Our Ref: PK/LAT/Ofwat

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Dear Ofwat

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

Please find attached SES Water's response to your consultation issued in April 2021 on the scope and balance of developer charges and incentives.

If you have any further queries, please do not hesitate to contact us for further information or clarification.

Your faithfully

[redacted]

Paul Kerr
Group Chief Financial Officer

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

We agree and are supportive of the conclusions of the Frontier Economics report, in terms of economic rationale. However, when balanced with the charging principles and the developer experience, there are points of consideration as detailed below.

We do agree with the Frontier Economics report that the arguments supporting the current approach are unconvincing. In particular:

- Income offset: We agree that the economic rationale for the current income offset is weak. It was not clear to Frontier Economics why developers should receive a discount for connection services, and Frontier Economics argued that it would be more cost-reflective to remove the income offset. We agree and believe the current fixed period nature of the balance of charges rules are not a sustainable long-term solution.

- Strategic assets: Frontier Economics highlighted that developers do not contribute to the costs of reinforcing strategic assets, such as building new treatment works, even when these costs are a direct consequence of new developments and not a result of general population growth or demand growth. Instead, these costs are funded entirely by the water company's wider customer base. Similar to the income offset, Frontier Economics argued that the economic rationale for this arrangement is weak, and that it would be more cost reflective if developers did pay their fair share of these costs – noting that work would need to be carried out to isolate developers' fair share. We agree with the economic rationale of Frontier Economics. However, when considered with the developer experience and the principle of predictable charges, this would have true complexity for water companies to implement in a satisfactory manner and therefore on balance we would favour the existing approach to strategic assets.

- Environmental incentives: Water companies typically set a flat rate infrastructure charge per new connection. Frontier Economics findings suggest that this approach does little to promote environmental incentives or user pays principles. Frontier Economics recommended exploring the use of zonal charges (where this is practicable) to send location pricing signals.

  We considered zonal charging for the 2021/2022 infrastructure charge and at this time we do not have evidence it would be appropriate for our community. This is because we cover a small geographical area and the network reinforcement requirements are similar across all areas meaning the differences would be minimal and we have the ability to supply much of the supply area from more than one treatment works. We did consult on our approach for 2021/22, asking 'We are proposing to maintain a flat rate for infrastructure charges rather than zonal. To what extent do you agree or disagree with this proposal?' 88% of respondents agreed with us maintaining a flat rate for infrastructure charges. Zonal charging could also disproportionally impact smaller developers as the larger developers may have more strategic opportunity/choice for the location of their developments.

  Frontier Economics also recommended greater use of water efficiency discounts. We agree with water efficiency discounts being a focus of industry collaboration and cases of best practice and learnings being shared.

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

Please see below for our views on the above points:

- Strategic assets: As previously stated above, whilst agreeing with the economic principals of Frontier Economics' findings, we agree with the proposal to continue with the status quo - this due to the developer experience and the principles of the charging rules around predictability, transparency and stability

- Income offset: We agree with the principle to remove the ability to offer income offset for English companies from April 2025 onwards, and the removal of the balance of charges rule at the same time. We are pleased that Ofwat acknowledges that this will increase developer bills for companies that do apply an income offset. More discussion is required on the impacts of this change - for example the 10% threshold in the statement of significant changes could be exceeded year on year depending on the infrastructure charge at that point in time. However, as the consultation states there are offsetting factors, for example the increasing competition and other related conversations on the direction of travel for the approach to Developer Services in PR24, that are encouraging and could increase the confidence held by developers and other customers that charges for developer services are fair. We would welcome more industry discussion on this topic and perhaps some additional provisions could be required between now and 2025 to smooth the impact of the removal of the balance of charges rule.

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 currently offer reduced infrastructure charge for water efficient properties in our Developer Services charging arrangements 2021/2022 as follows:

- A 15% reduction on the infrastructure charge per connection if all bathroom fittings are 'A'-rated based on the water label or rainwater harvesting or greywater recycling is fitted. This equates to a water usage of around 105 litres/person/day.

- A 30% reduction on the infrastructure charge per connection if all bathroom fittings are 'A'-rated based on the water label and either rainwater harvesting, or greywater recycling is fitted. This equates to a water usage of around 80 litres/person/day.

We welcome the industry learnings that have already been shared, on the developer uptake, compliance levels from applications to construction and a view that a fittings-based approach is preferable to a Per Capita Consumption approach. We think we could be more innovative as an industry and a discussion with stakeholders on what could be offered to encourage achieving water neutrality in developments would prove beneficial. As noted in the consultation it is important that these incentives are applicable to all types of developer services customers and work while maintaining a level playing field with SLPs and NAVs.

For context, when responding to draft Local Plans of the planning authorities in our region on the topics of water efficiency we have previously recommended the following inserts:

"Rainwater Harvesting / Grey Water Recycling - implementing either or both of these systems should be seriously considered to reduce the demand for water on the site. There are additional benefits such as reduced flood risk, saving on water bills, reducing the amount of water we need to abstract from the environment and could decrease the carbon footprint of water. Rainwater /Greywater could be installed for a range of uses from but not limited to toilet flushing, landscape watering & vehicle washing.

Water Efficiency Measures - ensuring all water efficiency measures are taken - at a minimum fitting water-efficiency devices across the site (tap aerators, shower regulators, low flow shower heads, efficient urinals, efficient toilets) – and ensuring landscaped areas need limited watering. Consideration could be given to specifying an efficiency level under the BREEAM certification scheme.

Finally, consider ways to prevent local rivers / groundwater being adversely impacted by this development, such as limiting road and silt run-off and implementing sustainable drainage systems."

It remains our view that water companies are not best placed to drive a change in developer behaviour - the best driver would be legislative developments by government, for example building regulations. Reduced infrastructure charge for water efficient properties should not be a substitute for developments achieving building regulations - the incentives should be in place for developments that achieve a greater efficiency (or indeed neutrality).