

# Ofwat Cambridge Water



## Reporter's Report to Ofwat on the Cambridge Water PR09 Final Business Plan

Part B Key Components

April 2009



**Ofwat**

City Centre Tower

7 Hill Street

Birmingham, B5 4UA

**Cambridge Water Company plc**

90 Fulbourn Road

Cambridge, CB1 9JN

# **Cambridge Final PR09 Draft Business Plan Reporter's Report Part B Key Components**

**April 2009**

Mott MacDonald

Demeter House

Station Road

Cambridge CB1 2RS

UK

Tel : 44 (0)1223 463500

Fax : 44 (0)1223 461007





# Cambridge Final PR09 Draft Business Plan

## Reporter's Report

### Part B Key Components

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## **1 Part B1: The Post 2010 Environment and the Longer Term**

### **1.1 Introduction**

There is no specific Reporter guidance for Part B1. General comments are made on the Company commentary by section.

### **1.2 Section 1: Achievements to date compared with earlier plans**

The Company see their main achievements compared with the PR04 plans as:

- (1) That their Customer Service as measured by the Overall Performance Assessment (OPA) score exceeds Monitoring Plan targets and in 2008/09 is expected to be 286, one of the highest scoring water companies.
- (2) They remain the second cheapest water supplier after Portsmouth Water.
- (3) Their old headquarters building was sold in 2005 and was replaced by their new Fulbourn Road headquarters building. Profits from the sale of building have reduced bills by 1.3%.
- (4) Following the failure to meet the leakage target in 2004/05 the Company decided to improve leakage management by transferring £2.0million from infrastructure renewals to construct District Meter Area (DMAs) in Cambridge and the surrounding areas. These DMAs are now being commissioned.
- (5) Investment in improved management systems and reporting by replacing the billing and works management systems.

### **1.3 Section 2: Assessment of the post 2010 environment for the company**

The Company considers this under four heading; satisfying the demand for water, delivering safe drinking water, adapt to climate change and minimising carbon usage.

#### **(i) Satisfy demand for water**

Though water demand will rise as a result of the significant housing growth predicted for the Cambridge sub-region, this is not expected to put pressure on the supply demand surplus until after 2035. The Environment Agency categorises the Company's resource zone as being an "area of serious water stress". Though this is regionally the case the Company's supply area has adequate resources at planned growth for the at least the next 25 years. On this basis it is difficult to justify projects that are designed to reduce water demand.

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**(ii) Deliver safe clean drinking water**

The Company have identified the steady rise in groundwater nitrate levels as the main threat to water quality. Projections of groundwater nitrate levels clearly point to the likelihood of failures of the nitrate water quality standard during AMP5 or even possibly before. The impact of this increase on public health is uncertain and may not be significant, but it is a regulatory requirement that the Company has no option but to comply with. The capital and sustained operational costs and environmental impact of investing in five nitrate removal treatment plants will be large. The Reporter considers that it is of high importance to understand the levels and changes in nitrates both horizontally and vertically throughout the chalk aquifer. This may enable options involving auxiliary and replacement boreholes that could reduce or delay the need for the investment in nitrate treatment plants to be identified. To this end, it is important the aquifer investigation and catchment studies scheme should be started as soon as possible. One of the objects of the catchment studies is to investigate ways of managing the catchment by controlling inputs into the aquifer.

**(iii) Adapt operations in the face of climate change**

The Company considers that Climate change could become a significant issue over the next 25 years, driving improvements in water efficiency and innovative tariffs. They believe the new houses will be designed to meet higher water efficiency standards included in the code for sustainable homes and that water re-use will start to be introduced. The Reporter's view is that climate change may have a significant impact during the next 25 years, but it is unlikely to have a major impact on the Company in AMP5.

**(iv) Mitigate effects of climate change by reducing carbon usage**

Ambitious carbon reduction targets have been set by the government and this will have a significant impact on longer term planning. The Company are not proposing any initiatives that will have a major impact on carbon usage in AMP5. It is difficult to conceive of cost effective initiatives that could provide a step change in carbon usage as the Company currently operates a local supply system with relatively low energy use.

The Company proposes to minimise the use of carbon by the use of water efficiency measures, smarter technology and improved pumping efficiency.

