08 June 2021

Via email: charging@ofwat.gov.uk

Dear Ofwat,

Re: A consultation on the scope and balance of developer charges and incentives

Thank you for the opportunity to respond to this consultation. Affinity Water are supportive of work across the industry relating to the scope and balance of developer charges and welcome the constructive report by Frontier Economics which supports this consultation.

Affinity Water have been very active in the work relating to developer charging, taking a prominent role in the new connections charging working group relating to standardising terminology and worked examples across the industry. Our consultation response, therefore, considers the Frontier Economics report, as well as wider conversations ongoing relating to charging.

In general, we support the recommendations set out by Ofwat and understand the economic principles which underpin each proposal. However, our response shares some concerns related to stakeholder engagement, particularly with regards to the proposal to remove income offset from 2025. As this would significantly increase the cost for developer customers, we would request Ofwat to collaborate with the industry to create and agree a stakeholder management plan and ensure water companies are aligned on engagement activities to limit any negative impact on our customer base. As this would be a change to charging rules, we see Ofwat as leading any consultations and supporting engagement, including timely publication of any consultation outcomes. We would request that this is not simply part of annual charging consultations carried out by individual water companies.

We also note that there is a strong narrative within the consultation for water companies to do more with regards to incentivising water efficiency. At Affinity Water we strongly support this notion and have recently commenced a demand management campaign 'SOS: Save Our Streams', with positive initial feedback from our customers. We also promote water efficiency through our new connections charging arrangements, with an £80 discount against the infrastructure charge for properties built to a standard of 110 litres per person per day. Whilst we agree that we, as water companies, should do more in this area, we note in our response that uptake on our environmental incentive through developer charging has not been significant and reforms in the planning process may have a bigger impact on building water efficient developments, and in turn, help improve water saving behaviours of end users.

Finally, we would request that thought is given regarding how outputs from this consultation interplay with upcoming charging consultations, particularly relating to cost-reflectivity and any future changes in new connection charging rules.

I hope you find our response helpful, please do not hesitate to reach out if you have any queries.

Yours sincerely,

[redacted]

Graham Turk

Director of Production & Supply

Cc: Pauline Walsh, CEO, Affinity Water
Amy Johnson, Head of Developer Services, Affinity Water

Q1: Do you have any comments on key conclusions from the Frontier Economics report?

Affinity Water welcome the Frontier Economics report examining proposals for future developer services charges. We believe the report provides an economically sound review of developer charges and is aligned to charging principles, particularly fairness and affordability and transparency for our developer customers.

Our comments on key conclusions are set out below.

Network Reinforcement

Network reinforcement charges linked to new development sites has been a charging topic for several years. Alongside the rest of the industry, we are faced with the challenge of meeting the demand of a growing population. This is particularly salient across our region. Currently, network reinforcement (including offsite costs for local assets) is recovered through the infrastructure charge and balanced across a 5-year time horizon. We agree with Frontier Economics assessment that this time period is too short in some circumstances, especially when managing large development schemes, or schemes which commence earlier than originally planned. This challenges water companies to balance a fairly stable infrastructure charge year on year, as well as reacting to a duty to provide water to a development. We would request the time period to be extended to 10 years.

Affinity Water's supply area is split into 3 regions. In 2019, as part of our charging consultations, we consulted with our customer groups on the possibility of introducing zonal infrastructure charges across these regions. We received feedback to these proposals which did not support zonal charging and that that this concept was dissonant with the charging principles of stability and predictability. Stakeholders also noted that it added an unnecessary layer of complexity for our developer customers. We believe this view remains the same. As a company, we would also have concerns about the principles by which zonal charging was introduced by each water provider as this would need to be standardised across the industry. This concept would also provide administrative challenges which may increase the cost of overheads within the charge itself.

We also feel that the introduction of zonal charges may inadvertently skew the market, with one-off or small home builders potentially experiencing a negative impact if they are in an area with a higher zonal charge but are bound by their geography.

We note Ofwat's intention not to prevent companies providing simple infrastructure charges, which we support, but propose a charging differential for developments in remote areas. We would request further information on this and would request a definition of a remote development, as the consultation does not adequately explain this.

Efficiency Discounts

Affinity Water currently offer customers a water efficiency credit of £80 for each new connection added to our network that can demonstrate a usage up to 110 litres of water per person per day. This credit is applied to the infrastructure charge of each new connection. While we are starting to see a greater uptake of this incentive, we would challenge that, in reality, water companies have limited influence over developer customers in this area. Our response to Question 3 outlines our experience in this area, alongside suggestions for improvements.

