

PR14 reconciliations

Data table commentary and relevant IAP actions

Hafren Dyfrdwy

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Commercially sensitive information has been redacted from this version of the commentary.

This document provides further commentary on our PR14 reconciliations data table submission which we have structured thematically. It also responds to two relevant initial assessment of business plan (IAP) actions. These are highlighted in the following text.

1. Summary of PR14 reconciliation adjustments for Hafren Dyfrdwy (HDD)

In the IAP, Ofwat identified the following action:

HDD.PD.A6 – “PR14 reconciliations: Further to the actions we have set out to address our concerns over the evidence provided in its business plan for the individual reconciliations, we will require the company to refresh all of its PR14 reconciliations to replace its 2018-19 forecast performance with 2018-19 actual performance and update the evidence for its forecast 2019-20 performance taking into account of the actual 2018-19 performance.”

We have updated the PR14 reconciliations for 2018-19 actual performance and updated 2019-20 forecast performance in line with our budget forecast. The following table summarises the adjustments and changes:

£m	Business plan submission		July update		Variance to business plan	
	RCV	Revenue	RCV	Revenue	RCV	Revenue
ODI	-	0.9	REDACTED	REDACTED	REDACTED	REDACTED
Totex Sharing	(3.9)	(0.9)	(2.7)	(0.8)	1.2	0.1
WRFIM	-	1.9	-	2.5	-	0.6
Retail True-Up	-	(0.0)	-	(0.5)	-	(0.5)
Land	(0.3)	-	(0.1)	-	0.3	-
PR09 Legacy	(1.5)	0.0	(1.5)	0.0	0.0	(0.0)

Except for the WRFIM model, which Ofwat has modified to accommodate the border variation, we have had to make some adjustments to the totex and residential revenue reconciliation models to ensure the models correctly calculate the rewards and penalties as a result of the border variation. The following changes to the models for the border variation have been made:

- Totex menu model – the ‘Additional income (applied at the FD)’ lines in rows 97 and 98 of the ‘Calcs’ sheet have been overwritten with the values determined for the counterfactual companies at PR14. We explain the reason for this further below under ‘Totex menu reconciliation’.
- Residential retail revenue model – additional inputs and calculations have been added to the ‘Inputs’ and ‘Calcs’ sheets to enable the model to apply separate modification factors to customers in the areas formerly served by each of the legacy companies.

2. Counterfactual cross checks

As we did for the business plan submission, we have created the counterfactual reconciliations to demonstrate that in aggregate the rewards and penalties would have materially been the same as if the border variation had not taken place. The table below summaries the reconciliation adjustments for Severn Trent England (SVE) and HDD compared to the counterfactual companies - Severn Trent (SVT) and Dee Valley (DVW).

Reconciliation adjustments	Counterfactual			Factual			Diff
	SVT	DVW	Total	STE	HDC	Total	
PR09 Legacy							
Water: RCV	10.9	(0.3)	10.6	10.7	(0.1)	10.6	(0.0)
Water: Revenue	(7.3)	0.1	(7.2)	(7.2)	0.0	(7.2)	0.0
Waste: RCV	1.0	-	1.0	1.0	0.0	1.0	0.0
Waste: Revenue	1.7	-	1.7	1.7	0.0	1.7	(0.0)
Water: CIS inflation	(70.7)	(1.9)	(72.6)	(71.3)	(1.3)	(72.6)	-
Waste: CIS inflation	(79.9)	-	(79.9)	(79.9)	(0.0)	(79.9)	-
Adjustment to RCV from disposal of land							
Water: Land	(10.4)	-	(10.4)	(10.4)	(0.0)	(10.4)	-
Waste: Land	(15.3)	-	(15.3)	(15.3)	(0.0)	(15.3)	-
Outcome delivery incentive reconciliation adjustments to be applied at PR19							
ODI in-period revenue	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	(0.4)
ODI end of period revenue	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	0.0
ODI end of period RCV	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	(0.1)
Wholesale total expenditure outperformance sharing							
Water: Totex revenue	33.7	(0.5)	33.2	34.4	(0.8)	33.7	0.4
Water: Totex RCV	125.3	0.1	126.3	127.8	(1.7)	126.1	(0.2)
Waste: Totex revenue	(20.2)	-	(20.2)	(20.3)	(0.0)	(20.3)	(0.0)
Waste: Totex RCV	(199.0)	-	(199.0)	(198.0)	(1.0)	(199.0)	(0.0)
Wholesale revenue forecasting incentive mechanism							
Water: WRFIM	(15.6)	6.9	(8.7)	(11.5)	2.1	(9.4)	(0.8)
Waste: WRFIM	(13.1)	-	(13.1)	(12.7)	0.4	(12.3)	0.8
Reconciliation of household retail revenue							
Residential retail	(8.0)	0.0	(8.0)	(7.5)	(0.5)	(8.0)	(0.0)
Total incentives and penalties	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	REDACTED	(0.3)