**(v) Financing the vision**

Raising finance to fund the capital programme is expected be more challenging in AMP5 than in AMP4. Funding providers are expected to impose more strict conditions on the supply of credit.

**(vi) Capital costs**

The Company will undertake more large capital schemes in AMP5 than they are used to when they construct the five nitrate plants and the southern ring main. Managing these large capital schemes will be a significant risk to the Company.

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## 1.4 Section 3: Managing key risks and uncertainties

The Company have adopted a low risk strategy in preparing the PR09 Final Business Plan. They have identified a number of risks and uncertainties that need to be managed. These are:

- (1) **Electricity costs:** Electricity costs are about 7% of the total annual Opex bill and have increased by about 50% in 2008 compared to 2003/04. The Company considers as it is highly uncertain that it should become a notified item. This has its advantages provided there is mechanism that encourages improvements in energy efficiency.
- (2) **Outsourced contractor costs:** Repair and maintenance and renewal costs have risen sharply over the last two years as a result of renegotiations of the contract with the repair and maintenance contractor. This was to prevent further losses by the contractor and improve the quality of work. Though a step change in cost has occurred over the last two years, it is questionable that large increases in costs should continue to occur until 2015.
- (3) **Debt collection:** An increase in unpaid debt is expected during the period to 2015, due to the impact of the current economic recession on low income households and lack of adequate enforcement measures.
- (4) **Major capital projects:** The construction of five nitrate treatment plants and the southern ring main will provide a project management and procurement challenge.

## 1.5 Section 4: Achieving the right balance for consumers and the environment

The Company are proposing a small increase in household water bills during AMP5 and as they are starting from a low base they will have lower bills in 2014/15 than most water companies.

The Company has not explained how its strategy will relate to the views of specific groups such as business customers and low-income customers.

## **2 Part B2: Improving Efficiency**

### **2.1 Methodology adopted by the Company**

Cambridge Water's business plan section B2 reviews the main cost drivers and the Company's expectations for change over the AMP5 period. The Company has substantially reviewed its efficiency assumptions for its final business plan. It has obtained updated estimates of future costs from suppliers, and has also made assumptions about its own scope for continuing efficiency improvements.

Efficiency forecasts have a significant element of judgement but from the information seen the Company has made reasonable assumptions about the level of efficiency for the AMP 5 period. It has used market data and bespoke quotations where possible, and then applied its own efficiency assumptions to its internal costs. The approach was consistently applied to capital and operating costs.

In addition to the Reporter Guidance, we challenged:

- The assumptions underlying the values stated in section B2;
- Scope for ongoing efficiency;
- The company's attitude to risk and its impact on costs.

### **2.2 Operating efficiencies**

#### **2.2.1 Overall operating efficiency assumptions**

Cambridge Water has reviewed its ongoing efficiency assumption for AMP5. It has included an assumption of 1% per annum efficiency over the AMP5 period (compared with zero in its draft business plan). In its DBP, the Company believed it could keep costs stable overall, but not reduce them and this efficiency will be delivered against a background of significant cost increases in contracts, and as such this appears to be a reasonable challenge.

#### **2.2.2 Assumptions underlying the values stated**

For each of the major cost items discussed in Cambridge Water's draft business plan section B2.2.4, we challenged the main assumptions underlying the forecast costs. The responses were:

##### **(i) Electricity**

Given the current market and the outturn of the new contract, these assumptions appear to be robust but for future years they are highly uncertain.

For the DBP we reported that the Company had experienced a price rise of +48% in a two-year contract for larger 'half-hourly metered' sites. Since the DBP it has received a quote for the non-half-hourly sites, which has shown a stable price for the two years from summer 2009. This is cheaper than the DBP assumptions and the Company has adjusted its opex estimate accordingly.

Given the current market and the outturn of the new contract, these assumptions appear to be robust for the short term. However, the longer term electricity price is uncertain and represents a significant risk to the company.

## **(ii) Chemicals**

Chemical prices have become volatile as they react to demand pressures and energy costs. Cambridge Water has assumed that chemical prices will remain stable at 2009/10 levels through AMP5. The approach appears to be reasonable. Chemical market costs have been highly uncertain but may stabilise in the short term as a result of reduced manufacturing demand and lower oil prices.

The approach appears to be reasonable, with chemical market costs being highly uncertain at the moment.

