Affinity Water: PR24 Business Plan Submission - Commentary

RET1: Cost analysis – residential retail (post frontier shift and real price effects)
RET1a: Cost analysis – residential retail

RET1.1 & RET1a.1: Customer services

We plan to further increase our investment in Customer Services during the 2025-2030 period, to provide excellent, simple service to all our customers. We plan to invest in an improved channel experience, with a new website platform and self-service app in order to enhance customer experience and drive improvements in our customer service metrics. This investment will be developed in the first two years of the 2025-2030 period, and will then incur an enduring licence cost, which we will mitigate through the delivery of further efficiencies in our customer service operation.

RET1.2 & RET1a.2: Debt management

Cash collection and the management of debt is a vitally important activity to our business. The headwinds caused by global macroeconomic trends in recent years have only increased the challenges we face. We propose to invest £1m in the first two years of the 2025-2030 period to replace our existing debt management system. This investment will support our teams in collecting cash from customers in a sensitive and appropriate fashion, while protecting our business from the risks of reduced collections. We have also included an increase in our affordability initiatives which we include on this line and are discussed in full in Chapter 5 (Customer affordability and acceptability) of our plan.

RET1.3 & RET1a.3: Doubtful debts
RET1.4 & RET1a.4: Doubtful debts (smoothed)

Our doubtful debt provision is forecast to increase as our revenues increase, and our target is to mitigate this impact. Our long-term target is to achieve an annual provision at less than 3% of revenue, and we move towards this during the course of the 2025-30 period. Our provision forecast appears flat but decreases as a percentage of revenue during the period. The table below shows our Doubtful debt provision from 2020 onwards in £m:

2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
7.948	7.061	11.199	7.505	7.505	7.999	7.999	7.999	7.999	7.999

Our provision has trended higher during the 2020-2025 period, with a small downward adjustment in 2022 as we understood the full impact of the Covid-19 pandemic. The high charge in 2023 was driven by the impact of the cost of living crisis and is not expected to recur.

RET1.5 & RET1a.5: Meter reading

We forecast our meter reading costs to increase at the start of the 2025-30 period, as our smart metering programme begins to roll out. While we will secure savings over time from the reduction in visual reads that we are required to undertake, we forecast to incur additional costs associated with customer questions and that our productivity on visual reads will reduce, before our smart meters reach a critical mass in rollout.

RET1.6 & RET1a.6: Other operating expenditure

Our other costs include investments in water efficiency and our share of the corporate overheads associated with the running of our business. This includes IT, Finance, HR and Regulation. We forecast a generally flat profile, with some additional costs from Year 3 associated with an increased level of support from IT for our new application landscape.

RET1.7 & RET1a.7: Local authority and Cumulo rates

This line includes the Retail business' share of business rates associated with our Head Office in Hatfield, and based on a forecast of our liability for the period. This forecast is based on our determination of rates received in 2023.

RET1.8 & RET1a.8: Total operating expenditure excluding third party services

Subtotal of 1.1-1.7

RET1.9 & RET1a.9: Depreciation (tangible fixed assets) on assets existing at 31 March 2015

No commentary on this line – nil value

RET1.10 & RET1a.10: Depreciation (tangible fixed assets) on assets acquired after 1 April 2015

No commentary on this line – nil value

RET1.11 & RET1a.11: Amortisation (intangible fixed assets) on assets existing at 31 March 2015

No commentary on this line – nil value

RET1.12 & RET1a.12: Amortisation (intangible fixed assets) on assets acquired after 1 April 2015

The charge on this line represents amortisation of investments made in technology assets and software, which become fully amortised during 2026-27, bar one small, longer lived technology asset which becomes fully amortised after 2030. These assets were acquired between 2015 and 2020, at an original cost of circa £1.8m, and are amortised over a 5-year period in accordance with our capitalisation and amortisation policy.

RET1.13 & RET1a.13: Recharge from wholesale for legacy assets principally used by wholesale (assets existing at 31 March 2015)

No commentary on this line – nil value

RET1.14 & RET1a.14: Income from wholesale for legacy assets principally used by retail (assets existing at 31 March 2015)

No commentary on this line – nil value

RET1.15 & RET1a.15: Recharge from wholesale assets acquired after 1 April 2015 principally used by wholesale

The charge on this line represents amortisation on IT assets acquired by wholesale that are used, in part, by our retail business. The amortisation is based on headcount and the assets will be become fully written down in 2028-29.

RET1.16 & RET1a.16: Income from wholesale assets acquired after 1 April 2015 principally used by retail

No commentary on this line – nil value

RET1.17 & RET1a.17: Net recharges costs

Subtotal of 1.13 – 1.17

RET1.18 & RET1a.18: Total retail costs excluding third party and pension deficit repair costs

Subtotal of lines above

RET1.19 & RET1a.19: Third party services operating expenditure

No commentary on this line – nil value

RET1.20 & RET1a.20: Pension deficit repair costs

This line captures pension deficit repair costs, which are due to be last incurred in 2022-23 and are allocated between wholesale and retail on the basis of active members. As our scheme is over 99% funded and will be operating on a new valuation based on 2023 assets, we include no further costs against this line.

RET1.21 & RET1a.21: Total retail costs including third party and pension deficit repair costs

Subtotal of cost lines above

RET1.22 & RET1a.22: Debt written off

We forecast debt written off across the 2025-2030 period to match the provision charged in our P&L.

