

PC21 Draft Determination
NI Water Response

Annex 5.19 Consequential Capital
Maintenance

Version 3.0

14 December 2020



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1. Introduction

In the Draft Determination (DD) the UR has included an allowance of £683m (an average of £114m per annum) for capital maintenance in PC21. £18.3m of this £114m per annum is associated with a consequential capital maintenance (CCM) allowance to reflect the overall increase in total capital investment including LWWP.

This paper provides a rationale for increasing the consequential capital maintenance allowance in the DD from £18.3m per annum to £28.9m per annum. The rationale is derived from top-down comparison with UK Water companies with similar sized determinations and bottom-up assessment by projects and sub-programmes.

2. Review of Top-Down Methodology

The Figure 4 below shows a comparison between Annual Capital Maintenance and Annual Enhancement Capex for NI Water and UK WASCs. The data was provided by UR in the Section 5.22 of Annex I in the draft determination.

NI Water note that the nearest UK comparator company in any single year has a +£100m allocation of capital maintenance relative to a comparable enhancement programme for NI Water in PC21. The average comparator (best fit dotted line) has a +£200m/yr allocation of capital maintenance.

PC27 and PC33 are likely to be comparable to PC21 in terms of our enhancement programme going forwards.

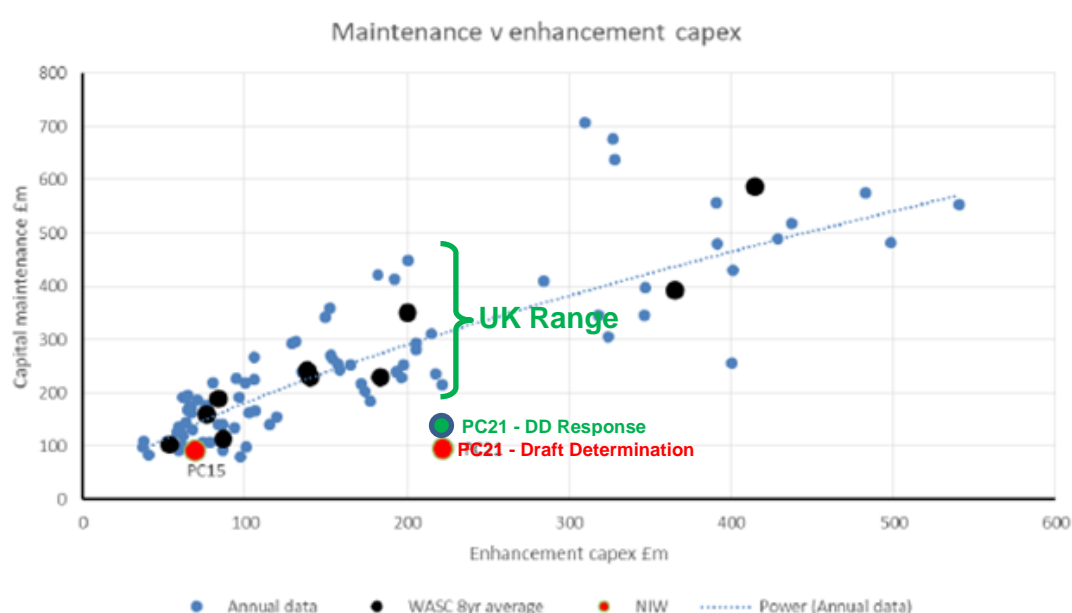


Figure 4: Maintenance capex of England & Wales WASCs relative to enhancement expenditure.

NI Water therefore surmise that our rationale for the inclusion for an additional £64m allocation of CCM above levels determined in the draft determination is still econometrically well below all other UK WASCs with respect to the size of similar enhancement programmes.

3. Review of Bottom-Up Methodology

We understand that the rationale used by the UR to determine the quantum of consequential capital maintenance relates directly to the material increase in the capital programme for PC21. Specifically, those sub-programmes of work with a major increase in capital maintenance expenditure since PC15, particularly those with increased enhancement activities.