## **(iii) EA charges**

These charges have generally risen faster than inflation. The Company has assumed that EA charges will continue to rise at 2.4% above inflation. The approach appears to be reasonable on the basis of past increases in EA charges.

## **(iv) Contract labour**

The draft business plan assumes an ongoing increase in contract labour costs, of 5% above inflation per year for the whole of AMP5. The value used is a judgement based on recent experience and the performance of the construction industry outturn price index (COPI), although that is influenced by construction material costs as well as labour and fuel. Contractors have been unable to deliver service at the costs initially forecast for AMP4, and Cambridge Water states that it expects costs to continue to rise to market rates. Cambridge Water believes that costs are strongly influenced by other infrastructure projects in the south-east of England, which directly affects labour costs.

Since the DBP the Company has taken advice on contract labour costs for the AMP5 period, from Franklin and Andrews, a member of the Mott MacDonald group. Its business plan takes account of the advice in its forecast to keep future contract labour costs constant at 2009/10 levels and as such is reasonable.

## **(v) Bad Debt**

Cambridge Water is assuming that bad debt will continue at about 1.1% of turnover. The value will thus increase in line with the Company's proposed price increases. The Company has assumed that it will be able to maintain bad debt at current levels, by improvements in debt collection methods being offset by increases in non-payment resulting from macroeconomic effects such as rising transport and housing costs and reduced employment. The assumptions seem to be reasonable.

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## **(vi) Pensions**

The Company has used the values as recommended by its actuary. The actuary has stated the company should increase its pension payments, a change from the position presented in the draft business plan when advice was not available.

## **(vii) Business rates**

The review of rateable values has doubled the RV of the Company's rateable asset base. The government's change in method for calculating business rates could lead to a significant increase in rates for the Company. There appears to be uncertainty as to the extent to which the new (profit-based) rates will be applied to the water industry, as this will have a noticeable impact on bills. The Company has made reasonable assumptions, in the absence of certainty in business rates.

## **(viii) Nitrate removal**

The Company plans to install five nitrate removal plants during AMP5 in order to protect drinking water quality compliance. The process produces a nitrate rich brine waste stream, for which the Company has not been able to secure a local disposal route. The operating cost estimate for the plant currently includes a high transport element, for tankering the waste to sewage works in either Lincoln or Norwich where Anglian Water have facilities that will accept it. Without reviewing the reasons with Anglian Water, the local sewage treatment company, it is not possible to comment on the validity of the refusal to take the brine at a local treatment works. The Company appears to have made reasonable assumptions on an alternative route, although we would expect it to try to find a cheaper disposal route.

### **2.2.3 Scope for ongoing efficiency**

#### **(i) General**

Since its DBP, the Company has reviewed and increased its assumptions of ongoing efficiency.

The Company has experienced a significant increase in network repair and maintenance contractor costs. Future efficiencies are only likely to be obtainable through a new contract. We challenged the Company on why it didn't do the work in-house. It responded that using a contractor provided access to a larger workforce when required (for example to cover leave or emergencies) and hence was more efficient than direct employment.

The Company is proposing to introduce field-working IT to help deliver improvements in efficiency from its own non-infrastructure maintenance team. However, the team is small and it is likely that productivity will increase rather than reducing the number of people. This should virtually eliminate overtime, which is already minimised, so that there is little or no out-of-hours repair work.

Non-infrastructure maintenance of its boreholes, treatment plant, and pumping stations is carried out by an in-house team of four electricians and a supervisor. Efficiency improvements are likely to show as a reduction in overtime or an improvement in levels of service rather than reduction in staff numbers, because a 25% improvement in efficiency would be required in order to reduce the team by one person.

Cambridge Water is concerned that in the long term staff numbers might need to increase due to business dis-aggregation

Power and chemical use is reviewed on a regular basis. Targets are set to reduce power consumption, both overall and at peak hours. Chemical consumption is reviewed on a similar basis.

Overall the Company is delivering ongoing efficiency improvements, but scope is naturally limited because teams are already small. Fluctuations in market prices for power and chemicals have a direct impact whenever supply contracts are renewed and the Company has little scope to absorb such changes by cuts in other areas.

## **(ii) Attitude to risk and its impact on costs**

In the draft business plan report, we challenged the Company on its attitude to risk.

