



# **SES Bulk Supply Charging Arrangements for New Appointments and Variations (NAV's) 2020/21**

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## 1. About this document

This Bulk Supply Charging Arrangements for New Appointments and Variations (NAVs) document is produced in accordance with the 'Bulk charges for NAVs: final guidance' which was published by Ofwat in May 2018. This document sets out the SES Water methodology for calculating bulk charges for NAVs.

### 1.1. Introduction

This document outlines the methodology SES Water has adopted for calculating bulk charges for NAVs and sets out the standard charges for 2020/21 applicable to NAVs requesting a bulk supply of water.

These Bulk Supply Charging Arrangements are updated annually and we welcome any feedback on its application so that we can reflect on it in future updates.

### 1.2. Content of this document

In this document we:

- Explain the background and purpose of this document and the scope of SES Water charges for the setting of NAV bulk supply charges;
- Provide explanation of the Ofwat general charging principles used in our approach to setting NAV bulk supply charges;
- Describe our approach to calculating NAV bulk supply charges;
- Provide a summary of the NAV bulk supply charges;
- Provide a worked example of the calculation of a NAV bulk supply charge;
- Describe our assurance process in calculating the NAV bulk supply charge.



## 2. Background

### The legal and regulatory framework

New Appointments and Variations (NAVs) were introduced under the Water Industry Act 1991 to provide a mechanism to facilitate new entrants into the water and wastewater sector.

A new appointment is made where a limited company is appointed by the Water Services Regulation Authority (Ofwat) to provide water and/or wastewater services for a specific geographical area.

A variation is where an existing appointed company requests Ofwat to vary its appointment to extend the area it serves.

In November 2017 Ofwat conducted a review of the NAV market and consulted on proposals for a new approach to calculating the bulk supply charges that incumbent water companies charge NAVs. It published its final guidance on bulk charges provided to NAVs in England and Wales in May 2018.

The Ofwat guidance sets out the general principles that will be used when making determinations on bulk supply agreements between an incumbent water company and a NAV. The guidance expects NAVs to have access to clear information on bulk charges ahead of bidding for developer work. Incumbents are expected to:

- Publish tariff information that NAVs can use to estimate bulk charges ahead of bidding for developer work;
- Publish an explanation of the methodology a NAV should use to estimate its overall bulk supply charge;
- Promptly adjust their bulk supply charges to reflect any material changes.

### Purpose

The aim of the Ofwat guidance on pricing for bulk supply services for NAVs is to contribute to the creation of a level playing field in the provision of developer services and the provision of water services to the end-customers in new developments.

The purpose of this document is to support this aim by:

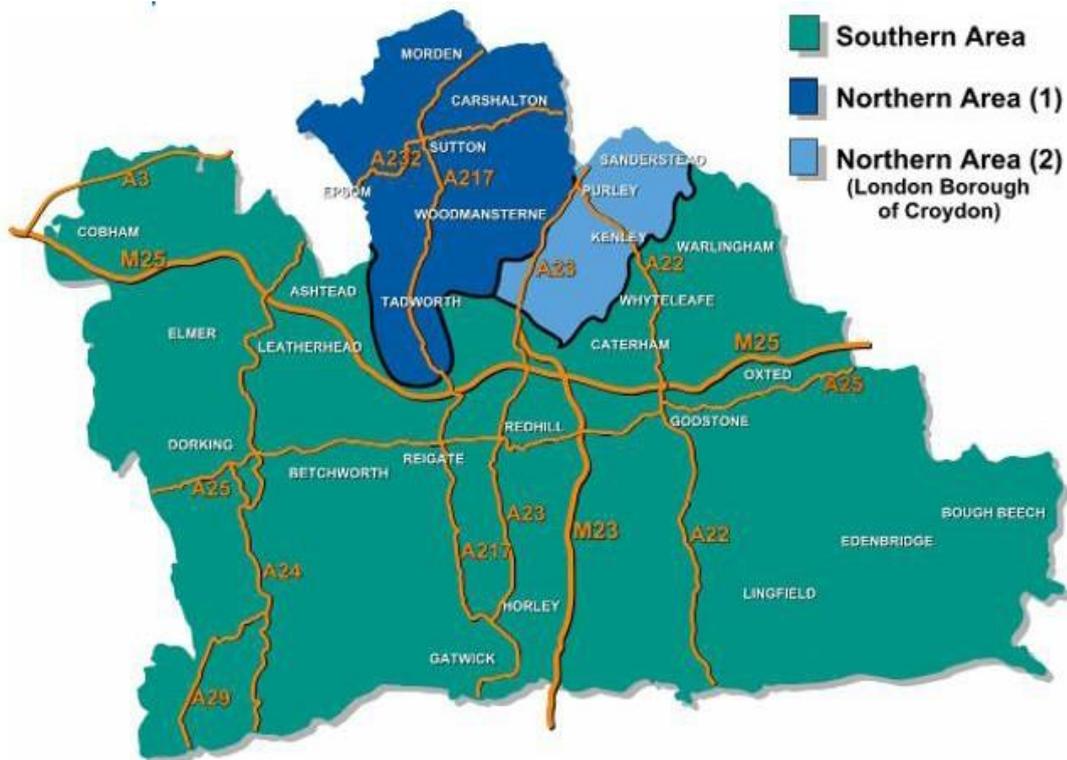
- Providing clear and transparent information for use by prospective applicants who are looking to apply for a NAV within the SES area and;
- Providing the methodology and general approach set out in the Ofwat guidance in calculating the NAV bulk supply charges, further details of this approach are set out in Section 3 below.