There are a few areas where our approach has resulted in more than £1k compared to the counterfactual. We discuss these further below:

1. Totex revenue and RCV adjustments: We have calculated a weighted average PAYG rate for HDD based on DVW and SVT, which results in a slightly higher allocation of the totex adjustment to revenue (+£392k) and a lower allocation to RCV (-£271k). Overall there is a net increase of £18k for water. This is balanced by slightly lower values for both revenue and the RCV for waste (-£6k in total).
2. WRFIM adjustment: Compared to the counterfactual, there is a positive movement of £80k for water, which is offset by an equal negative movement for waste. The differences arise due to the base revenue figures for 2018-19 following the variation being based on the allowed revenue in the PR14 Ofwat financial model. These are different from those that would result from the application of PR14 K factors because the PR14 calculation of K was not consistent with the construction of the price limit within the licence.

- ODIs: The separation of performance targets and restatement of historical data for low pressure results in a difference of £0.41m between SVE and HDD and the counterfactuals. A full reconciliation of the cross check to the counterfactuals has been set out in section 3 Outcomes.

3. Outcomes

As a company with in period ODIs (including part deferrals of the rewards) and has had incentive rates and targets reallocated for the border variation, we recognise that the reconciliation between APR table 3A, App5 and App27 will not be as straightforward and transparent as it will for other companies. We have therefore set out below the approach we have taken to determine the values that have been submitted in App27.

AMP6 annual performance

The annual reported values in App27 have been sourced from APR table 3A for years 2015-16 to 2018-19 and from App5 for 2019-20.

HDD	2015-16	2016-17	2017-18	2018-19	2019-20	Total
ODI performance 2015 - 2020						
Table 3A						
Summary						
Actual performance 2015-16 to 2018-19 (APR table 3A)						
Water in period	0.000	0.000	0.000	-0.323		-0.323
Water end of period revenue	0.025	-0.008	0.021	-0.060		-0.022
Water end of period RCV	0.000	0.000	0.000	0.000		0.000
Waste in period	0.000	0.000	0.000	0.024		0.024
Waste end of period revenue	0.000	0.000	0.000	0.011		0.011
Waste end of period RCV	0.000	0.000	0.000	-0.081		-0.081
Total	0.025	-0.008	0.021	-0.429		-0.391
Check	0.000	0.000	0.000	0.000		
Company in period ODI claim (will all be allocated to SVE up to 2017-18)						
Water in period - SVE						0.000
Waste in period - SVE						0.000
Water in period - HDD						
Waste in period - HDD						
Total	0	0	0.000			0.000
Ofwat in period final determination (will all be allocated to SVE up to 2017-18)						
Water in period - SVE						0.000
Waste in period - SVE						0.000
Water in period - HDD						
Waste in period - HDD						
Total	0	0	0			0.000
Table App5						
Summary						
Forecast performance 2019-20						
Water in period				-0.323		
Water end of period revenue				-0.060		
Water end of period RCV				0.000		
Waste in period				0.024		
Waste end of period revenue				0.000		
Waste end of period RCV				-0.081		
Total				-0.440		
Check to 3A/ App5				0.011		
Total ODI performance - 2015-2020						
Water in period	0.000	0.000	0.000	-0.323		
Water end of period revenue	0.025	-0.008	0.021	-0.060		
Water end of period RCV	0.000	0.000	0.000	0.000		
Waste in period	0.000	0.000	0.000	0.024		
Waste end of period revenue	0.000	0.000	0.000	0.011		
Waste end of period RCV	0.000	0.000	0.000	-0.081		
Total	0.025	-0.008	0.021	-0.429		

For 2018-19, there is a difference of £0.011m in the total performance reported between APR table 3A and App5. The difference relates to the Overall Environmental Performance measure (SC7) where a proportion of the ODI outperformance is being allocated to Hafren Dyfrdwy, which is then subjected to the overall outperformance cap.

AMP6 total performance to be applied at PR19

For the 'Total to be applied at PR19' column in App27, we have calculated the rewards and penalties on the amounts that we want to claim for at PR19. This will include the deferred in period wastewater ODIs for 2017-18, in period ODIs for years 2018-19 and 2019-20 as well as end of period ODIs for the AMP.

