Statement of significant changes to primary wholesale charges

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(a) Introduction

This statement sets out potential significant changes to our primary wholesale charges for the 2024-25 charging year.

Our primary wholesale charges are set out in Section 3 of our Wholesale Statement of Principles and Charges document which can be found on our website (https://www.southernwater.co.uk/wholesale-charges). They are the charges that we make under sections 66E and 117I of the Water Industry Act 1991, to water and sewerage licensees with a retail authorisation or a restricted retail authorisation. The charges relate to the supply of water and sewerage services, both on an enduring or temporary basis, and including:

(i) fixed and volumetric charges and allowances;

(ii) any other charges set out in Section 3 of our Wholesale Statement of Principles and Charges document in relation to specific circumstances or events.

This statement of significant changes is published alongside our indicative primary wholesale charges for 2024-25, in accordance with Ofwat's wholesale charging rules (rule A3).

(b) Overall level of expected bill increases

Taken together, the impact of the factors referenced within this document are expected to result in an increase in non-household dual-service and water bills that are 8.5% – 9.0% above inflation (as measured by CPIH, assumed at 4.5%)[1]. The majority of non-household wastewater only customers will see increase at 6% above inflation. The increase to typical combined metered household bills will be 6% above inflation, slightly lower than the non-household impact due to a decrease in retail charges.

As required by Ofwat, the Board has considered customer impacts and handling strategies where customer bills are increasing by greater than 5%.

We will be consulting further with our stakeholders, including customers, retailers and customer representatives, about the scope for changes to our 2024-25 final charges.

Our 2024-25 charges will be available for final publication, once they have been reviewed and approved The Board of Southern Water Services Ltd., no later than 13 January 2024 ("Final Charges"). The level of Final Charges may vary from those of the Indicative Charges.

(c) Factors affecting the level of our wholesale charges for 2024-25

Under Ofwat's regulatory formula, each year we can increase our charges by inflation, as measured by CPIH, plus or minus a percentage determined by Ofwat – known as the K factor. The K factor reflects Ofwat's assessment of the efficient costs of running our business as determined at the 2019 price review.

In addition, charges reflect any penalties or rewards associated with performance against our Ofwat targets (ODI payments) in previous years, adjustments in relation to under or over-recovery of revenues in previous years.

Inflation

Our charges for 2024-25 will reflect inflation, as measured by the November 2023 CPIH figure published by the Office for National Statistics. The latest forecast for November CPIH inflation is 4.5%. This value may be higher or lower by the time final charges are set.

[1] These % changes include ODI impacts that are based on our own view of in-period adjustments, which may differ from Ofwat's final determination of these adjustments and we are consulting with Ofwat soon to potentially defer a proportion of these penalties. The final charges will take account of Ofwat's final decisions on in-period adjustments.

K factor

In its final determination, Ofwat's assessment of price limits, Ofwat set a K factor of (1.5%) for wholesale water and (1.1%) for wholesale wastewater.

Impact of performance in previous financial years

Actual revenue recovered in 2021-22 was lower than allowed by Ofwat in the Final Determination. Due to exceptionally high inflation, we deferred the recovery of this revenue in 2023-24.

Wholesale water

For wholesale water, the impact of adjustments relating to prior year revenue variances increases revenue by 10.9%, which is partly offset by the ODI penalties' impact of (6.0%). A downward trend in consumption is resulting in a further increase to charges of 4.4%.

The overall net increase to wholesale water charges, without mitigation, is 13.4%, which is 8.9% higher than forecast CPIH.

Wholesale wastewater

For wholesale wastewater, the impact of revenue under-recovery in 2022-23 results in an increase to revenue of 4.8% in 2024-25. The downward trend in consumption is contributing to a 3% increase.

The overall net increase to wholesale wastewater charges is 10.4%, which is 5.9% higher than forecast CPIH.

Retail revenue is lower by 6.0%, which has the effect of offsetting some of the wholesale charges increase for household bills.

Impact of Covid-19

In setting charges, we need to forecast the number of properties and consumption for the year ahead, to ensure that our charges recover our allowed revenues from the price control. The Covid-19 pandemic has led to significant changes in the water consumption of both households and businesses which is still unwinding. Forecasting the ongoing impact of these changes continues to be a challenge and it is important that we reflect the latest available information in our forecasts.

(d) Significant changes in charging policy

Social Tariff: 'Essentials' tariff

In 2021-22, we amended the eligibility criteria for our social tariff so that we could engage with more customers in need of financial support. In 2022-23, in response to the cost-of-living crisis our customers were facing, we significantly increased the minimum discount offered from 20% to 45% and increased the customer cross-subsidy so we can reach even more customers who are most in need.