RET1.23 & RET1a.23: Capital expenditure

We forecast no capital expenditure against our retail price control in 2025-2030. The investments and interventions we plan to improve our systems and services will be funded through operating costs, in accordance with accounting guidelines.

RET1.24-26 & RET1a.24-26: Demand side water efficiency costs

This block of lines captures our demand side water efficiency costs, including our behavioural change campaigns and other interventions. In 2020-25 these are fully funded by the wholesale price controls. During the 2025-2030, we propose to refine our approach to demand side efficiency based on our smart metering programme, as well as to invest directly in efficiency interventions from our retail price control.

RET1.27-29 & RET1a.27-29: Customer side leakage costs

This block of lines captures our costs associated with customer side leakage. We plan to enhance our offering and support to customers during 2025-2030, by offering free customer side leak repairs to anyone on one of our social tariffs.

RET2: Revenue – residential retail

Overview

Based on actuals AMP to date, and our forecasts of allowed and actual revenues for the remaining years of the AMP, we expect to have over recovered residential retail revenue. This means that there are forecast revenue imbalances to return to customers in the AMP8 period, so customers' bills will be a little lower than otherwise.

In the early years of the AMP, it was unusually difficult to forecast revenues with accuracy. Stay at home pandemic restrictions in the first two years of AMP7 caused significant disruption to residential demand that made it more difficult than usual to set charges to target allowed revenue levels.

RET2.1: Wholesale revenue

No commentary for this line.

RET2.2: Retail revenue

No commentary for this line.

RET2.3: Total residential revenue

No commentary for this line.

RET2.4: Revenue Recovered ("RR")

At the time of business plan preparation, our best forecast of actual retail revenue recovered in year 2023-24 is that it will be equal to allowed revenue for that year. This is because tariffs for that year have only recently become effective and it is too early to project imbalances.

We have not yet set retail charges for 2024-25 and do not yet know the final determinations for in-period adjustments. Our forecast is therefore that actual revenue recovered will be in line with the allowed level. We prepared our allowed revenue forecast for 2024-25 assuming zero in-period adjustments, as we completed this table prior to Ofwat's publication of draft and final in-period adjustment determinations for 2024-25.

RET2.5: Revenue sacrifice

No commentary for this line.

RET2.6: Actual revenue (net)

No commentary for this line.

RET2.7: Actual customers ("AC")

At the time of business plan preparation, we do not know actual customer numbers "AC" for years 2023-24 and 2024-25 because we have not yet completed APRs for these years. Accordingly, we have entered our current best forecasts of actual customers.

RET2.8: Reforecast customers

We settle our re-forecasts of customer numbers for the current charging year in December of that charging year, as part of setting charges. This means that at the time of business plan submission (October 2023), we have not yet made re-forecasts for years 2023-24 or 2024-25. As re-forecasts are not yet available for the last two years, we project re-forecast customer numbers to be equal to our forecasts of customer numbers as in Table SUP1A.10

There is a one year offset in table RET2.8 versus the entries for re-forecast customers in the Retail Revenue Reconciliation model. This is because table RET2.8 requires the value for re-forecast customers in the ongoing charging year at the time of submitting the APR, but calculations in the reconciliation model do not require the same offset. The figures we use in RET2.8 and the reconciliation model are the same, just offset by one year between the two sets of input tables.

RET2.9: Allowed revenue ("R")

We project allowed revenue using the Residential Retail reconciliation model. This takes into account Ofwat's in-period determination made for 2023-24 charges. As the in-period determination for 2024-25 charges is not yet available, we have used the value for allowed revenue for that year from the last published determination, November 2022.

This means that our projection for 2024-25 is stated before application of any in-period adjustment for C-Mex or other performance commitments that will be applicable to that year.

RET2.10: Net adjustment
No commentary for this line.

RET2.11: Average household retail revenue per customer
No commentary for this line.

RET3: Business retail tariffs (Welsh companies only)

This table is intentionally unpopulated as it's not relevant to Affinity Water.

RET4: Cost adjustment claims – residential retail

Overview
The evidence to support our cost adjustment claim is set out in the Economic Insight Report 'Cost Adjustment Claim to Fund Additional Retail Costs from Transience, in Appendix AFW43. We submitted this report in June 2023 as part of our early submission, plus supporting files and calculations. These set out the evidence for our claim, including valuation of implicit allowance and symmetrical adjustments. The claim is unchanged from that submitted in June 2023.

RET4.1: Description of cost adjustment claim (res retail)
No commentary for this line.

RET4.2: Type of cost adjustment claim (res retail)
No commentary for this line.

RET4.3: Symmetrical or non-symmetrical (res retail)
No commentary for this line.

RET4.4: Reference to business plan supporting evidence (res retail)
No commentary for this line.

RET4.5: Gross value of the claim (res retail)
No commentary for this line.

RET4.6: Implicit allowance (res retail)
No commentary for this line.

RET4.7: Total net value of the claim (res retail)
No commentary for this line.

RET4.8: Historic total expenditure (res retail)

No commentary for this line.

RET4.9: Totex for the control (res retail)

No commentary for this line.

RET4.10: Materiality

The materiality amount is 2.37%, which we recognise to be lower than Final Methodology threshold. However, Appendix AFW43 which contains our supporting evidence for this claim, notes that:

- Materiality is not an issue if retail cost assessment econometric models include transience as an explanatory variable, and provides the case for doing this; and
- Economic Insight consider that their valuation may be conservative