

APPENDIX DS12-2

Communication sent to customers on 11 October 2019

Important changes to charges for new developments from 1 April 2020

Dear customer

We are writing to you to inform you of some important changes that affect the way we charge for services to support new developments. These changes, which affect our developer services customers i.e. developers, self-lay providers (SLP) and new appointments and variations (NAV), are as a consequence of new charging rules that have been introduced by our regulator, Ofwat:

<https://www.ofwat.gov.uk/publication/charging-rules-new-connection-services-english-undertakers/>

Background

In April 2019, Ofwat issued a consultation in which they confirmed their latest charging rules for new development, to be applied from 1 April 2020. As a consequence of the new charging rules, all water companies will be changing the way they charge customers that require new connections to their networks.

Ofwat's consultation can be found at:

<https://www.ofwat.gov.uk/consultation/consultation-on-charging-rules-for-new-connections-and-new-developments-for-english-companies-from-april-2020/>

In summary, the key changes and rules are:

1. Currently, developers pay a proportion of the cost of providing new water mains and sewers. The remainder of the cost has been funded by the future water and/or sewerage revenue we receive from occupiers of the new homes and buildings that that developers connect to our water and sewerage networks. The use of this future revenue is commonly referred to as income offsetting. The new charging rules mean there are to be no income offsets for requisitioned water mains and sewers in the future. Thus, where a developer requisitions water mains or sewers from us they will be charged the full cost. Where a developer asks an SLP to construct water mains for them and we agree to adopt the mains, we will no longer pay an asset payment (equal to the income offset amount) to the SLP or developer. This will result in a significant increase the charges developers pay us in relation to new water mains and requisitioned sewers from 1 April 2020.

Ofwat has made this change to enable NAVs to compete on a 'level playing field' with SLPs and incumbent water companies for the provision of new water mains and sewers required to serve new development sites.

2. If water companies wish to continue applying income offsets, the charging rules require that they must be applied to infrastructure charges. This would enable the same amount of income offset to be applied to developments irrespective of whether water and/or sewerage infrastructure is constructed by a water company, self-laid or provided by a NAV. Ofwat has confirmed they do not require water companies to offer an income offset and have not said how it should be calculated or what level it should be.
3. Ofwat has confirmed that they expect the balance of charges developer services customers to pay to be equivalent to the position that existed prior to 1 April 2018.
4. Ofwat has confirmed that the infrastructure charge income water companies receive must continue to match their average spend on network reinforcement over the five years to 31 March 2023.

Our position

In the three years prior to 1 April 2018 the aggregate income (related to new mains, service connections, requisitioned sewers and infrastructure charges) we received from developer services customers matched our costs to support development.

As a consequence of Ofwat's latest charging rules we are required, in the five years from 1 April 2020, to maintain the matching balance in our charges that existed prior to 1 April 2018. We are projected to have, on average, £18 million per year of costs to support development across our operating areas in the North East and in Essex and Suffolk.

In order to match our income to our forecast of network costs required to support new development growth, it is our intention to:

1. Apply a zero income offset to water and wastewater infrastructure charges, and
2. Reduce water and wastewater infrastructure charges to match our current forecast of network reinforcement costs.

From 1 April 2018 we reduced our water infrastructure charges significantly from £365 per house to £185 per house¹ and our wastewater infrastructure charges from £365 per house to £335 per house². These changes came about as a consequence of new charging rules

¹ We introduced a scheme to incentivise developers to construct water efficient houses. Where a house meets certain water efficiency eligibility criteria (105 litres per capita per day) we charge zero infrastructure charges, on receipt of a relevant claim.

² We introduced a scheme to incentivise developers to construct houses that drain surface water away from our existing sewers. In such cases we charge a wastewater infrastructure charge of £50 currently for eligible houses.

that Ofwat introduced at the time. Rules were introduced to ensure water companies' infrastructure charge income matched the forecast of network reinforcement costs for their water and wastewater networks.

Since 1 April 2018 we have been monitoring our expected network reinforcement costs and, if the current trend continues, we will require less income than originally forecast to fund reinforcement work up to 31 March 2023. We therefore intend to reduce our water infrastructure charges to around £135 per house and our wastewater infrastructure charges to around £235 per house for the charging year that begins on 1 April 2020. We will continue to offer incentives for water efficient houses and those where surface water drains away from our existing sewers.

Our intention is to publish some comparison scenarios to show the transition of charges from before April 2018 to post April 2020. We will share these with you by the end of this month.

Transitioning to the new way of charging

Moving to new ways of charging presents uncertainty for customers, particularly where they may have already committed to a development based on previous charging arrangements. We have drafted transitional arrangements to cater for those instances and they are attached as an appendix below. The transitional arrangements set out our intended approach for those developments already underway and those being proposed in the lead up to 1 April 2020.

Your feedback

These new charging rule changes will have an impact on the way we charge customers going forward. We hope that this communication is useful in helping you to understand how things will change from next April. If you have any comments that you would like to share with us, we would be pleased to hear from you by 15 November 2019. You can write to us using our email address ConnectConsult@nwl.co.uk or contact the following members of our Developer Services team who will be happy to talk to you:

[Redacted contact information]

Draft transitional arrangements for new development charges post 1 April 2020

This document sets out our proposed transitional arrangements that apply to some of our charges for new developments as a consequence of the introduction of Ofwat's "Charging rules for new connection services (English undertakers)", published on 2 July 2018 (the "new rules").

The transitional arrangements to which this document refers are limited to:

- Income offsets where water mains and/or sewers are requisitioned
- Income offsets where water mains are offered to us for adoption
- Income offsets associated with development sites where a NAV has provided water mains and/or sewers
- Water and wastewater infrastructure charges

Moving to new charging arrangements presents uncertainty for customers, particularly where they may have already committed to a development based on previous charging arrangements.

Income Offsets

Our proposed transitional arrangements are as follows:

1. Quotations for water mains and/or sewer requisitions provided under current arrangements, which apply up to and including 31 March 2020 (the "old rules"), and accepted before 1 April 2020 are to continue to apply until 1 April 2025 unless we agree to vary the quotation in consultation with the customer.
2. Where a legal agreement is already in place in relation to water mains and/or sewers as part of an adoption, then the charges defined within that agreement remain valid for the life of the agreement unless we agree to vary those charges in consultation with the customer.
3. Where a legal agreement is already in place with a NAV then the income offset amounts defined within that agreement remain valid for the life of the agreement unless we agree to vary those amounts in consultation with the customer.
4. Charges relating to the old rules will be adjusted by inflation if the quotation or legal agreement includes an appropriate provision for adjusting the charges.
5. Applications for water main requisitions, sewer requisitions, self-lay water mains and those relating to NAVs received between 1 February 2020 and 31 March 2020 for relevant work that will be carried out after 1 April 2020, will be quoted under the old rules. During this period, developers, SLPs and NAVs can opt to be quoted under the new rules, if they prefer.

6. Developers, SLPs and NAVs that have received a quotation or draft agreement under the old rules, but have not formally accepted can re-apply after 1 February 2020 for a quotation in accordance with the new rules.

Infrastructure Charges

1. After 1 April 2020, connections made to a water main or sewer that was provided as a requisition under s41 or s98 of the Water Industry Act 1991 respectively, or a water main that was self-laid under s51 between 1991 and April 2018 will be charged using the new infrastructure charge.
2. After 1 April 2020, connections made to assets other than those above will be charged in accordance with the new infrastructure charge as defined in the rules.