### SES wholesale charges

The applicable charges for wholesale services relevant to the setting of NAV bulk supply charges varies by region within SES. The company has three charging areas – Southern, Northern (1), and Northern (2). These charging areas can be seen on the area map below. For the purposes of calculating NAV bulk supply charges the two Northern charging areas can be regarded as one, as the measured charges are the same for each Northern area. The relevant wholesale charges that apply for the calculation of NAV bulk supply charges for the Northern and Southern charging areas are shown below in Section 4.

Figure 2.1: Area map of SES Water supply area



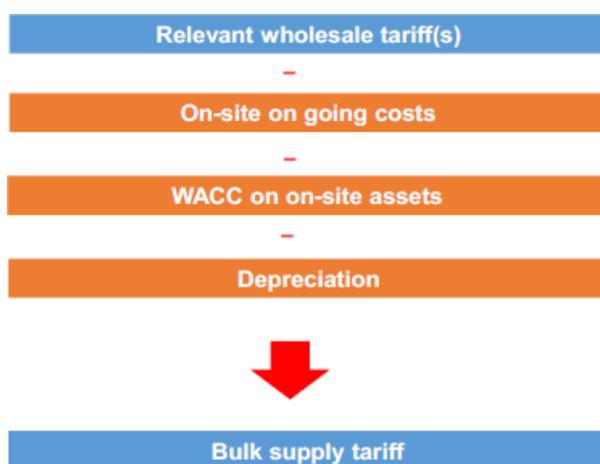


### 3. General charging principles

The general principles adopted by SES Water for the calculation of NAV bulk supply charges have been developed to comply with Ofwat's bulk charges for NAVs guidance.

In developing these charges, we have used the 'wholesale-minus' approach which Ofwat has said it will use in any dispute on NAV bulk supply charges. This approach set out in the Ofwat guidance starts from the relevant wholesale tariffs and 'deducts costs that the incumbent water company would no longer incur if a NAV supplied the new development instead'. A diagrammatic illustration of this taken from the Ofwat guidance is shown below in Figure 3.1.

**Figure 3.1: Relevant starting point for wholesale-minus approach and costs to be deducted**



The relevant wholesale tariffs are taken from the published SES wholesale tariffs for 2020 which can be found in the [SES Wholesale Charges Schedule](#)

The methodology applied to calculate the bulk supply tariffs is set out in Section 4 below.

While this methodology and the information in this document has been developed to meet the majority of expected NAV site applications it is recognised that there could be sites that have materially different operating characteristics, or a very large volume consumption. SES Water will therefore review each NAV bulk supply application before finalising any bulk supply agreement. For large forecast volumes it will be important to get reliable volume forecasts to prevent material changes to the NAV charge in the year-end 'true-up' of actual volumes (see Section 6 below).

The bulk supply charge for each NAV site is site-specific and calculated each year based on our published wholesale tariffs adjusted in accordance with the Ofwat 'wholesale-minus' approach and the methodology detailed in Section 4 of this report. Any material differences between the NAV forecast and actual information for the site will result in the final charges to the NAV being adjusted as part of a 'true-up' of the bulk charges as described in Section 6 below.