Deferred ODIs

For years 2016-17 and 2017-18, Severn Trent agreed with Ofwat to defer part of the reward on wastewater performance until PR19. For 2016-17, £27m of the £39.994m net reward was deferred and for 2017-18, £63.203m of the £87.815m net reward was deferred. It was agreed as part of the NAV process that customers who were part of Severn Trent when the performance was earned should be in the same position as if the variation had not taken place. Hafren Dyfrdwy customers will therefore pay a share of the wastewater payments deferred by Severn Trent.

The 2016-17 deferred payment of £27m earned by Severn Trent before the border variation has been allocated between Severn Trent and Hafren Dyfrdwy using the revenue adjustment agreed with Ofwat as part of the NAV process.

For 2017-18, Ofwat's 2018 in-period determination allocated £62.925m of the deferred payment of £63.203m to Severn Trent, with £0.278m allocated to Hafren Dyfrdwy

An adjustment for financing has also been added to the deferred payments for both years in line with the guidance set out in Ofwat's information note (IN18/17).

HDD	2015-16	2016-17	2017-18	2018-19	2019-20	Total
ODI performance to be applied at PR19						
Deferred ODIs						
SVT Ofwat final in period final determination - Deferred outperformance payments						
Water in period	0.000	0.000				0.000
Waste in period	0.000	27.000				27.000
Total	0.0000	27.000				27.000
HDD Ofwat final in period final determination - Deferred outperformance payments						
Water in period			0.000			0.000
Waste in period			0.278			0.278
Total			0.278			0.278
HDD allocation of SVT ODIs						
Water		0.58%				
Waste		0.44%				
Ofwat final in period final determination - Deferred outperformance payments - HDD share						
Water in period	0.000	0.000	0.000			0.000
Waste in period	0.000	0.119	0.278			0.397
Total	0.000	0.119	0.278			0.397
Deferred outperformance payments - HDD share adjusted for financing						
Year payment due to be taken		2017-18	2018-19	2019-20		
Number of years to 2019-20		2	1	0		
WACC		3.6%				
Water in period	0.000	0.000	0.000			0.000
Waste in period	0.000	0.119	0.278			0.397
Total	0.000	0.119	0.278			0.397

End of period ODIs

For end of period ODIs, the net payments earned by Severn Trent and Dee Valley before the border variation have been allocated between Severn Trent and Hafren Dyfrdwy using the revenue adjustments agreed with Ofwat as part of the NAV process. This is set out below.

HDD		2015-16	2016-17	2017-18	2018-19	2019-20	Total
End of period ODIs							
DVW end of period ODI's							
Water end of period revenue		0.025	-0.008	0.021			0.038
Water end of period RCV		0.000	0.000	0.000			0.000
Waste end of period revenue							0.000
Waste end of period RCV							0.000
HD share of DVW end of period ODI's							
Water	60.2%						
Waste							
Water end of period revenue		0.015	-0.005	0.012			0.023
Water end of period RCV		0.000	0.000	0.000			0.000
Waste end of period revenue							0.000
Waste end of period RCV							0.000
SVT end of period ODI's							
Water end of period revenue		0.000	0.000	0.000			0.000
Water end of period RCV		0.000	0.000	-0.463			-0.463
Waste end of period revenue		0.000	0.000	0.000			0.000
Waste end of period RCV		0.000	0.000	0.000			0.000
HDD share of SVT end of period ODI's							
Water	0.6%						
Waste	0.4%						
Water end of period revenue		0.000	0.000	0.000			0.000
Water end of period RCV		0.000	0.000	-0.003			-0.003
Waste end of period revenue		0.000	0.000	0.000			0.000
Waste end of period RCV		0.000	0.000	0.000			0.000

Summary of ODI performance to be applied at PR19

The table below provides a summary of the ODI amounts that we are claiming for at PR19.

HDD	2015-16	2016-17	2017-18	2018-19	REDACTED
ODI performance to be applied at PR19					
Water in period	0.000	0.000	0.000	-0.323	
Water end of period revenue	0.015	-0.005	0.012	-0.060	
Water end of period RCV	0.000	0.000	-0.003	0.000	
Waste in period	0.000	0.119	0.278	0.024	
Waste end of period revenue	0.000	0.000	0.000	0.011	
Waste end of period RCV	0.000	0.000	0.000	-0.081	
Total	0.015	0.114	0.288	-0.429	

Significant changes to performance commitment actuals and forecasts

In the IAP, Ofwat identified the following action:

HDD.PD.A3 – “PR14 outcome delivery incentives: Hafren Dyfrdwy is required to update the evidence for its forecast 2019-20 performance to take account of the actual 2018-19 performance for all its performance commitments.”

We explain in the table below the differences between the original forecast submitted in September 2018 and the revised forecast of July 2019. We explain in more detail the differences in the commentary section that follows. All values reflect the ODI payments in £m.

