

# AffinityWater

## AFW61 - Additional information request - Energy commentary



## Affinity Water

### Additional information request – energy costs

Please provide actual and forecast nominal input and export energy prices between 2018-19 and 2029-30.

Please find attached the corresponding excel file.

Also explain how your energy price forecasts have been derived in accompanying commentary

Our position related to energy prices is not complicated. We have very little self-generation (c.1%) which we use on site and do not export back to the grid. We do not operate any long term PPA agreements. Our forward purchasing is either done via locking in prices with our physical provider or by entering into derivatives with ISDA counterparties.

Forecasts of energy prices for FY24 and FY25 have been derived using management forecast for expenditure in those years. We have forward locked the cost of 100% of the commodity element for FY24 and FY25 so have cost certainty on this element. The remaining costs (Grid and other) in FY24 and FY25 have been forecast based on contractual prices and management expectations. The figures provided for FY24 and FY25 are consistent with internal budget/forecast figures.

The forecasts for AMP8 (FY26-FY30) have been derived using market forecasts from Cornwall Insight. This forecast was commissioned by Water UK and is dated June 2023. We are aware that in a market environment like energy, any forecast is out of date as soon as it is published. However, we believe the Cornwall Insight forecast is suitable these purposes as it was developed by an industry leading forecaster and provides full transparency of costs which is key for the PR24 process.

The Cornwall Insight report is used for both grid and commodity forecasts in AMP8. We have not locked the cost for any energy in AMP8 so all prices are derived from Cornwall. For full transparency we have provided the Cornwall Insight report along with this submission.

There is no price difference between the energy price paid by the retail business and the wholesale business of Affinity Water.

Percentage of forecast energy consumption hedged for each year up to 2029-30, as at the end of 2022-23.

## How much of its energy consumption it hedges in advance, and if/how it operates a 'hedging ladder'?

A significant proportion of energy costs are driven by Grid costs which cannot be hedged. Grid cost, also referred to as 'Pass Through Costs', include BSUoS, TNUoS, DUoS, FITs and many other components.

The commodity element can be hedged. Our hedging strategy for energy has evolved over the first 3 years of AMP7 and will continue to evolve over FY24 and FY25.

Our current strategy is based on the following principles:

- Recognition that there is no risk avoidance strategy. If we choose to do nothing (i.e. not hedge), it is an active decision
- Adoption of a consistent and phased approach, buying little and often, avoiding any single good or single bad decision
- Provide budget certainty a minimum of 6 months in advance

The strategy was developed in 2021 and has allowed us to avoid the ultra-high rates in 2022. However, hedging itself is not a cost management tool as hedges are struck at available market prices at a point in time, so our energy cost has been much higher than anticipated at PR19.

The higher energy costs have been partly recognised by the inflationary increases in wholesale revenue, however inflation is also a cost driver for labour, materials, technology etc, which means non energy costs have also increased significantly, resulting in a net fall in operating profit.

We have now purchased 100% of energy required for AMP7, as we purchased in advance and energy prices have reduced, some of our forward purchased for Year 4 and 5 are now 'out of the money'.

We have not yet made any energy purchases for AMP8, The programme of forward buying has been paused for the following reasons:

1. Whilst not wishing to rely on speculation, the 'purchase in advance' strategy which served us well in the raising market between 2021 and 2022 is likely to have the opposite effect in a falling market. So we are reconsidering our approach.
2. It is not yet clear how energy will be dealt with under PR24, and without clarity on this point, any further hedging would introduce a new risk. If prices fall, the Final Determination could set revenue based on the prevailing and lower market prices, so in effect our purchases could be deemed inefficient.

However, as we move towards year 1 of AMP8, it is increasingly untenable to have no purchases in place, even after considering the regulatory uncertainty around the treatment of these costs in the price review.

How much (if any) of its consumption is effectively purchased at spot market prices?

We have not purchased any energy at spot in AMP7, this is due to our 'purchase in advance' strategy. Our AMP8 strategy is still under consideration although it is unlikely that purchasing at spot will form a significant element as we value cost certainty more than the opportunity to benefit from speculation.

How much (if any) of its consumption is set under long-term offtake contracts?

None, we did consider some longer term PPAs in 2021 but there was no pricing benefit compared to rates that could be secured with other market participants. Our view was that locking in long term (10+ years) at a volatile time was not sensible, particularly when the year 1, 2 and 3 prices could be hedged