number of factors e.g. customer and stakeholder priorities, legislative and regulatory drivers
- The enhanced expenditure we need to make goes through the same robust costing process.

Taking customers' and stakeholders' views into account

- Determining priorities for investment
 - Balancing customer, stakeholder and regulator priorities, and preferred levels of service, with risks to security of supplies
 - result is translated into our outcomes and performance commitments
- Making sure we remain operationally resilient
 - Investment in projects/schemes prioritised on multiple resilience benefits
 - New programme specifically targeting interruptions to supply resilience – high priority for customers (and learnings from recent freeze thaw event)
 - Increased resilience to flooding risks on our operational sites
- Making sure our investment is innovation and efficiency-centred
 - Toolboxes development to drive greater innovation, efficiency and more collaborative investment solutions
 - Customers want more info/knowledge (e.g. smarter meters/data)
 - Using behavioural change toolbox to make customers part of resilience solution applied to plan PCC (Advizzo trial) and partnership toolbox e.g. working with other stakeholders
 - Innovation in new technologies (e.g. Calm networks/Smart Networks)

Taking customers' and stakeholders' views into account – examples of where we have changed our investment approach

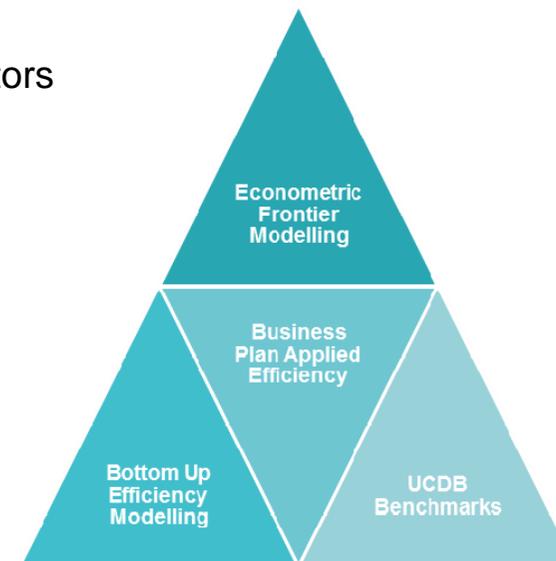
- WRMP research, EFG, CCG and regulator feedback resulted in more ambitious PCC and leakage targets:
 - Leakage now being reduced by 15% by 2025 (4% reduction originally considered)
 - Per capita consumption (PCC) to 139 litres per person per day by 2025 (145 originally considered)
- Interruptions and water quality target improvements
 - Both highly ranked by customers (e.g. among top three service attributes in Willingness to Pay/Supercharge) and stakeholders
 - Regulatory drivers to do more to keep high quality water flowing to customer taps to maintain customer trust - and high levels of satisfaction
 - Increasing expectations of how we respond and recover our water supply services when things go wrong.

Taking customers' and stakeholders' views into account – examples of where we have changed our investment approach (cont'd)

- Much wider range of environmental performance commitments to drive environmental resilience - CCG, EFG, Environment Agency and Natural England input to suite of environmental ODIs
- Carbon reduction targets to decrease emissions and reduce energy costs to company and customers – again highly ranked by customers in research (from WTP and Supercharge)
- Detailed environmental investment plan includes:
 - **Catchment Management (36 schemes)** Water catchments which are at risk of, or compromised, by increasing levels of pesticides including metaldehyde (reflected in performance commitment)
 - **Restoring Sustainable Abstraction (23 schemes)** Waterbodies at risk of drying out, or experiencing low flows - targeting changes to abstraction and or wider waterbody management (reflected in performance commitment)
 - **Non-Native Species (6 schemes)** Avoiding cross contamination between water catchments (example scheme Bewl to Darwell)
 - **Producing a net gain in biodiversity/wildlife** through active conservation work (reflected in performance commitment)

How have we assessed our investment is efficient

- We have applied an efficiency target of 5.05% to our total expenditure
- That equates to savings of £46 million from 2020 to 2025
- Our efficiency target is challenging but realistic – and will maintain our upper quartile position in the UK water sector on this measure
- We have used three elements to determine our efficiency estimate:
 1. Comparative top down econometric assessment of efficiency. (An independent high level review of likely efficiency savings for the water sector by 2025)
 2. External benchmarking of other water companies and other sectors
 3. Bottom up efficiency modelling



Base total expenditure for 2020 to 2025 business plan (the wholesale part)