3.1 Baseline Calculation in the Draft Determination

We noted a number of amendments were necessary to Table 5.4 of Annex I of the DD. The corrected Table and associated Consequential Capital Maintenance (CCM) values are included in our Table 1 below.

Table 1 - DD Annex I Table 5.4 Amended Version

SP ID.	Sub-Programme Name	BASE Capital Investment All figures are Post Efficiency, 18/19				
		PC15 (£m)	PC21 (£m)	Increase (£m)	Increase Allowed for CCM (%)	CCM Allowed (£m)
00	Capitalized salaries and on-costs	47.9	60.9	13.0	60	7.8
00	Capitalized salaries (LWWP)	0	0.2	0.2	60	0.1
01	Capital maintenance (water)	31.3	60.4	29.0	50	14.5
02	Capital maintenance (sewerage)	129.6	163.7	34.1	0	0.0
05	Water trunk mains	3.0	7.9	4.8	100	4.8
12	Sewerage programme	51.6	57.4	5.9	100	5.9
12	Sewerage programme (LWWP)	0.0	16.9	16.9	100	16.9
16	Wastewater treatment	21.7	40.1	18.4	100	18.4
16	Wastewater treatment (LWWP)	0.7	47.2	46.5	100	46.5
20	Management & General	59.6	92.8	33.2	0	0.0
20	Management & General (LWWP)	0	2.8	2.8	0	0.0
All	Sub-programme total	345.4	550.2	204.8	56	115.0
DD	Difference to Table 5.4 Annex I	4.3	7.8	-1.3		-2.8

The CCM allowance when these corrections are made is £115.0m as opposed to the £117.8m per annum included in the DD.

In section 5.28 the UR further reduced the consequential capital maintenance allowance by 6.7% in line with the Generic Reporter Adjustment (GRA) factor. This adjustment factor has been disputed in its entirety and is explained in Annex 5.3. This paper does not consider adjustment for GRA appropriate in any setting and has hence not discussed or included it further in this paper.

3.2 Summary of Additional CCM requested

Table 2 below summarizes the additional consequential base allocation requested by sub-programme. The rationale for each change is described further below.

Table 2 – Summary of CCM Requested

SP ID.	Sub-Programme Name	BASE Capital Investment				
		All figures are Post Efficiency, 18/19				
		Increase (£m)	Increase Allowed for CCM (%)	CCM Allowed (£m)	Increase Requested for CCM (%)	CCM Requested (£m)
00	Capitalized salaries and on-costs	13.0	60	7.8	100	13.0
00	Capitalized salaries (LWWP)	0.2	60	0.1	100	0.2
01	Capital maintenance (water)	29.0	50	14.5	50	14.5
02	Capital maintenance (sewerage)	34.1	0	0.0	51*	17.5*
05	Water trunk mains	4.8	100	4.8	100	4.8
12	Sewerage programme	5.9	100	5.9	100	5.9
12	Sewerage programme (LWWP)	16.9	100	16.9	100	16.9
16	Wastewater treatment	18.4	100	18.4	100	18.4
16	Wastewater treatment (LWWP)	46.5	100	46.5	100	46.5
20	Management & General	33.2	0	0.0	100	33.2
20	Management & General (LWWP)	2.8	0	0.0	100	2.8
All	Sub-programme total	204.8	56	115.0		173.7
All	Average Annual CCM Allocation					28.9

*Base element of WW Regulation Reform elements Annex 5.5 (£35.5m x 0.41) plus and 50% WwPS (£6m x 50%) as per SP01 approach.

3.3 Capitalised Salaries and Overheads

The UR has allowed 60% of the difference in Capital Maintenance between PC15 and PC21 for SP00 as Consequential Capital Maintenance on the basis of his adjustment to staffing levels from 99 to 60. Annex 5.4 provides extra information with regard to the need for 99 staff.