Its response was:

- Every-day operations and investment planning involve a balanced approach to risk of service failure, but the Company aims to maintain full compliance with drinking water standards and high OPA at low cost to consumers. In operational terms, the adoption of the target to pump 40% of water volume at night means that service reservoir draw-down is greater during the day than it was under a continuous pumping regime. The result is that operational risk of losing supply in the event of an asset failure is increased, because the time available to carry out repairs before the reservoir empties is shortened. This is also true of the approach to minimising overtime, since it can leave failed assets out of use for longer, thereby reducing overall system resilience.
- Although the Company does not appear to be taking large risks, it does appear to be making managed decisions on the level of risk, rather than eliminating risk at all cost.
- In its final business plan, the Company has accepted more risk by making bolder assumptions about its ability to reduce future costs.

## **2.3 Capital efficiencies**

Capex estimates have been obtained for many individual schemes proposed for AMP5. Being a relatively small company the Company has the advantage of being able to get bespoke capital estimates for almost all of its planned capital investment.

The capital investment estimates are the forecast outturn price of the proposed projects and are net of efficiency.

Although mains renewals are delivered through its framework contractor, specialist projects such as trunk main and water treatment enhancements are procured by tender, enabling the Company to test market rates.

The Company has revised its estimates for many of its proposed capital schemes, to reflect current market rates. It has also taken account of challenges in other sections of the plan, and has reduced the scope of some projects.

For the FBP the Company is assuming capex efficiencies for infrastructure projects of 10% by 2012/13. The Reporter considers that the Company is realistic in assuming that there is scope for reducing infrastructure costs in AMP5. The approach used to derive the efficiency assumptions is detailed and robust.

## **2.4 Out-performance of 2004 assumptions**

### **2.4.1 Operating costs**

Cambridge Water reported out-performance of operating costs of 7.4% in the first year of AMP4 but this has declined in subsequent years. The Company's forecast for the final two years of AMP4 is to under-perform the FD04 assumption as a result of rising electricity, chemical and contract labour prices; increases which it expects to contribute to higher costs in AMP5, as discussed above.

### **2.4.2 Capital costs**

There is significant variation in out-performance over the AMP4 period, with two years' out-performance being more than balanced in the subsequent two years. Final year forecast outturn is a significant out-performance of £0.5m. If the final year outturn is in line with forecast then there will be a net efficiency over the AMP4 period of about 4.5% (£14.342m revised FD04 forecast to be delivered for £13.698m).

## **2.5 Conclusions**

### **(i) Assumptions about future efficiency**

Cambridge Water has taken account of the feedback to its draft business plan, and obtained revised market data for many of the assumptions of external costs. Its assumptions are therefore fully up to date for the final business plan and take account of the reduced costs in the construction sector, as experienced locally. Whereas the Company's DBP did not forecast any opex efficiencies, it is now forecasting 1% per annum. The Company is constrained by current contracts and believes that for pipeline repair and maintenance a step-change to market rates was unavoidable. Given the expectations for external costs, this appears to be a reasonable assumption.

No opex savings resulting from AMP5 capital schemes have been assumed for MNI schemes as the Company assumes that these are included in the overall opex savings of 1% per year. It is not clear to the Reporter what proportion of the opex savings are provided by savings from projects included in the capital programme.

For the FBP the Company is assuming capex efficiencies for infrastructure projects of 10% by 2012/13. The Reporter considers that the Company is realistic in assuming that there is scope for reducing infrastructure costs in AMP5. The approach used to derive the efficiency assumptions is considered to be detailed and robust.

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**(ii) Inclusion of efficiency assumptions in the plan**

The assumptions about future cost increases have been carried forward to the capital and operational aspects of the business plan.

**(iii) Stage at which efficiency assumptions have been applied**

The Company has projected future costs it expects to incur, based on its judgement of market rates, so efficiency assumptions (for example from procurement) are effectively built in to the cost estimates (rather than subtracting an efficiency assumption from current costs).

**(iv) Operating efficiencies**

The table B2.2 has been completed in accordance with Company Guidance.

**(v) Capital efficiencies**

The table B2.2 has been completed in accordance with Company Guidance.

## **2.6 Table commentaries**

The tables have been completed in accordance with the Company Guidance.

