

Ofwat Consultation

4th August 2017

New Connection Charges for the Future – 5th July 2017

The Home Builders Federation (HBF) welcomes the opportunity to respond to this latest Ofwat consultation “New Connection Charges for the Future”. Given the significant change these latest proposals are likely to make when it comes to new housing delivery we have sought to set out the house building industry’s views in such a way that further debate/discussion can take place from an informed perspective.

HBF is the representative body for house builders in England and Wales. HBF’s membership of more than 300 companies build most of the market sale homes completed in England and Wales, and encompasses private developers and Registered Providers. As the main trade association for the house building industry our members constitute one of the largest customers who will be affected by these proposals. As such, we trust that Ofwat will attach appropriate quantitative and qualitative weight to our response, in particular when making any decisions arising from this consultation.

Under section ‘A5 of the consultation, i.e. “*Upfront Charges - Assessment of Approaches*”, we noted how some WaSCs and WoCs¹ were being less than transparent in disclosing their costs – this is an issue for house builders as it works against the principles on which the system should operate. Moreover, the consultation included no question(s) related to this particular aspect, nor for that matter, any detail as to what this will mean when dealing with infrastructure requisitions and/or diversions. From HBF’s perspective this is somewhat concerning in that one of main stated reasons that the Charging Rules and the Water Act 2014 were taken forward was to allow developer customers to obtain that granularity of charges which they are denied at present. To produce two lines to say that a scheme will cost, say, £200,000 is unfair and unacceptable, especially if the objective is for key

¹ From here on and for ease of communication when we refer to WaSCs this also includes WoCs.

customers to have trust in a vital part of the utility sector. Developer customers must have a clear and confident understanding of what they are being asked to pay for, and on what basis. We would, therefore, ask Ofwat to note our concerns in this regard and to provide clear and unequivocal Charging Rule guidance as we move forward.

Consultation Questions

Question 1

In considering our response to this question we welcome the fact that Ofwat is looking at options to promote competition in this area. The HBF is always open to constructive and well thought out ideas in this regard, especially when it comes to the ongoing reforms in the Water & Sewerage Sector. **Unfortunately, we have concerns about option 3, (as defined in this consultation) to the extent that we do not believe we can support the proposal for a number of compelling reasons:**

1. After due consideration and following the subsequent e-mail exchanges after our related discussions on 28th July 2017, our current belief is that option 3 will place our Members in a position of having to accept higher charges for the provision of water mains on their developments. The concept of ‘aggregation of charges’ goes against a number of the principles set out/confirmed by Defra in the Charging Rules Guidance issued to Ofwat in December 2016.
2. The fact that charges will be spread across all new connections irrespective of whether it is a new water main requisition or if a connection is being made directly onto an existing incumbent water main, is at variance to the now established/crystallised Defra Guidance. Based on the experience of our members we estimate that about 20% of all new connections are made directly onto existing water mains. Consequently, this would result in an immediate lowering of charges by a broadly proportionate level.
3. We are very keen to see far greater competition through the wider introduction of NAVs in the Water & Sewerage Sector – we have noted that this latest consultation/proposal appears to be driven by that objective. However, Defra’s Guidance to Ofwat on the Charging Rules is only aligned to principles and charges

specific to the Water Industry Act 1991 rather than an attempt to deal with any problems that may exist (perceived or otherwise) with the imbalance NAVs encounter when trying to compete against the WaSCs and SLPs. In our discussions with NAVs we have been made aware of a number of issues which rightly need addressing in order to make NAVs able to compete with other water and sewerage infrastructure providers on a 'level playing field'. As an aside, we would expect the costs associated with foul sewer connections and especially offsite connections, requisitions and reinforcement to be highlighted in the Frontier Economics report – the earliest possible disclosure of this report is considered an essential requirement if we are to approach any Charging Arrangements on an informed and transparent basis. Moreover, it is also relevant to the whole issue of the Charging Rules, in particular the commercial relationship between WaSCs and NAVs, in particular, when it comes to the major imbalance that exists where developers build foul sewer assets and gift them to either a WaSC or NAV. Over time the view taken by Ofwat that offsite network reinforcement would not be charged to developers due to the above gifting of onsite sewers seems to have been disregarded by both Ofwat and all WaSCs. It is important to point out that these offsite reinforcement charges can, in many circumstances, be considerable. Moreover, in nearly all cases, the need for such charges is unproven and in the vast majority of instances unwarranted. Therefore, if we were to seek the introduction of the same concept as the options in this consultation it would result in a major impact on existing customers. The point we are trying to bring to the attention of Ofwat here is that NAVs are not the only organisation that encounters charging disparity.