Subject to this new capitalised salaries proposal being accepted by the Utility Regulator we have applied a factor of 100% on the increase from PC21 in line with the UR methodology.

3.4 Capital Maintenance (Sewerage)

The UR has allowed 50% of the difference in Capital Maintenance between PC15 and PC21 as Consequential Capital Maintenance for SP01 which NI Water welcome especially given the age profile of our WTWs. We also welcome the use of the DRRM modelling in this regard.

The UR has not allowed any Consequential Capital Maintenance based on the difference in Capital Maintenance between PC15 and PC21 for SP02 on the basis that the difference is mostly accounted for by the deduction of £33m for Mature Compliance Capex / Reforming Wastewater Compliance Capex in the DD.

Additional information with regard to Water Regulation Reform is included in Annex 5.5. This paper describes additional enhancement projects which would be subject to CCM allocation. Subject to this proposal being accepted by the Utility Regulator we have applied a factor of 41% to reflect the base allocation in Annex 5.5.

In addition NI Water request that 50% of the increase in WwPS capital maintenance expenditure (c£6m) be allowed as CCM given that the same pressure applies on WwPS assets as for WTW and WPS assets and applying the same principle as the UR applied in SP 01.

3.5 SP20 Management and General

The UR has not allowed any CCM for SP20 on the basis that the capital maintenance activities included in the company's assessment are to maintain its existing assets and facilities something which is common to the comparator companies used in the econometric benchmarking.

NI Water's proposed PC21 expenditure on SP20 M&G is relatively large in a NI Water Price Control context. We believe that our PC21 M&G programme contains a number of enhancement type and atypical projects for which CCM allowances should be considered in the FD.

For example, these include a range of large projects which:

- Are not typical for other WASCs in that the proposed investment is for new systems and facilities (eg Planning for the Future; Intelligent Operations Centre; Analytical Services Refresh etc);
- Represent catch-up investment due to historic funding shortages (eg Health & Safety; Model Library updates to support our waste water investment); or
- Address responsibilities that other WASCs do not generally hold (eg Historic Estate)

Table 3 below presents our assessment of the consequential base maintenance that we believe should be considered for SP20 M&G in the Final Determination.

Table 3 – Summary of M&G projects proposed for CCM Allowance

Project No. & Name	Base Capital Investment	Rationale for CCM
2394 - Studies to Inform PC27 - Top 271 Priority Drainage Areas	■■■■	NI Water have never reached a position where we have base DAP models for all catchment areas. Following purpose allocation rules for modelling as per the UR query response in 2009 this investment must be allocated to Base Maintenance but NI Water believe this warrants consideration as consequential base to enable us to get to a position of having a full suite of drainage models.
2327 - PftF - IOC Building	■■■■	NI Water have ambitious plans to move to being a new industry exemplar company employing the digital tools and technologies to modernize the company operations with this specifically designed building. This is a step change for NI Water and we believe consideration should be given to allowing consequential base for this project
2326 - PftF - IOC Building	■■■■	As per Project 2327
2603 - Facilities H&S Compliance	■■■■	Having undertaken an extensive examination of Health & Safety facilities, NI Water have identified that considerable work needs to be completed to reach a stable position and ensure the long term safety of our staff and operations. As all H&S investment is allocated to Base as per the purpose allocation rules NI Water believe consideration should be given to consequential base for this re-shaping of our H & S management approach.
2604 (20z) - Facilities H&S Compliance	■■■■	As per Project 2603