### **Table B2.1a – operating expenditure out-performance in AMP4**

**Line 3 (Supply demand costs logged up):** The costs are the result of increased numbers of meter optants compared with those assumed in the FD04.

**Line 11 (Pension adjustment to reported operating expenditure):** The adjustment for the difference between FRS17 and SSAP24 is taken directly from a letter from the Company's Actuary.

**Line 12 (Other adjustments to reported water operating expenditure):** Reporting the difference in mains diversion activity from that assumed in FD04, which Cambridge Water records as Opex.

**Line 14 (Actual out-performance opex):** The adjusted outturn for the years 2007/8 and 2009/10 was forecast to be more expensive (2008/9: -£0.378m; 2009/10: -£0.112m, from lines 10 and 13) than assumed in the FD04 assumptions, but out-performance is shown as nil in the calculated results in line 14. This complies with the Company Guidance (PR09 CG B2 pg 7 para 5).

### **Table B2.1b – capital expenditure out-performance in AMP4**

**Line 3 (supply demand costs logged up):** Increased numbers of meter optants compared with those assumed in the FD04. See also the adjustment in Line 8.

**Line 8 (merger savings):** Cambridge Water has used this line to correct for a difference in COPI and RPI assumptions between its own financial planning and the values assumed by Ofwat in the calculation of Line 1. This price base adjustment has the effect of increasing Cambridge Water's adjusted regulatory expectation for AMP4 yrs 1-3, making it appear to be more efficient compared with the values used in Line 1. But it reduces the expected outturn for yrs 4 and 5.

**Line 9 (Rephasing of programmes):** Rephasing adjustments sum to zero over the AMP4 period, as required in the Company Guidance.

Rephasing has been done by reviewing the anticipated delivery date for individual projects and updating the expenditure forecast for each year.

**Line 13 (Actual out-performance – water service capex):** Cambridge Water attributes the £2.405m overspend relative to FD99 assumptions in the year 2004/5 to building its new office, when it relocated from Cambridge city centre to Fulbourn. The costs were not included in the PR99 or PR04 business plans so they show as overspend. As mentioned in our DBP report, the re-phasing effectively transfers out-performance to the final year.

## **Table B2.2 – Water service efficiency improvements**

### **Block A – Operating expenditure (base)**

**Line 1 (Assessment of relative efficiency):** Ofwat's revised methodology for assessing relative efficiency has resulted in the Company moving from band B in 2006/7 to band D in 2007/8. The Company has submitted a 'special factor' to support its case that it is more efficient than Ofwat's current assessment suggests.

**Line 2 (scope for opex catch-up efficiency):** The Company has assumed catch-up of 1% per annum, compounding to 4.9% for the AMP period. It has made this assumption after reviewing the results of the January 2009 Relative Efficiency Report and the potential of its ongoing efficiency programmes. The assumptions appear to be reasonable.

**Line 3 (Assume continuing opex efficiency):** The Company has assumed that it will be able to maintain stable costs and that there is no scope for continuing efficiency beyond its catch-up efficiency assumptions. In its DBP, the Company assumed that costs would increase and also included cost effects of business dis-aggregation and accounting separation.

### **Block B – Operating expenditure (enhancement)**

**Line 5 (catch-up factor):** The Company has assumed that catch-up opportunities will be the same for base and enhancement opex (factor = 1)

**Line 6 (assumed enhancement opex catch-up profile):** The Company has not used this line because it considers that its cost forecasts are net of efficiency.

**Line 7 (continuing efficiency factor):** The Company has assumed that opportunities for continuing operational efficiency of enhancements will be the same as for base opex.

**Line 8 (continuing efficiency profile):** Therefore follows the same profile as Line 3 – i.e. stable costs. For AMP6 the Company has assumed that costs will remain stable (in its DBP, CAM assumed costs would rise faster than inflation).

### **Block C – Capital maintenance (infra)**

**Lines 10 and 11:** The Company has assumed an efficiency improvement of 10% by the year 3 of AMP5 as it believes that infrastructure installation costs will fall. The validity of capex programme assumptions is discussed in our report on section B3.

### **Block D – Capital maintenance (non-infra)**

**Lines 12 and 13:** Cambridge Water has not used these lines to forecast ongoing efficiency improvements because it considers its non-infrastructure capex costs to be forecast net of efficiency, based on project-level cost estimates. The validity of capex programme assumptions is discussed in our report on section B3.