REDACTED

REDACTED

Water Quality Complaints (Dee Valley Water Measure)

Ofwat identified an inconsistency with our calculation of the forecast ODI values for this measure (A1). We had incorrectly multiplied the value by a factor of 100, using the ODI rate per 0.01 contacts rather than per contact.

We have corrected this error both in our APR19 submission and our restated App5 tables.

Cross check to the counterfactual

Comparing the 2018-19 performance to the counterfactual view results in a difference of £0.43m; this is driven by (all values in £m):

	Measure	SVE	HDD	Counterfactual	Difference	Reason
A1	Discoloured water contacts	0.0019	-0.0011	0.0017	0.0001	Due to asymmetric outperformance and underperformance incentive rates.
B1	Average duration of interruptions	0.0074	0.0089	0.0209	0.0046	Due to the outperformance cap being breached in one area but not in the counterfactual view.
WB2	Leakage levels	(2.2546)	0.0000	(2.2386)	0.0160	Due to the underlying level of leakage in Powys being favourable; on the counterfactual this would net off against the penalty incurred.
WB4	Number of minutes	(7.7199)	-0.2794	(7.7660)	0.2333	The application of the 5-minute event cap in Powys

	customers go without supply each year					would not have been triggered in the counterfactual view.
WB7	Customers at risk of low pressure	-0.01975	0.00474	0.064	0.0790	We have restated historic data and taken account of this in the APR19 submission. The counterfactual is based on in year performance.
SA4	Asset stewardship - blockages	0	(0.0810)	0	0.0810	The post-NAV target for Powys was not met, but the counterfactual combined target was.
SB1	Customers rating our services as good value for money	0.1245	0.0000	0.1250	0.0005	The wastewater cap being triggered in Powys
SC7	Overall environmental performance	2.389	0.000	2.400	0.011	A proportion of the ODI being allocated to Hafren Dyfrdwy, which is then subject to the wastewater cap.

Our forecasts for 2019/20 have assumed that the performance commitments in Powys are delivered, nullifying the impact of any ODIs. As such the counterfactual balances for 2019/20 with the exception of:

	Measure	SVE	HDD	Counterfactual	Difference
WC1	Customers rating our services as good value for money (based on tracker survey)	0.1243	0	0.125	0.0007
SB1	Customers rating our services as good value for money	0.1245	0	0.125	0.0005

For APR19 we split the incentive rate between Severn Trent Water and Hafren Dyfrdwy to ensure that the incentive is allocated between customers in line with the revenue adjustments agreed for the NAV. However, this measure is not active in Powys in 2019/20 and as such the small inconsistency between the factual and counterfactual exists of £13k.

4. Land sales

We have updated App9 for the 2018-19 actuals.

As confirmed in our IAP response and in line with our detailed land sales plan, we are not forecasting to make any disposals of protected land in 2019-20 within the HDD operating area.

5. Residential retail revenue

We have updated 2018-19 for the actual customer numbers reported in APR table 2F.

Following query HDD-DD-PD-003, the 2019-20 forecast of actual customer numbers have been updated for our latest view of the customer numbers. The view is based on updating the 2018-19 actual number of customers for the same movement in customer numbers as used in our previous forecast. A review of the underlying assumptions used in the original forecast indicates that the growth in customer numbers has not materially changed from our previous forecast.

6. Totex menu reconciliation

We have updated the 2018-19 numbers to actuals in our latest table.

We note that the actual position for the wholesale services is around £4m higher than our previous forecast (after removing the impact of the NAV asset transfers, as set out in 4B commentary in the APR).

This increase is all in water services and is attributable to the additional investment in the water treatment and distribution asset base, and improvements in telemetry and security (explained in further detail in our response to query HDD-DD-CE-006) which were not fully scoped at the time of the original plan submission.

Looking forward, we expect the additional activity and investment to continue as we ensure the asset base is fit to meet the challenges of AMP7.

For 2019-20, the costs included in the true up are based on our revised internal budget for the year, and are expected to include an additional £5.5m vs our previous submission forecast of £26.7m.

For both years we have also adjusted the 3rd party costs and totex to remove the intercompany bulk supply charges from our true ups. These were not adjusted for in the FD when the NAV changes were agreed.

Whilst the costs and revenues net to zero between HDD and SVE overall, as the true up relates solely to cost, these values do not net to zero. In order to eliminate this difference, we have removed these intercompany transactions from the true up. The values for 2018-19 can be found in the APR 4B table commentary.

7. Wholesale revenue incentive forecasting mechanism

We have updated the 2018-19 numbers for actual performance in the table. For 2019-20, we are forecasting that we will outturn in line with the allowed revenue and therefore there will be no adjustment for WRFIM for the year.