

AffinityWater

Statement of Significant Change - Indicative Primary Wholesale Charges 2023/24

13th October 2022



1. Background

1. The purpose of this Statement of Significant Changes is to provide our stakeholders with information about the changes we intend to make to our primary wholesale charges in 2023/24. It sets out our assessment of the impact of those changes and information about our handling strategy.
2. Primary wholesale charges are the charges we make for providing wholesale water supplies to retailers operating in the competitive market, but wholesale charges also form a significant component of the tariffs we charge to household customers.
3. Wholesale activities include water abstraction, raw water transport, treatment and distribution and typically make up about 90% of end customers' water bills.
4. Ofwat regulate primary wholesale charges through enforceable limits to the total amount of wholesale revenue that we may recover in any year. We calculate our charges so that the revenue we expect to recover from those charges does not exceed the amounts allowed by the revenue limit. In setting primary wholesale charges we must also follow charging rules published by Ofwat that contain guidelines and principles for charging.
5. The charging rules require that if we need to make significant changes to charges we should publish a Statement of Significant Changes setting out:
 - i. what changes are expected;
 - ii. how water supply and sewerage licensees (as a whole or in groups) and customers occupying Eligible Premises (as a whole or in groups) are likely to be affected; and
 - iii. the handling strategies that may be adopted by the undertaker or why the undertaker considers that no handling strategies are required.
6. The following sections provide detailed information on these items.

2. Summary of Changes to Charges

7. Our primary wholesale charges vary according by region as shown in the diagram below. In our Central Region, there are also four sub-regions for unmetered rateable value charges: Colne Valley, Lee Valley, Rickmansworth and North Surrey which reflect historical company boundaries.



8. In 2023/24 we project that we will need to increase our primary wholesale charges by 10.4% on average. The main drivers of the change in charges are:

- Our wholesale K factor, net of performance related rewards and penalties, +4.7% for next year's charges
- Our forecast of CPIH inflation, 9.3%
- Revenue correction adjustments from 2021 – this includes the net effect of prior year's revenue under recovery and net performance penalties
- Changes to the charging base over which we recover our charges

9. In addition to the drivers of bills noted above, we propose this year to update our tariff structure. It is worth noting that the changes to our tariff structure would not by themselves result in significant changes to charges > 5%, it is the inflation and K factor adjustments that produce the significant change. The changes we propose to our tariff structure are summarised below;

- make simplifications to our schedule of metered fixed charges
- simplify the regional structure of our unmeasured tariffs
- make a rebalancing adjustment to our large user tariffs so that we derive a greater share of revenue from the volumetric element of charges and less from fixed charges than before

10. Regarding simplifications to metered fixed charges, we currently charge metered fixed charges using 12 bands that vary according to meter size. We propose to

simplify this schedule of charges into 3 bands that correspond to small, medium and large meters. For most customers, the fixed charge will stay the same, or reduce. For about 12,000 customers currently charged on the basis of a 19/21mm meter, the bill will be about 0.5% higher than otherwise, and for about 6,000 25mm meter customers, the bill will be about 0.2% higher than otherwise.

11. Today, we operate 6 different tariffs for rateable value that vary according to region. We propose to simplify this structure by merging tariffs so that there is a single uniform tariff in the Colne, Rickmansworth and North Surrey areas. We plan to introduce this change over two years to smooth the effects on bills over time. This change means that this year, we propose that charges in the Rickmansworth rateable value charging area will increase by about 2% more than otherwise.
12. Our large user tariffs apply to customers using more than 50,000m³ per year. Typically they set a volumetric rate that is lower than the standard tariff rates and a supplementary fixed charge. We plan to re-balance the tariff to place greater weight on the volumetric element and less weight on the fixed charge element. Over time, rebalancing the tariff in this way will produce a tariff structure that is common across our 3 regions. Further, by placing more weight on the volumetric element of charges rather than fixed, we increase the economic incentives in our charges towards efficient water use.
13. We have projected our indicative charges using the latest information available to us and our current view of prospects for 2023/24, informed for example by projections of inflation published by external bodies. Our demand forecasts were also scrutinised by Atkins, our external assurance provider.

3. Wholesale charges for Non-Household customers

14. Our primary wholesale charges to retailers operating in the competitive market typically comprise a fixed charge per customer (that varies according to meter size) and volumetric charges that vary according to consumption. Retailers pay wholesale charges to us on the basis of the applicable fixed charges and consumption aggregated across all of the customers they supply. By studying the impacts on typical customer bills across a range of customer size, types and regions, we can assess by how much aggregated charges to retailers are likely to change.
15. Table 1 sets out the impact of our indicative charges on typical small business customers in each of our 3 charging regions. The table assumes that consumption is held constant at the levels indicated and that small business customers use a 25mm meter.

Table 1. Typical Bills to Measured Small Business Customers £/year and % Change

	Typical Consumption (m3/year)	Typical Bill 2022/23 (£/year)	Typical Bill 2023/24 (£/year)	Change (%)
Central region	488	505.22	562.48	11.3%
East region	303	529.05	589.02	11.3%
Southeast region	385	709.97	790.44	11.3%

16. Table 2 sets out the impact of our indicative charges on typical medium business customers. For the purposes of comparison the table assumes that consumption is held constant at 5,000m3/year and that medium business customers use a 40mm meter.