4. If we are to achieve the objectives, as set down by Defra in its Charging Rules, there is considerable merit in comparing what happens in the energy sector. Typically, and for good reason, aggregate charging has been avoided in both the gas and electricity sectors. We venture to suggest that the overarching reason for this lies in the fact that there are a number of variables that work against making 'gross value' assumptions, i.e. they have the propensity to be unrealistic and unrepresentative. In many respects a 'generic' approach does not really work for onsite infrastructure. A 'swings and roundabouts' concept may seem advantageous in theory but in practice, development characteristics vary considerably. For example, housing

density, housing typology, highway design, the length of the water main(s) needed and the size of water main required to serve each individual site can have considerable influence. Similarly, water & sewerage infrastructure has its own set of variables, for example supply demand, asset capacity and functionality and not just throughout the UK, but also down to the site/location specific level within each WaSC. In practical terms and given the degree of variability, it appears to HBF that it is near impossible to fix an income offset which is fair, reasonable and representative and one that can be introduced without distorting competitive market dynamics.

5. We are unclear how adopting option 2a, 2b and 3 will affect the legal rights to gain access across third party land. This is an issue of significant importance to developers - the Water Act 1973 effectively resolved the issue of ransom potential but the present Charging Rules appear to be taking us back to the pre-1973 condition. To lose the ability to gain access across third-party land and to be held to ransom will not only affect costs it will inevitably make many sites unviable and **fewer homes will be built**. As we understand at present, NAVs will have no statutory ability to gain access to and/or across third-party land at minimal cost and thereby negate the inequitable demands of unscrupulous land owners. In other words, have the same statutory powers of entry enjoyed by incumbent WaSCs. This is a key area for consideration as it has a direct impact on a NAV's ability to compete on a level playing field. As such, we would welcome further discussion on this issue.
6. Consultation Issue - The Complexity of the Calculation for the DADS and Asset Payment. – We agree that it is complicated but if Ofwat and the WaSCs were to collaborate on a simple process which allows variables, i.e. scheme cost, build rate and customer tariff, to be varied in calculations, we would suggest that it would go a long way towards addressing this inherent complexity. It is not unreasonable to expect that WaSCs and Ofwat have such calculation capabilities so why is it not possible to produce something that can be used by all stakeholders?

7. Consultation Issue – SLO Lack of Transparency – Again we agree with this and we are of the opinion that Ofwat will go a long way to addressing this issue by introducing the new, combined infrastructure charge. This will remove a large part of the complexity that exists at present, in particular, when WaSCs introduce ‘charges’ within their terms and conditions for dealing with requisitioned network reinforcement and strategic infrastructure. Coupled with our earlier suggestions in this response, it would seem to be a logical way forward leaving only the greater cost transparency on the part of WaSCs as part of a commitment to provide a detailed breakdown of scheme costs.
8. Consultation Issue – SLO not receiving Asset Payments – At the moment SLOs and developers receive Asset Payments after the water main has been completed but only after it is deemed that the works have met the necessary standard to warrant the payment. In essence, this is a normal contracting arrangement. Under option 3 there would be no Asset Payments. In light of this, the consultation fails to address the issue of what WaSCs will need in place of the Asset Payment to protect themselves from substandard installations. Clarification is required. It is likely that this will be some form of bond. If this is the case would it be a cash bond or third party bond? In our opinion this would prove hard for a SLP to fund and/or obtain and would result in a major barrier for SLPs to operate in this market. At least with the Asset Payment being paid after the works are completed the WaSC has some security against the quality of the works.
9. Consultation Issue – The Income Offset is only paid when developers require On-site Water Mains – We are somewhat confused by this issue as income offsets are only applicable where new water mains are required. Why those properties that are connecting directly to an existing water main are subject to this change is difficult to understand. We would welcome an Ofwat explanation as to why this is the case as this contradicts the provisions of the Water Industry Act 1991. The inference is that developers gain some form of financial advantage through income offsets which needs to be shared with the wider developer community, however, this has yet to be explained to the point of being coherent or justifiable. This is contradictory as in the past an Ofwat determination resulted in a refund to developers who only

