Driscoll 2
Ellen Street
Cardiff, CF10 4BP
Telephone: 02920 028 711
Website: iwnl.co.uk

Ofwat
Charging team
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Email: charging@ofwat.gov.uk

8 June 2021

Dear Ofwat,

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

I am writing to you on behalf of independent Water Networks Limited ("IWNL"), part of the BUUK Infrastructure Group of companies, in response to Ofwat's May 2021 publication "A consultation on the scope and balance of developer charges and incentives". In addition to the general comments set out in this letter, we have responded to Ofwat's specific consultation questions in Appendix 1. I can confirm that this response is not confidential.

We are supportive of the clarity the consultation provides with respect to the objectives, and associated incentives, that the balance of charges should facilitate. We recognise the benefit that cost-reflective developer charges could have in terms of facilitating the sustainability of future new build homes and incentivising desired outcomes such as water efficiency. We also note that the principles of better regulation promote transparency and consistency / fairness, which are aligned with the objectives presented in the consultation.

We understand that the rationale for introducing the balance of charges rule was to facilitate a smooth transition to new charging rules that were implemented in England from April 2018. Given that three years have passed since these changes were made, we suspect this transition is now complete, and agree that there is merit in establishing charges that are more reflective of underlying costs and facilitate the above objectives.

We welcome the research from Frontier Economics which presents some interesting conclusions on the balance of developer charges and provides the basis for the Ofwat proposal to shift the balance of cost recovery away from end customers and more toward developers. We note that the proposed approach will have limited financial impact on NAVs given that any increase in costs would largely be passed through to developers.

I hope that these comments are helpful. Please do not hesitate to contact me if you have any questions about our response or would like to discuss these issues in more detail.

Yours Sincerely,

Keith Hutton
Regulation Director (Heat, Fibre and Water)

Independent Water Networks

Driscoll 2
Ellen Street
Cardiff, CF10 4BP
Telephone: 02920 028 711
Website: iwnl.co.uk

Appendix 1: Responses to specific consultation questions

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

We welcome the Frontier Economics research which presents interesting conclusions on the balance of developer charges and provides the basis for the Ofwat proposal to shift the balance of cost recovery away from end customers and more toward developers. However, we note the government focus on increasing the housing supply in recent years and, in line with this, the growing importance that has been given to accelerating the pace of housing construction.

- In 2017 the new conservative government emphasised it's continuing commitment to the 2015 pledge of the previous government to deliver one million homes by the end of 2020 and, built on this, establishing a new target to "deliver half a million more [homes] by the end of 2022".
- In February 2017, the Housing White paper included "a comprehensive package of reform to increase housing supply".
- The 2017 Autumn Budget set out an ambition "to deliver 300,000 new homes a year."
- The 2019 Conservative Government manifesto included a pledge to "continue to increase the number of homes being built… towards our target of 300,000 homes a year by the mid-2020s".

Given the significant importance being placed on the growth of the housing stock, we question whether the proposed rebalancing of developer charges and incentives at this time is fully aligned with government policy in this area.

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

We welcome the consistency in the approach that Ofwat proposes to take with respect to charges for strategic assets and the treatment of income offset in the future. As such, we note that Ofwat's rationale for proposing not to introduce developer charges for strategic assets and to remove the provision of the income offset payment are based on the same premise. In this respect, Ofwat highlights that population growth is the key driver of both strategic asset costs and the future revenues that accrue to relevant undertakers from new developments. These conclusions suggest that introducing developer charges for strategic assets and removing provisions related to income offset payments would shift the burden of costs too far toward developers. We believe the consultation presents an appropriate balance of costs that reflects the respective dynamics at play in the market.

Following the same line of reasoning, we agree that there is no direct causality between new developments and the need for strategic assets. Although a new development may contribute to an incumbent's business case for investing in a strategic asset in a specific area, we suspect that population growth was likely the key driver of the developer's decision to take forward the new-build site. While the growth of the population provides the developer with a ready-market to sell new-build homes to, the presence of this market is due to population growth and the incumbent would need to accommodate the increased population with new strategic assets even in the absence of the development. However, we recognise that the developer's decision to progress construction of new homes on a given site is likely to directly impact the resulting reinforcement works that are required. We therefore agree with the rationale for, and proposed approach of, allowing incumbents to choose whether to vary infrastructure charges by location.

As outlined above, our position on Ofwat's proposal to remove the income offset payment is one of relative neutrality. We note that removal of these provisions would have a limited financial impact on NAVs given that the resulting cost increase would largely be passed through to developers. However, we would flag the importance of establishing supporting transition arrangements to effectively ensure that any income offset arrangements agreed at the outset of a new build development, prior to the removal of those income offset provisions from 2025, are honoured until full completion of the build programme. This will avoid creating any concern that income offset payments may be disapplied unexpectedly in the middle of a construction project.

Recognising that the potential will exist for incumbents to earn additional revenues once the income offset provisions are removed, we would expect Ofwat to establish arrangements to ensure that these funds are effectively used to either reduce end customer bills, facilitate environmental improvements, or support the establishment of a nationwide social tariff. On the specific topic of social tariffs, we are aware of growing concerns around water poverty and that incumbents are able to offer social tariffs that provide assistance to those facing hardship. As a NAV we currently have limited scope to provide similar support and therefore question whether some of the income offset value could be redistributed across the sector to provide more consistent support in this area.

We understand that the rationale for the balance of charges rule was to facilitate a smooth transition to the new charging arrangements, implemented in England from April 2018. Given that three years have passed since the changes were implemented, we anticipate that this transition is now complete, and agree that there is merit in establishing charges that are more reflective of underlying costs and facilitate the objectives outlined above.

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 are supportive of any initiatives that facilitate sustainability and deliver enhanced environmental outcomes. However, we recognise the complexity of this issue and the need to consider all possible options that could be implemented, from the perspectives of a variety of industry parties. We are keen to highlight that this is a 'live' issue that is currently undergoing industry discussion as part of the bulk supply working group. We would therefore urge Ofwat to be mindful of the work being taken forward in this related

Driscoll 2
Ellen Street
Cardiff, CF10 4BP
Telephone: 02920 028 711
Website: iwnl.co.uk

forum and to consider the outcomes of both these discussions and the balance of charges consultation prior to reaching any conclusions regarding environmental incentives.

We would also note that currently NAVs receive a limited share of the benefits that accrue to incumbent water and wastewater companies as a result of NAV and / or developer efforts to reduce water consumption or improve water efficiency and / or leakage. NAVs are providing more of the water and wastewater networks for new housing sites, and we expect this to grow so that NAVs provide and own the majority of networks on new sites. We believe independent providers are well placed to offer innovative and sustainable solutions, and therefore consider changes are needed to the regulatory framework to recognise the role of NAVs and developers in facilitating improvements in these measures on behalf of incumbents.