Table 2. Typical Bills to Measured Medium Business Customers £/year and % Change

	Typical Consumption (m3/year)	Typical Bill 2022/23 (£/year)	Typical Bill 2023/24 (£/year)	Change (%)
Central region	5,000	4,679.34	5209.90	11.3%
East region	5,000	7,553.80	8410.62	11.3%
Southeast region	5,000	6,376.84	7099.98	11.3%

17. We offer large user tariffs for customers using in excess of 50,000m3 per year who meet eligibility criteria.

18. Our large user tariffs currently offer lower volumetric rates than standard, based on differential use of network infrastructure by large users, but an additional fixed charge. In addition to changes in expected bills driven by inflation and K factor and as noted earlier, we propose to rebalance our tariffs away from the fixed element of charges and towards the volumetric rate.

19. Table 3 sets out the impact of our indicative charges on typical large business customers. The table assumes that consumption is held constant at 50,000m3/year and that large business customers use a 100mm meter.

Table 3. Typical Bills to Measured Large Business Customers £/year and % Change

	Typical Consumption (m3/year)	Typical Bill 2022/23 (£/year)	Typical Bill 2023/24 (£/year)	Change (%)
Central region	50,000	46,395.00	51,655.00	11.3%
East region	50,000	66,520.04	74,787.52	12.4%
Southeast region	50,000	63,085.84	70,239.48	11.3%

20. Table 4 shows the impact of our indicative charges on extra-large customers, assuming that extra-large business customers use 500,000m³ per year and are supplied on large user tariffs using a 150mm meter. As noted above, we propose to make a re-balancing adjustment to our large user tariffs so that a greater proportion of revenue is derived from the volumetric element of our tariffs and less from fixed charges than today. This change intends to strengthen the tariff incentives towards efficient water use for large business customers. The change means that wholesale bills for the largest customers will increase by a greater percentage than for other large users, because we are increasing the contribution of volumetric use towards bills compared to today. The different rates of change for wholesale bills for large and extra-large customers can be seen by comparing the percentage bill increases between Table 3 and Table 4.

Table 4. Typical Bills to Extra Large Business Customers £/year and % Change

	Typical Consumption (m³/year)	Typical Bill 2022/23 (£/year)	Typical Bill 2023/24 (£/year)	Change (%)
Central region	500,000	321,030.00	369,805.00	15.2%
East region	500,000	458,775.00	526,927.56	14.9%
Southeast region	500,000	630,175.84	701,634.48	11.3%

21. For unmeasured customers, we charge retailers a fixed charge per property and a rateable value element that varies according to the rateable value of each property supplied. The rateable value element of tariffs varies by region reflecting historical company boundaries.

22. As noted above we propose adjustments over the next two years to combine the rateable value based tariffs applicable in the Colne, Rickmansworth and North Surrey regions, to produce a uniform tariff rate applicable across all three areas. We are introducing this change over two years to smooth the adjustment over time. We are also combining the existing tariffs in the East and Southeast regions into a uniform tariff. These simplifications will reduce the number of separate rateable value tariffs from 6 to 3. For this reason, the tariff in the Rickmansworth area is this year will increase more quickly than tariffs in the other areas. For the very small number (43) unmeasured RV customers in the Folkestone area, there is a reduction in tariff, reflecting the equalisation of that tariff with the rate used in the East area.

Table 5. Typical bills to unmeasured business customers £/year and % change

	Typical Rateable Value (£/RV)	Typical Bill 2022/23 (£/year)	Typical Bill 2023/24 (£/year)	Change (%)
Rickmansworth area	619	361.02	417.52	15.7%
Colne area	638	380.62	429.41	12.8%
Lee area	494	369.23	416.46	12.8%
North Surrey area	542	336.76	379.50	12.7%
Folkestone area	376	676.18	507.81	-24.9%

4. Wholesale charges for Household customers

23. There are two broad categories of household customers, metered and unmetered. Metered customers pay a fixed charge and a volumetric charge depending upon usage. Unmetered customers pay a fixed charge that does not vary with water use but varies according to the rateable value of the property they occupy. Broadly this means that unmetered customers who occupy larger properties pay a higher unmetered water bill than those occupying smaller properties.

24. Household customer bills comprise two components, wholesale and retail. The wholesale element recovers our costs of activities including water abstraction, raw water transport, water treatment and distribution. The retail element recovers our costs of billing, revenue collection, customer service and meter reading. This statement is concerned with the impacts of changes to the wholesale element of household bills, which makes up about 90% of the final bill charged to household customers. It does not include the retail element.

25. Table 6 shows the impact of our indicative charges on the wholesale element of metered household bills. The table assumes that consumption is held constant at the levels indicated.