### **Block E – Capital enhancement infra**

**Lines 14, 15, and 16:** In line with its assumptions on capital maintenance infrastructure efficiency, the Company has assumed a 10% reduction by year 3 in AMP5. The validity of capex programme assumptions is discussed in section B4, B5, and B6.

### **Block F – Capital enhancement non-infra**

**Lines 17, 18, and 19:** In line with its assumptions on non-infrastructure capital maintenance efficiency, the Company considers that its non-infrastructure costs are net of efficiency, as they are based on bespoke estimates for individual projects. The validity of capex programme assumptions is discussed in section B4, B5, and B6.

### **Block G – Capex meters**

**Lines 20 and 21:** Cambridge Water has not forecast ongoing efficiency improvements because it considers its capex costs to be forecast net of efficiency. The validity of capex programme assumptions is discussed in section B3 and B5.

## **7 Part B7: Financial Projections**

### **7.1 Depreciation and asset lives**

#### **7.1.1 Methodology systems and processes**

##### **(i) CCD spreadsheet**

The Company have used the same methods for calculating depreciation and asset lives as used in JR08 and in previous June returns.

The Company calculates Current Cost Depreciation (CCD) using an Excel spreadsheet that was used in calculating CCD for JR08 and earlier June returns. The 2008 version includes capital additions for 2007/08 and the RPI increase for 2007/08. It contains individual worksheets for the various asset types and a summary worksheet that is used to calculate the CCD inputs.

The Reporter also considers that the Company's intention to calculate CCD directly in Navision using the CCD module will improve the robustness of their CCD calculation and reduce the possibility of human error. Problems with current methodology are:

- (1) Considerable manual intervention is required to sort and transfer data from Navision into the CCD spreadsheet.
- (2) The CCD spreadsheet depreciates the capital spend from the year following the expenditure, whereas the CCD module includes assets from the month an asset is created (as is the case for HCD).
- (3) CCD for short life assets is not calculated with HCD data from Navision used in the CCD spreadsheet.
- (4) The CCD spreadsheet needs to be extensively modified every year to calculate CCD for each June Returns.

The net effect of the simplifications associated with the approach adopted, is that CCD is underestimated. An approximate calculation indicates that the underestimate of CCD could be about 3%.

##### **(ii) Fixed asset register in Navision**

The financial system, Navision, includes a fixed asset register which can be used to calculate both CCD and HCD. Currently it is used to calculate only HCD. The Company plans to update this system to calculate both CCD and HCD. Within the Navision fixed asset register there is an asset life schedule and sub-schedule that covers 48 asset codes.

The fixed assets register involves breaking down assets at each site into their components. The Company reports that the engineering work for the update was completed and that the assets register has now been uploaded into Navision. The fixed asset register was not used in the FBP.

**(iii) Use of CCD module in Navision**

The Company plans to build on the updated fixed asset register in Navision by using the CCD module to calculate CCD. This will mean that in future CCD will be calculated directly in Navision and the manual insertion of data into the CCD spreadsheet will no longer be required. Another advantage of this is that CCD for short life assets will be calculated correctly. These changes would improve the confidence grade of the CCD data and also eliminate the time consuming process of updating of the CCD spreadsheet every year.

The Company are not sure when the necessary work will be complete but it has not been completed for the final business plan.

**7.1.2 Asset Lives in the fixed asset register**

The Navision fixed asset register has an asset life schedule with the following asset lives. These asset lives are used by the Company and they are inserted manually into the CCD spreadsheet.

**Assumed Asset Lives**

Asset Category	Asset Life (years)	Life Category
Computer equipment Telephone equipment	4	VS
Office equipment Software Vehicles Asset management planning	5	VS
Communications systems Major software investments (eg <i>Basis2</i> )	10	S
Plant (including pumps and valves) Standby pumps Other installations including security installations Domestic flowmeters and power meters	15	S
Control panels District meters	20	M
Meter installations	40	ML
Offices, depots, houses and water towers	60	L
Pumping stations, reservoirs and booster stations	80	L

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## **7.2 Table B7.3 Depreciation**

### **7.2.1 Reporter guidance**

#### **(i) Allocation of expenditure to life categories**

The Company allocates expenditure to life categories in accordance with their assumptions on asset lives set out in the table above. The procedures are the same as have been used in the preparation of the 2007/08 June Returns. The Reporter considers that they are reasonable but considers that they will be improved when CCD is calculated using the CCD module in Navision.