In 2024-25 we will again increase the cross-subsidy to the maximum value of £13, which was accepted by customers as part of our PR19 Willingness-To-Pay research. We will continue to offer a minimum 45% discount, and this additional funding will allow us to support 158k customers by the end of AMP 7, which exceeds our PR19 target by 50%. This will result in additional meaningful support and benefit to our most vulnerable customers.

Large User Tariff

We are continuing a phased approach to reducing the discount that Large Users attract. To date, the charges have reflected the difference in costs between users of the whole distribution network and those that only use larger diameter pipes.

With a growing population and impacts of climate change, we are operating in an increasingly water-stressed region. On that basis, we need to invest more in water resources and remove incentives to use higher volumes of water. Removing this discount will be more reflective of the long-run costs associated with providing water.

Currently, there are just over 810 non-household connections attracting these discounted Large User Tariffs. 230 of these customers are water only customers and on average their bill increase is 0.8% greater than the wholesale charges increase of 13.4%. The highest increase is 22.9%.

For the remaining dual-service customers the average combined bill increase is 12.2% which is in line with the increases for standard non-household customers. The highest increase is 23.7%. We intend to support all our large user customers with targeted water efficiency interventions to help them be as water efficient as possible before the tariff is removed. We will continue to consult with our regulators in advance of publishing final charges in relation to mitigating bill shock for customers.

New ammonia charge for trade effluent

We introduced a separate trade effluent charge for ammonia within the Mogden formula for the first time in our 2021-22 charges. The decision was made to introduce this charge in a phased way, to minimise the impact on affected customers whose bills could have increased by more than 5%. This means that full cost-reflectivity for this charge will be achieved over a number of years. We will continue with this phased approach in 2024-25 charges to appropriately balance the competing objectives of stable bills and cost reflectivity.

Removal of non-household fixed charges

In 2017-18, we introduced a new transitional fixed charge for non-household customers. This was intended to help smooth the transition to the opening of the non-household retail market and reduce the risk of bill increases for larger customers. When we introduced these fixed charges, we made clear that they were temporary and that they would be phased out over time.

We removed the fixed wastewater charges in 2020-21 and reverted to fully volumetric charges. We intend to phase out and remove our water fixed charges but are committed to doing so in a way that does not lead to significant bill changes for customers. We will not be considering further phasing out of these charges in 2024-25 given charges are already, but likely commence doing so from year 1 of AMP 8.

E) Innovative tariff development for the future

Social Tariff: ‘Essentials’ tariff

While we already provide a significant minimum discount of 45% to our customers most in need, we are aiming to increase our reach of customers significantly in AMP 8. We have completed further extensive customer research which now supports an increase to the cross-subsidy, bringing it to £20 per annum in today’s prices.

Our bespoke affordability models have provided insight into the volume of customers likely to be eligible for more support, and we continue to review options with our Board regarding funding to increase the reach of support to all in need.

Surface water drainage fixed charge

Our existing tariff structure reflects a fixed annual charge to recover the costs of surface water drainage for all customers. The charge is linked to meter-pipe-size of a customer and the vast majority of both household and non-household customers incur the lowest charge of £25.

We are currently investigating the potential benefits and customer-impact of moving to site-area-based-charges or volumetric-band charges. We have identified that such bases of charge could more accurately reflect the costs associated with the drainage of surface water into our network and/or serve to apportion the burden of charge more appropriately. We have also identified that such a change to this charge could serve as a catalyst to encourage the use of more sustainable drainage systems across our area, and we are keen to work with our customers to support such enhancements.

While we will not reflect any change to the existing basis of charge in 2024-25, we intend providing “shadow charges” for those customers with very large site areas draining to our network by year 1 of AMP 8. We hope that such shadow charges will help us to assess customer impact and to identify benefits and potential next steps for this project.

Our 2024-25 Indicative Wholesale Charges also reflect an adjustment to the balance of revenue recovered via surface water drainage charges versus foul water treated, without altering the basis of charge.

Tariff trials - Rising Block tariffs

As part of the PR24 drive for innovation in charges to support affordability, we welcome Ofwat’s request to commence trials in advance of AMP 8. We have already completed some customer research and internal analysis of consumption to assist in the development of progressive and effective tariffs to support our affordability and sustainability goals.

The guiding principles for the design of a tariff trial include:

- Simplicity - for customers to understand and engage
- Affordability – to support our customers with increasing bills in a cost-of-living crisis
- Sustainability – information and signals for behaviour change in our water-scarce region
- Support – vulnerable customers and those most in need will not be disadvantaged

We have decided to commence a trial in 2024-25 using rising block tariffs and will share details in due course regarding consumption analysis, tariff design and trial size.