Table 6. Typical wholesale element of bills to measured household customers £/year and % change

	Typical Consumption (m ³ /year)	Typical Wholesale Bill 2022/23 (£/year)	Typical Wholesale Bill 2023/24 (£/year)	Change (%)
Central region	118	132.76	145.92	9.9%
East region	82	154.37	169.98	10.1%
Southeast region	98	191.77	211.61	10.3%

26. Table 7 shows the impact of our indicative charges on the wholesale element of unmetered household bills. The table assumes that rateable value is held constant at the levels indicated.

Table 7. Typical wholesale element of bills to unmeasured household customers £/year and % change

	Typical Rateable Value (£/RV)	Typical Wholesale Bill 2022/23 (£/year)	Typical Wholesale Bill 2023/24 (£/year)	Change (%)
Rickmansworth area	248	177.91	202.66	13.9%
Colne area	278	200.01	223.50	11.7%
Lee area	251	218.62	244.68	11.9%
North Surrey area	249	186.50	208.11	11.6%
East area	184	237.75	266.45	12.1%

27. The indicative percentage increase for unmetered customers is larger than for metered customers. This is necessary to keep metered and unmetered bills in cost reflective balance. We accomplish this balance by adjusting tariffs so that unmetered customers pay a charge that reflects the level of water used by unmetered customers but because they do not have a meter, do not have to contribute towards the additional costs of operating metered accounts.

28. Since 2020/21 we have observed water use per unmeasured property to have increased faster than seen in metered properties. To remain in cost reflective balance, unmetered tariffs need to be higher in relation to metered tariffs than they have been in prior years, to reflect this additional water use in bills. We are spreading the adjustments needed over time, to smooth the effects on bills for our unmetered customers.

5. Impact Assessment and Handling Strategy

29. We understand that we are proposing significant changes to our water charges at a time when our customers are already experiencing significant cost of living pressures. Whilst our water bill accounts for a smaller proportion of household expenses than other services such as gas and electricity, we recognise that it will nevertheless add to pressures on household budgets. Therefore we are developing our handling strategy to mitigate the effects of bill changes on our customers and manage the implementation of changes to charges.

30. In setting our tariffs for next year, we propose initiatives designed to mitigate the impact of household bill changes. Firstly, we will continue to promote our social tariff to customers likely to be eligible and we plan to accept an additional 30,000 customers by 31 March 2024 over and above the 100,000 customers we already

supply on these terms. We cap the bills of social tariff customer bills at a level that represents a 40% discount to the average household bill.

31. We are developing a scheme to target the way we return revenue over recovery amounts towards customers at greatest affordability risk. We are working on the details of the scheme, but in outline expect that we will be able to assist customers at risk, in the form of credits against water bills, to a total value around £1.5m. This amount corresponds with the un-used capacity for cross subsidy supported by a majority of customers in customer research. We project that we may be able to assist up to 30,000 customers with their water bills in 2023/24, that we identify both proactively and reactively, alongside customer cases referred to us by third party agencies.
32. We have considered the balance of fixed and variable charges in our household tariffs and how adjustment to this balance can alleviate cost of living pressures next year. Therefore we propose to freeze fixed charges for household customers at last year's level and weight tariff adjustment instead onto the volumetric rate for metered customers, or the rateable value element of charges in the case of unmetered customers. This measure means that bills for lower consumption customers and customers occupying low rateable value properties will increase less quickly than for high consumption customers and those living in higher rateable value properties. Overall, we consider that this assists affordability as it will mean lower rates of bill increase for single occupiers and those living in smaller homes, which helps because affordability difficulties are most frequent in single occupier households.
33. Table 8 below shows the effects of rebalancing fixed and variable charges on the bills of low and high consumption customers. It shows that the bill increase would be between 1.1% and 1.7% lower for low consumption customers compared to high consumption customers.

Table 8. Typical wholesale element of bills for low consumption and high consumption household customers £/year and % change

	Consumption (m3/year)	Wholesale Bill 2022/23 (£/year)	Wholesale Bill 2023/24 (£/year)	Change (%)
Central area	65	80.79	88.05	9.0%
Colne area	42	87.26	95.26	9.2%
Southeast area	65	132.85	146.01	9.9%
Central area	300	312.12	345.63	10.7%
East area	225	394.28	437.10	10.9%
Southeast area	300	552.42	613.17	11.0%

34. In addition to the tariff assistance approaches described above, we are also analysing the impact of water bill changes on different customer groups. We

intend to use the results to tailor our customer communications around next year's charges. The principal features of our strategy are:

- Affordability assessments, to model the effect of bill changes on customer affordability, bad debt risk and vulnerable customers, and use the insights to understand and plan how these effects can be mitigated.
- Deciding our approach to customer communication, determining the different requirements of different customer groups, the appropriate communication channels and the content and timing of our communications.
- Determine how we will make customers aware of and signpost the support available to them
- Determining our internal communication plans so that our personnel are well briefed and in position to assist customers in the run up to and after tariff changes.
- Producing our engagement plan for regulators, stakeholder groups and third party agencies to determine key messages and optimal timings for communications and consultations.

6. Next Steps

35. We will consult with stakeholders about our proposals for charges next year, including the measures we have proposed to mitigate the impacts of bill changes. Following consultation, we will refine and finalise our handling strategy and charges leading to publication of our final wholesale charges in mid-January 2023.