



The scope and balance of developer charges and incentives

Response to Ofwat's Consultation

7 June 2021

Northumbrian Water response to: A consultation on the scope and balance of developer charges and incentives

The consultation does not cover what we believe is a critical area of developer market reform for PR24. The inclusion of developer services income within the single till revenue allowance creates a disincentive for water companies to support development in their region (revenue is captured, costs are treated as overspends). Ofwat have addressed this in part through the DSRA, but this only applies for new residential properties, leaving a disincentive for companies to attract & support non household investment in their region.

The key protections for developers are:

1. The growth of the NAV/SLP market, ensuring developers have a choice about their provider.
2. The ongoing developer charging guidance that charges must be cost reflective.

Note that these protections do not require developer services to be part of the single till, or even captured as part of the price control process. Indeed, price control regulation can be contradictory or detrimental to these protections, for example, where a Periodic Review sets developer income and cost allowances that are different from actuality and effectively assumes a company over or undercharges developers.

We intend to contribute further on this area as part of the PR24 consultations.

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

The Frontier Economics report is helpful as it does seem to recognise how the development market works in practice rather than theory. There are many small changes that could be considered to make charging more 'accurate', but the key tests should be:

1. Would developers/NAVs welcome this as a better approach?
2. Is the change complex or onerous in comparison to the perceived benefits?
3. Would the change really change behaviour?

The recent charging changes do seem to be successful in encouraging a growing NAV/SLP market, with greater choice for developers. The focus of all developer charging should be practical in terms of 'what works' rather than theoretical.

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

Removal of the income offset

Northumbrian Water has set the income offset at zero from 2020-21 onwards, whilst maintaining the balance of charges. This involved an increase in requisition charges offset by a reduction in infrastructure charges. This simplification was received well by developers and NAVs alike and has made developer charging simpler and more transparent.

We support this approach being applied to all companies, but we do note that this does appear to reinterpret the original Defra guidance and we suggest that a Defra note agreeing the change would be helpful.

Strategic Assets

We do not support the inclusion of strategic assets in the network reinforcement costs that are recharged to developers via infrastructure charges. This would further increase infrastructure charges at the same time as removing the income offset for little obvious benefit.

It would be difficult to allocate any increased demand at a treatment works between existing and new customers. Allocating these costs to infrastructure charges would share them across all developers over 5 years, blunting the price signal of any direct recharging of specific developments.

Finally, new customers bring new income, which does contribute towards the costs of supplying them.

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?

Northumbrian Water offers an incentive of lower infrastructure charges where developments are designed and built to promote a lower consumption of water. We lower the water infrastructure charge if evidence is provided to show a house is to be built with fittings and appliances to achieve a consumption of no more than 105 litres per person per day.

We understand that Defra is due to publish its response to the 2019 consultation on personal water consumption. We expect that the 125 l/head/day target will be removed with the, currently, optional 110 l/head/day becoming the new target. If or when Building Regulations are changed accordingly, companies may wish to move their incentive requirement to one based on per capita consumption that is lower than the statutory requirement. If mandatory water labelling becomes a requirement in the future, companies may wish to make eligibility for their incentive based upon the rating of appliances and fittings.

It is very important to recognise that all new developments have metered customers, which have volumetric tariffs that are a clear and direct incentive for water efficiency. A developer that builds houses that are water efficient will thus be adding value to those properties when selling them.

We also offer lower infrastructure charges where developments are designed and built in such a way that wastewater is drained away from our existing wastewater networks. This fits well with the recommendations of Frontier Economics to offer incentives for sustainable drainage systems, reducing demand on our wastewater system.

We further encourage the use of sustainable drainage systems through our strong working relationships with our Local Planning Authorities, SuDS Approval Body, and developers themselves, encouraging the use of the surface water hierarchy of preference for all development.

NAV's are also charged on a volumetric basis by incumbents, and, provided the incentive amounts for their margin are set as fixed values rather than volumetric, they should not be penalised for delivering water efficient developments. NAV's are also eligible for the lower infrastructure charges as set out above.