#### **(ii) Departure for rules and procedures**

The Reporter is not aware of any departures from the rules and procedures adopted in previous years and the reported asset lives are consistent with those used for the calculation of depreciation profiles and those of assets and lives reported in Table 34 of the 2008 June return.

#### **(iii) Calculation of depreciation charge**

The Company has not used proportional allocation between services and it has no impact on its depreciation charge.

#### **(iv) Accounting rules used for depreciation**

The Company's rules for depreciation on additions have not been stated in their commentary, but are the same as in the June Returns. They have though stated their accounting rules on WIP. Their rules have been followed in the completion of the tables.

The Company have not commented on asset life assumptions which are the same as in the June Returns.

#### **(v) Review of asset lives**

The Company have re-valued their assets for the final business plan. Their approach to asset lives is consistent with that used in recent June Returns and this approach is used in Table B7.3. Asset lives were not reviewed when the fixed asset register was revised.

#### **(vi) Consistency with capital programme**

The Reporter confirms that the allocation of capital expenditure across asset life categories is consistent with the assumptions on the capital programme made elsewhere in the plan.

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### **(vii) Inconsistencies in asset lives**

The Reporter is not aware of any instances where the Company have not provided commentary on inconsistencies in asset lives and investment allocation between those used in previous years and those reported in Table B7.9.

### **(viii) Inconsistencies between engineering and financial judgements**

The Reporter has reviewed in the June Returns potential inconsistencies between the financial asset lives included in the accounting system and the likely engineering life of these assets. The potential inconsistencies identified are:

- (1) Flowmeters at reservoir and borehole sites have an asset life of 15 years whereas district meters are assigned a life of 20 years. This seems to be inconsistent and a uniform asset life of 15 years would be more reasonable.
- (2) Communication equipment generally has an asset life of 10 years except for when it is part of a security scheme where it has an asset life of 15 years. A uniform asset life of 10 years for all communications equipment should be considered.
- (3) Pressure reducing valves and pressure sustaining valves have an asset life of 20 years whereas other valves have an asset life of 15 years. An asset life of 15 years for all types of valves would be more appropriate.
- (4) Labour and installation costs for flowmeters have been assigned an asset life of 40 years. This issue was raised by the previous Reporter. An asset life of 40 years for these elements of work does seem to be excessive as meter technology and installation requirements are likely to change substantially over the next 40 years. A lower figure should be considered as it may better reflect the likely engineering life.

In aggregate the overall significance of these changes should they be introduced is not expected to be significant. The Company has not reviewed asset lives when the fixed asset register was updated and loaded into Navision.

## **7.2.2 Table commentary**

**Block E Lines 15 to 19:** The average asset lives set out in this table comply with the asset lives used by the Company in their June Returns and their Asset Inventory (see C3 commentary)

## **7.3 Table B7.7 Historic cost depreciation and amortisation**

### **7.3.1 Reporter guidance**

The Company has not used proportional allocation between services and it has no impact on its depreciation charge.

### **7.3.2 Table commentary**

#### **Block A Line 1:**

These data have been derived from the HCD data in Navision projected forward.

### **7.4 Table B7.8 Grants and contributions: amortisation**

#### **7.4.1 Reporter guidance**

The Company reports grants and contributions for meters, mains and infrastructure charges. The meter contributions have been given an asset life of 15 years (short) and the mains and infrastructure charges contributions an asset life of 80 years (long). This is in accordance with company procedures for these asset types. All contributions for meters, mains and infrastructure charges have been categorised as enhancements.

It is confirmed that the asset lives for grants and contributions are the same as those for the asset to which they relate.

#### **7.4.2 Table commentary**

**Line 4:** Grants and contributions allocated to this line are for meters. They are assigned an asset life of 15 years.

**Line 8:** Grants and contributions allocated to this line are for mains and infrastructure charges. They are assigned an asset life of 80 years.

### **7.5 Table B7.9 Depreciation of assets, non-infrastructure asset lives**

The lives allocated to the lines in Table B7.9 are in accordance with Company's historic practice and procedures.