requisitioned water mains. In one particular determination involving Anglian Water, the refund was evaluated by over-estimating the apportionment specific to a strategic water main when considering the impact of new development(s). However, Ofwat decided that the refund would not take into consideration those connections which did not have a requisition. If the growth was spread across all connections it would have resulted in a greater refund to those developers who requisitioned their water mains. Yet Ofwat in this consultation appears to suggest the opposite approach which requires a more detailed explanation.

10. Consultation Issue – Defra Comment ‘Quicker, easier and cheaper for Self and Custom Builders to connect to the water and sewerage works’ – It is difficult to understand how option 3 would make any difference to the above unless it would mean that developers building a single plot would not have to apply for a connection under section 45 of the Water Industry Act 1991. Moreover, we cannot see any reason why these developers should not have access to a SLP to make these connections. Why these developers should gain from other developers who have had to install water mains on their sites is really difficult to understand.

11. Consultation Issue – The Income Offset could lead Developers to make inefficient decisions on the location of new Developments and a Developer might choose to build in a high cost area, rather than a lower cost area, because there is little or no difference in the relative requisition cost – From a developer perspective the issues above are not a material consideration. Where a developer decides to buy land and build houses is first influenced by the planning system and thereafter the affordability of the scheme. The main issue which the WaSC does influence is in the need for offsite network reinforcement – in many cases; this can be a substantial cost.

Question 2

It has not been possible to fully evaluate the Impact Assessment supporting the consultation on the grounds that it appears to be void of sufficient detail, in particular when considering quantum. For the house building industry to give an informed view we would need far more granularity of costs. At present, the consultation appears to be considering just principles but principles can be undermined once the actual/true cost is known.

The interesting aspect of this consultation is that Ofwat appears to be implying that there is a benefit to developers who proceed to requisition water mains and make a connection onto the requisitioned water main when compared to a developer that only needs to connect directly onto an existing incumbent's water main. We cannot see this either practically or in Ofwat's Impact Assessment supporting this consultation.

It would also be of some help to understand the cost differentials highlighted in the Frontier Economics report to see how NAVs are finding it difficult to compete against WaSCs.

Question 3 & Question 4

Because we are unable to support option 3 we do not believe it necessary to provide Ofwat with a response to these two questions.

Summary/Conclusion

As much as Ofwat may see our response as not supporting option 3 we do hope that it can be seen as a productive way forward to stimulate debate and discussion on the important issues that have been identified.

The absence of quantum still raises concerns for our members as there is a lack of clear, unequivocal cost data. In many respects there are procedural issues that can and will have a direct bearing on any organisation's ability to compete. We understand how the WaSCs currently operate, similarly, SLPs. However, NAVs in having other commercial considerations to take on board, for example, bulk supply tariffs, sewerage disposal tariffs, water quality testing costs etc., must be starting from a disadvantaged position already as these costs will surely have an impact on competitiveness and the level of income offset? In addition, SLPs not only provide water and sewerage infrastructure but can also deliver every other utility service subject to meeting the appropriate accreditation standards. Therefore, what stops the SLP from exercising a more competitive edge by using its commercial relationship with other parts of the utility sector to win greater market share from NAVs, and the Sector as a whole, and at a more competitive cost? Conceivably, one of the unintended consequences that has not been considered?

HBF is in favour of the introduction of NAVs as we consider that they provide another option to service new developments and as such they could be a viable alternative to the incumbent WaSC. In closing, we would welcome the opportunity to see the Frontier Economics report when it is issued on how a level playing field can be achieved for NAVs. Therefore, we will have to reserve our final judgement on this consultation until we have had the opportunity of evaluating the report prepared by Frontier Economics.

HBF London

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