Base	AMP6 Forecast	AMP7 Plan £m	Expenditure Covers
Maintenance Above	117.3	124.3	Maintaining all our existing Water Treatment Works, Pumping Stations, Reservoirs and Buildings to meet our base commitments
Maintenance Below	88.7	86.3	Maintaining all our existing Water Mains and Customer Meters to meet our base commitments
Botex CAPEX	206.0	210.6	
Botex OPEX	328.1	335.0	Operational costs to manage our existing plant e.g. Energy, Personnel, Chemicals, Hired and Contracting
Wholesale Botex £m	534.10	545.6	

Enhancement total expenditure for 2020 to 2025 business plan (the wholesale part)

Enhancement	AMP6 Forecast	AMP7 Plan £m	Expenditure Covers
Water Quality (WQ)	£ 16.35	£ 17.6	New regulator quality requirements for Nitrate and Chromium removal
National Environment Programme (NEP)	£ 18.45	£ 69.6	Customer and regulator driven programme for Invasive species, Catchment Management, Restoring Sustainable Abstraction, Producing a net gain in biodiversity/wildlife
Water Resource Management Plan (WRMP)	£ 50.10	£ 57.2	New WTW, Increasing capacity of current WTW securing long term water security to meet regional population growth, new schemes and technology to meet targets for Leakage and PCC
New Development (AMP6 Includes Customer Metering Programme)	£ 159.02	£ 57.7	Ensuring resilience for population growth ,typically this includes for New Pumping Stations, Reservoirs, Water Mains, New Connections and includes costs in AMP6 for 90% Customer Metering
Resilience	£ 3.14	£ 21.7	New resilience programme targeting interruptions resilience, Increased Site flooding resilience. Based on reinforcement to our mains network and additional protection of our treatment sites.
Enhancement CAPEX	£ 247.1	£ 223.8	
Enhancement OPEX	£ 2.0	£ 23.1	Operational costs to manage our new enhancement assets as above e.g. Energy, Personnel, Chemicals, Hired and Contracting
Enhancement TOTEX £m	£ 249.05	£ 246.9	

Wholesale Opex

- 2018-19 Budget used as platform for 2020-25 opex
- On top of budget (base), key opex cost increases (above inflation) are considered:
 - Increased leakage activity - £16m – to reduce leakage by 15%
 - Energy - £12m – rising energy prices
 - Water efficiency - £7m – to assist with customer demand reduction
 - Highway permits - £800k – more authorities charging for lane closures, etc
 - Water Quality upgrades - £500k – to improve drinking water standards
 - Aylesford - £500k – introduction of new water source for supply
- Efficiency challenge of 5.5% for period – equivalent to £12m over five years
 - Efficiency challenge aimed to ensure SEW is a top 5 industry efficient company
- Final cost equal to £481m across period (£96m per annum)

Significant challenges / new costs in this plan

- Key cost considered:
 - Increased leakage activity - £32m – to reduce leakage by 15% and improve network performance.
 - Key environmental schemes - £36m – improvements to biodiversity and wildlife
 - Water Quality upgrades - £23.8m – to improve drinking water standards
 - New Water Treatment Works (Aylesford) £24.8m – introduction of new water source for supply
 - Energy - £12m – rising energy prices
 - Water efficiency - £7m – to assist with customer demand reduction
- Efficiency challenge of 5% for period – equivalent to £46m over five years
 - Efficiency challenge aimed to ensure SEW is a top 5 industry efficient company
- Final cost equal to £911m across period

Retail Opex

- Forecast operating expenditure for 2020-25 equal to £82.6million
- Compares to predicted £83million UQ assessment from Oxera based upon preliminary Ofwat econometric models
- Retail forecast focuses on freezing majority of customer service activity 2018-19 budget costs (e.g. billing, payment handling, network enquiries, debt management); exceptions:
 - Meter reading & billing enquiries/complaints allowed to continue with CTS profile to reflect growth in measured customers
 - Other operating expenditure set wholesale efficiency challenge (i.e. 1.125%) – largely attributed to support services (e.g. HR, IT)
- Overall cost to serve reduces to £18.03 per property by closure of period, from 2018-19 budget position of £19.82

	Retail HH	2020-21	2021-22	2022-23	2023-24	2024-25	TOTAL
1	Customer service	6.101	6.120	6.139	6.159	6.179	30.698
2	Debt management	0.667	0.667	0.667	0.667	0.667	3.336
3	Doubtful debts	2.200	2.200	2.200	2.200	2.200	11.000
4	Meter reading	1.142	1.156	1.169	1.182	1.196	5.845
5	Other operating expenditure	5.408	5.350	5.293	5.236	5.181	26.467
6	Local authority and Cumulo rates	0.297	0.302	0.308	0.314	0.320	1.540
7	Pension deficit repair costs	0.708	0.722	0.735	0.750	0.765	3.680
8	Total operating expenditure (excluding t	16.523	16.516	16.511	16.509	16.508	82.567