2019 - ASR Project - New Labs (Building)	■■■■	Given the huge step in the Enhancement capital programme and the associated additional demand for lab services associated with this programme the Base element of this project should be considered for a consequential base allowance.
1389 - NIW Historic Estates	■■■■	This specific protocol for the Historic Estate is NI specific. Given this is Government Estate and NI Water is Government owned we must follow this protocol. This is not directly comparable with the private industry in the UK and should be considered as being outside the Econometric modelling principles. It should be noted that this project area is a first time investment as the assessment to inform this project was initiated during PC15.
2605 - H&S Other	■■■■	Having examined H & S NI Water have considerable work to complete to reach a stable position and ensure the long term safety of our staff and operations. As all H&S investment is allocated to Base as per the purpose allocation rules NI Water believe consideration should be given to a consequential base allowance for this reshaping of our H & S management approach.
2606 - H&S Other	■■■■	As per Project 2605
2130 - Westland Campus Upgrade	■■■■	This project is linked directly to the IOC and providing a new access to the site to reduce access H&S concerns associated with the current Westland site access location. Given the direct link it should be treated in a similar way to the IOC project.
2185 - Westland Campus Upgrade	■■■■	As per Project 2130
2634 - PftF - IOC Building (LWWP)	■■■■	The IOC project will include for the displaced Telemetry and other teams from Bretland to facilitate the upgrade of Duncrue WWTW. As such this is a direct link to the intervention at Duncrue and should be considered in that light for consequential base allowance.
2635 - PftF - IOC Building (LWWP)	■■■■	As per Project 2634
2474 - ASR Project (New Labs) ICT & Lab Equipment	■■■■	Linked to new labs to facilitate upgrades to WWTW facilities
2590 - PftF - Reliability Centred Maintenance (RCM)	■■■■	The introduction of RCM is integral with the capital programme and how assets will be maintained in the future. Given this is a step change in approach it should be considered in the consequential base assessment.
2591 - PftF - RCM	■■■■	As per Project 2590
2475 - ASR Project (New Labs) Temp Staff	■■■■	Linked to labs as above.
2414 Fleet	■■■■	Electrification of vehicles will provide a step change carbon reduction in our stock. Consequential base should be considered.
2415 Fleet	■■■■	As per Project 2415
TOTAL	■■■■	

The aggregated sum of M&G projects proposed for CCM allowances is [REDACTED]. We are providing additional information with regard to many of these projects as part of the draft determination response. Subject to our proposals for these projects being accepted by the Utility Regulator we propose that the CCM for SP00 be increased to an aggregated value of £36m in line with the threshold indicated in the proposed DD methodology.

4. Impact on Total Capital Maintenance

In the Draft Determination Main Report Table 4.4 the UR has included an allowance of £683m (an average of £114m per annum) for capital maintenance in PC21. £18.3m of this £114m per annum is associated with a consequential capital maintenance (CCM) allowance to reflect the overall increase in total capital investment including LWWP.

Subject to acceptance of this proposal for adjusted CCM we would expect the total base allocation to adjust accordingly.

Table 4 below is an update of Table 4.4 with the inclusion of £28.9m/annum for CCM. The revised total base allocation following the rationale in this paper would be £747m.

Table 4 – Update of DD Table 4.4 with proposed CCM allowance

Capital Maintenance Element	£m/a
NI Water current capital maintenance expenditure	96.5
Upper quartile econometric estimate	91.4
Target cost at the end of PC21 after closing 80% of the gap to current upper quartile performance in England and Wales	92.4
Average Expenditure over PC21 (average current and target)	94.4
Adjusted for growth net of frontier shift (+1.2%)	95.6
Add consequential capital maintenance allowance	28.9
Determined average capital maintenance for PC21	124.5

5. Conclusion

Our analysis of potential adjustments to the consequential capital maintenance allowances result in an average of £28.9m per year across PC21. This calculation is subject in part to acceptance of other papers provided as part of this draft determination response.

The total quanta of consequential capital maintenance allowances proposed are considerably econometrically lower than the gap to the nearest UK comparator company with comparable enhancement programme.

6. Recommendation

We recommend that the UR review the allowance for consequential capital maintenance in line with the new rationale and evidence provided in this paper.