The Reporter considers the asset lives in Table B7.9 to be reasonable, conforming to general industry practice.

There is no difference between the asset lives disclosed in this table and the asset lives adopted in prior years.

The inconsistencies between financial and engineering judgements noted in the commentary for Table B7.3 are not relevant to the categories listed in this table. The Reporter is not aware of any other inconsistencies.

The Reporter is not aware of any inconsistency in the reported lives with general industry trends for assets that are not company specific.

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## **7.6 Tables B7.10 and B7.11 Comparison of CCD and MNI expenditure for the period 1997-98 to 2024-25**

### **7.6.1 Reporter guidance**

The Reporter confirms:

- (1) That the CCD charge and the maintenance non-infrastructure expenditure for prior years are consistent with those already submitted in the June Return 2008.
- (2) That the CCD charge has been calculated using the same depreciable life categories given in Table B7.3.
- (3) That the forecast MNI expenditure includes the Company's assumption of no future efficiency savings.
- (4) That the Company has not amended its view on prior year's information.

The Company include two explanations for differences between CCD and MNI expenditure and they are; the CCD on long life assets that are not replaced during the period and the depreciation on the new headquarters building. The new headquarters building and its associated CCD is atypical and company specific.

### **7.7 Tables B7.13 Water service MEA revaluation reconciliation**

The company has carried out the revaluation exercise for the FBP and the Reporter agrees that the table adequately represents the movements in both gross and net MEA as a result of the revaluation.

## **8 Part B8: Revenue Projections**

### **8.1 Reporter guidance**

The Reporter has been asked to “*scrutinise and provide an opinion of the basis the company has used to forecast revenue streams for non-tariff basket revenue that are input on this table, highlighting any assumptions that the company has made, along with any supporting evidence.*”

### **8.2 Table commentary Table B8.1 Revenue forecasts**

The Company has entered data on non-tariff basket revenue streams on three lines in Table B8.1.

#### **Line 7: Large user and special agreements**

The income from large users and special agreements was £830k in 2007/08.

#### **Line 10: Rechargeable works**

The £187k/year entered in this line is for income from mains diversions. The assumed amount is a typical income from mains diversion works during AMP4. This income stream is unpredictable, as the high total of £1.53million in 2007/08 is a result of mains diversion work associated with the Cambridgeshire Guided Busway demonstrates.

The total of £187k/year is balanced by an equivalent operating cost.

#### **Line 11: Income from bulk supplies**

The revenue from bulk supplies is projected to increase by “K” throughout AMP5. No allowance has been included for any increase in charges during the remainder of AMP4 or AMP5. The impact of this would be to increase revenue but the quantum would not be significant.

## **9 Part B9: Overlap Programme**

### **9.1 Background**

The Company states that “*Cambridge Water does not have any projects which it expects to start in AMP5 and complete in future AMPs. We, therefore, have no data in table B9 and further commentary in this chapter.*”

### **9.2 Projects that start in AMP5 and will be completed in AMP6**

#### **9.2.1 SEMD site security programme**

In accordance with advice the Company's SEMD site security programme is split on a 60/40 basis between AMP5 and AMP6. As the programme is split into a large number of individual schemes the actual schemes are not split but are allocated on a priority basis to either AMP5 or AMP6.

## **10 Part B10: Large Projects**

Cambridge Water does not believe that any of its AMP5 projects fulfil the criteria identified by Ofwat for large projects and no projects have been included in Part B10.

The Reporter does not consider that any AMP5 projects should be identified separately as large projects.

## **11 B11 Capital Expenditure Incentive Scheme**

### **11.1 Reconciliation between draft and final business plans**

The Company has provided the required overview reconciling the difference between the draft and final business plans. The data is considered to be:

- Consistent with other parts of the business plan
- Consistent with the changes to outputs, expenditure and efficiency made between the draft and the final business plan.
- Consistent with company draft baseline as set out in Ofwat's national and company specific draft baseline documents.

### **11.2 Reflecting (CIS) incentives in the final business plan modelling**

The Company are seeking to have a CIS ratio of 100 in that they propose that the CIS baseline will be the same as their AMP5 capital expenditure.

### **11.3 Additional income**

As the Company have proposed a CIS ratio of 100, there is no additional income to calculate.