Income Offset

While the introduction of income offset was welcomed by developer customers, particularly smaller home builders and one-off customers, we agree that the economic rationale for it is weak. We understand that by removing income offset payments, we further move to a more cost-reflective position for developer charges, however we would be concerned about the impact this would have on our customer base. This is likely to significantly increase costs for developer customers and we would request that extensive stakeholder engagement is led by Ofwat, to fully understand how, as an industry, we can support a more sustainable approach. One suggestion could be to carry out a phased removal over a period to time to reduce the impact to developer customers.

Strategic Assets

Taking into consideration the proposal for removal of the income offset to provide fairer cost reflective charges, from a principles and theoretical perspective, we agree with Frontier Economics view that Developer Customers should fund the cost of strategic assets. However, in practice, it would be extremely complex for water companies to implement. This is because not only would you need to define at what point a new development impacts on the strategic asset, but that the proportion of cost is equivalent to the increase in network demand as a direct consequence of the growth. This would also increase costs for developer customers, and we would not support both the removal of income offset and the introduction of charges for strategic assets at the same time.

Q2: We seek views on our reasoning and proposals with respect to charges for strategic assets, income offset and the balance of charges rule

Strategic assets

As indicated in Question 1, we would suggest maintaining position on charging for strategic assets. We do not feel that the ends justify the means and would simply increase costs for our developer customers and increase complexity for water companies during charging reviews.

Income offset

The ability to apply an income offset at a per plot level, calculated by predicted income from the new connection, allows us to provide customers with cost benefits, including self-lay providers and NAVs. We believe this discount is seen as an advantage to many of our customer groups which may not have benefitted from this on mains requisition/self-lay schemes when DADs/RD and AVP calculations were in place. However, we are fully cognisant that the economic rationale for income offset is weak, and we agree that developer customers should pay cost-reflective charges. As such, we believe the reasoning for the proposal to remove the income offset from 2025 is sound. Nevertheless, we do note that this will increase costs significantly for developer customers and would urge Ofwat to carry out more extensive customer engagement with key stakeholders, as well as work with the industry to create and agree stakeholder management plans to support in any transition. We would also note that removal of the income offset may be detrimental for the cost of homes moving forward due to the pass through of costs by the Developer. This could have an unforeseen negative impact on the housing targets set by Government. However, we agree with Frontier Economics that this is not necessarily an issue for water companies to resolve and could be better tackled through taxation.

Balance of charges

We agree with the proposal to retain the balance of charges rule until 2025, before removal. However, we would note that care should be taken when considering formal introduction of cost-reflectivity as a charging rule, as it is unlikely that this will allow for continuation of balance of charges until 2025.

Q3: What environmental incentives should water companies be offering developers and NAVs? We are interested in examples of good practice. How can we better support this?

We agree that the water industry has a responsibility to ensure we are working with developers to protect the environment and develop more sustainable development sites. At Affinity Water we are committed to building campaigns and innovations to support this ambition. We recently launched our 'SOS: Save Our Streams' campaign, aimed to reduce water use across our household customers, with a view to reduce demand by 130 mega litres per day. Water efficiency is also something we introduced in our 2020/21 new connections charging arrangements, by providing a discount per plot of £80 against the infrastructure charge for developments built to a standard of 110 litres per person per day.

However, we feel that water companies, through their developer charges, are somewhat limited in the influence they have over developer customers. The uptake for our water efficiency discount has been relatively low, and ability to evidence installations meeting the 110 litres per person per day, has also been challenging.

In addition, we feel the current level of environmental discounts provided do not go far enough to make it worthwhile for developer customers, particularly when considering rainwater harvesting/grey water re-use system installations. These can add substantial costs for developer customers during construction, and also provide water quality risks for the water companies if they are not installed or maintained correctly. As such, the discount needs to provide enough incentive for the developer customers, while still ensuring adequate risk protection for the water company. We feel that when you begin to consider these much larger discounts, there is direct tension between this and other charging principles, particularly relating to cost reflectivity.

We feel that there are much better opportunities to drive environmental incentives and ambitions through either the planning process, enforced through a reduction in the threshold of Part G Building Regulations, or through the industry making strong representations to shape government bills, such Defra's upcoming Environmental Bill.