## 4. Applying the charges

The details of the NAV bulk supply charge calculation are shown below using the 'wholesale minus' approach and the general principles described above.

### 4.1. The relevant starting point

Based on the Ofwat guidance the relevant starting point in calculating the NAV bulk supply charges is the appropriate wholesale tariffs that reflect the NAV's end-customers. A summary of SES wholesale tariffs is set out in Table 4.1 below. A full list of SES Water charges can be found in the [SES Wholesale Charges Schedule](#) and form part of the final bill for all customers.

**Table 4.1: Summary of SES Water wholesale tariffs**

	Northern £'s	Southern £'s
<b>Household</b>		
Fixed charge	1.00	1.00
Volumetric charge (per m <sup>3</sup> )	1.0297	1.3204
<b>Non- Household</b>		
Fixed charges		
• Standard (<10MI per year)	1.00	1.00
• Mid user (10 - 49MI per year)	932.87	1,357.87
• High user (>50MI per year)	3,077.84	4,019.00
Volumetric charges		
• Standard (<10MI per year)	1.0297	1.3204
• Mid user (10 – 49 MI per year)	0.9039	1.1555
• High user (>50MI per year)	0.8613	1.1041



## 4.2. Avoided ongoing on-site costs

The deductions for on-site costs represent the SES costs avoided because the NAV is servicing the site instead of SES. The costs considered here are the operational costs of the activities that a NAV will undertake in operating and maintaining the site.

These SES avoided costs are calculated using the other operating costs and length of mains installed from the latest business plan used to set the SES wholesale tariffs. This information is then adjusted to ensure they reflect only the on-site costs of a new development by using information from the published regulatory accounts (Table 4D for treated water distribution), SES finance systems, and new development operational information.

These on-site avoided costs are calculated on a per property connected basis as the on-site costs are more likely to vary by the number of connections compared to the amount of water delivered. The calculated avoided operational cost for 2020/21 is £20.08 per NAV property connected. Please note that this avoided cost is indicative whilst we undergo internal assurance. Final values will be determined and updated (if necessary) following our assurance review.

These avoided on-site costs also include an allowance for leakage as recommended in the Ofwat guidance. The leakage allowance is to reflect the water loss between the boundary of the NAV site (after bulk supply meter) to the premises on site (before the end-customer meter). The leakage assumption has been assumed as 4.9% which is based on the average leakage from the current NAV Water Resource Management Plans. The NAVs assessment of leakage is likely to be a more accurate representation of the leakage likely to occur on a newly developed NAV site than the average leakage of the SES network.

## 4.3. Avoided capital on-site costs (WACC and depreciation)

The Ofwat guidance identifies the weighted average cost of capital (WACC) and the depreciation from the on-site assets (e.g. installation of on-site mains) as additional costs to be deducted from the wholesale tariff. The Ofwat guidance says this should be applied to the regulatory capital value (RCV) relating to the on-site assets that the incumbent would incur.

For new development sites where the developer requisitions the on-site assets from the incumbent, the developer would incur the costs of installing the assets less any 'income offset'. The 'income offset' is a discount to the developers for the cost of installing the on-site assets to reflect future income to the incumbent from the newly connected properties. This discount or 'income offset' would be incurred by the incumbent and result in an increase in their RCV.

From 1 April 2020 Ofwat introduced new charging rules for new connections which has changed the treatment of the 'income offset' such that this is now applied to the infrastructure charge rather than the requisition cost of the new development. The result of this is that the developer will pay for the full amount of the on-site assets and therefore there will be no increase in the incumbents RCV.

The implication of this change in the charging rules for new connections is that there will not be an increase in the incumbents RCV for new developments and therefore there is no deduction from the WACC or depreciation from on-site assets that will be made.



## 5. NAV bulk supply charges 2020/21

Table 5.1, below, shows the SES 2020/21 standard (for water volumes up to 10Ml per year) household and non-household charges and the deductions for on-site costs used to set the NAV bulk supply charge.

**Table 5.1 Standard HH and NHH Charges and Deductions**

		Northern	Northern	Southern	Southern
		Household	Non-Household	Household	Non-Household
	Units	£'s	£'s	£'s	£'s
Volumetric Charge	£/m <sup>3</sup>	1.0297	1.0297	1.3204	1.3204
Fixed Charge	£/conn	1.00	1.00	1.00	1.00
<b>Deductions</b>					
On-site costs	£/conn	20.08	20.08	20.08	20.08
Leakage assumption = 4.9%					

## 6. Updating the NAV bulk supply charges

This document will be updated annually to reflect the latest wholesale charges and costing information from the business plan, regulatory accounts and other financial and non-financial sources to calculate the relevant avoided costs to deduct from the wholesale tariffs.

In addition, there may be a 'true-up' at the end of each charging year for existing and new NAV applicants. At the end of the charging year the actual volume of connections and volumes will be collected (from the NAV and the bulk supply meter). If there is a material difference in the calculation of the NAV bulk supply charge from these revised volumes than a revised bill will be issued to reflect this change.

## 7. Example of NAV bulk supply charge for South area

Table 7.1 below gives a worked example of a NAV bulk supply charge based on the following on-site characteristics:

- Household connections = 200
- Non-household connections = 10
- Household consumption = 20,000 m<sup>3</sup> (100 m<sup>3</sup> per household)
- Non-household consumption = 2,000 m<sup>3</sup> (200 m<sup>3</sup> per non-household)



Table 7.1a Fixed Charge

	Units	South
Households	No	200
Non- Households	No	10
<b>Fixed charge - households</b>		
Fixed charge - households	£	1.00
<b>Fixed charge - non-households</b>		
Fixed charge - non-households	£	1.00
<b>Total fixed charge - households</b>		
Total fixed charge - households	£	200
<b>Total fixed charge - non-households</b>		
Total fixed charge - non-households	£	10
<b>Total fixed charged for site (A)</b>	£	<b>210.00</b>
<b>Deductions for on-site costs</b>		
Connections	No	210
Avoided cost per connection	£	20.08
<b>Avoided cost for site (B)</b>	£	<b>4,216.08</b>
<b>Fixed charge after avoided costs (A)-(B)</b>		
Fixed charge after avoided costs (A)-(B)	£	<b>(4,006.08)</b>

Table 7.1b Volumetric Charge

	Units	South
Household volume	m <sup>3</sup>	20,000
Non-household volume	m <sup>3</sup>	2,000
<b>Total volume delivered to site (A)</b>	m <sup>3</sup>	<b>22,000</b>
<b>Volumetric charge - households</b>		
Volumetric charge - households	£	1.3204
<b>Volumetric charge – non-households</b>		
Volumetric charge – non-households	£	1.3204
<b>Total volumetric revenue - households</b>		
Total volumetric revenue - households	£	26,408.00
<b>Total volumetric revenue – non-households</b>		
Total volumetric revenue – non-households	£	2,640.80
<b>Total volumetric revenue (B)</b>	£	<b>29,048.80</b>
<b>Weighted volumetric charge (B)/(A)</b>		
Weighted volumetric charge (B)/(A)	£ / m <sup>3</sup>	<b>1.3204</b>
<b>Leakage</b>		
Leakage	%	4.9
<b>Weighted volumetric charge after leakage</b>		
Weighted volumetric charge after leakage	£ / m <sup>3</sup>	<b>1.2557</b>

Table 7.1c Bulk Supply Charge

	Units	South
<b>Fixed charge after avoided costs (A)</b>	£	<b>(4,006.80)</b>
<b>Total volume delivered to site</b>		
Total volume delivered to site	m <sup>3</sup>	22,000
<b>Weighted volumetric rate after leakage</b>		
Weighted volumetric rate after leakage	£/ m <sup>3</sup>	1.2557
<b>Volumetric charge after leakage (B)</b>	£	<b>27,625.40</b>
<b>Bulk Supply Charge (B)-(A)</b>		
Bulk Supply Charge (B)-(A)	£	<b>23,618.60</b>



## 8. Assurance and compliance with Ofwat guidance

In developing our approach to calculating bulk supply charges for NAVs we have taken account of Ofwat's bulk supply charging guidance and other applicable regulation and legislation. In calculating the bulk supply charges we have used the latest wholesale tariff information, the PR19 final determination and the latest available accounting separation and operational information to calculate the avoided costs.

To provide assurance and compliance with the Ofwat guidance we have undertaken third party assurance to ensure that the cost models used to calculate the bulk supply charge are accurate and produces a fair and reasonable NAV bulk supply charge in accordance with Ofwat's bulk supply charging guidance.