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

South East Water response

June 2021

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Introduction

South East Water welcomes the opportunity to provide feedback on the consultation regarding the balance of charges and environmental incentives for New Development. We understand that water efficiency needs to be at the forefront of new housing projects in the future and that incumbent companies have a part to play in supporting developers with this task.

We also welcome the review on the balance of charges and understand that the changes over the last 3 years means that a review on the methods previously used to maintain the balance of charges needs to be reviewed and potentially amended.

Question 1 response

Do you have any comments on key conclusions from the Frontier Economic report?

We agree with many of the core principles laid out by Frontier Economics in their paper. We see the benefits of the principle behind using zonal infrastructure charges to encourage building work to take place in areas that are less resource stressed. However, we believe that zonal infrastructure charges would add and an additional layer of complexity to charges that need more simplicity and transparency. Whilst the idea of Developers moving work due to infrastructure costs seems like a good idea in theory connections costs are relatively small when compared to other costs developers face and it is unlikely to alter a developer's decision in where they are likely to build. Having said this, we would welcome any case studies from companies who have used or are currently using zonal infrastructure charges that show a decrease in building activity as a direct result of the charges.

We also understand that zonal infrastructure charge will have an impact on smaller developers who are generally tied to specific regions within our area and have limited ability to decide where they build.

An infrastructure charge for "remote development" would need more thought and a very clear definition of what a remote development is. We also need to be clear about what we are trying to achieve. Is the aim to discourage remote development or simply avoid installation costs of additional infrastructure and the potential ongoing costs to deliver water (e.g. pumping costs, carbon)? Or is it just looking at a fairer way for developers to pay? Each company will have different issues with infrastructure requirements, and it might be that a number of different options are provided so that companies can determine the issues they have specifically and therefore the charging mechanism they need to influence where developers build.

In Frontier's report they spoke about how the charging rules detail that the cost of network reinforcement should be recovered over a 5 year period. We agree with their statement that it might be more appropriate to think about recovering costs over a longer time horizon. This avoids a timing issue: e.g. the cost of one big investment could fall on a relatively small number of developers, and then developers in subsequent years effectively get this for 'free'. This might move us towards the world of charging developers for the long run average cost per new connection, where some years you may under-recover and some years you over-recover, with some adjustments.

Question 2 response

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

Following the economic principles laid out by Frontier in their paper it would seem logical that developers pay for all work relating to new development, including the proportion of strategic schemes that are required because of new connections. We understand the complexity of trying to apportion charges in this way, however, a starting point could be as suggested in the paper, modelling the strategic scheme requirements without any new development (i.e. giving you a baseline if no development was carried out) and then determining what strategic schemes would be required, then re running the model with the new developments added. We are mindful that any costs associated with new developments that are not recovered from developers will be picked up by end user customers in their bills.

If Ofwat do go forward with their view that strategic schemes should not be funded by developers, we would welcome a clearer understanding on the definition of strategic schemes. In our business plan South East Water included intrazonal schemes as strategic. These schemes will ensure that the resources in our zones are equally available to all customers. In Ofwat's Final Determination of our business plan we were instructed to recover some of costs of strategic mains from developers. This is at odds with the comments on Page 14 of the consultation and therefore a more detailed view from Ofwat on what is considered a "strategic scheme" would be useful.

We agree with the reasoning behind the removal of the income offset, and therefore the current "maintaining the balance" rule, it will lead to more cost reflectivity and transparent charges. The current use of the income offset as a balancing tool has worked to maintain the balance of charges pre 2018, however, it may mean, in some instances, that charges may not be cost reflective. Obviously the removal of the income offset will have a significant impact on Developers, SLP's and NAV's. Impact on D-MeX, and therefore the related reward and penalty associated with it, will also need to be thought about. Ultimately companies that currently provide a high level of income offset are likely to have poorer survey results if developer charges rise significantly, where companies who either offer no income offset, or a lower income offset will see less of an impact. We assume that Ofwat will provide more guidance on how they propose to mitigate the risk to companies in this area, it would not really seem fair for companies to be penalised if they have historically provided a high rate of income offset.

We hope that if the proposed changes go ahead, as well as companies individual engagement plans there will be an industry level engagement plan for key stakeholders to explain the reasoning behind any changes in the charging rules.

Question 3 response

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

South East Water's broadly supports the direction of travel and would like to see developers and NAVs incentivised. But we feel there are several important areas that still need to be fully explored and addressed to be confident an environmental incentives scheme works well and meets its objectives:

1. The incentives on their own may not necessarily lead to a reduced need for investment in the network capacity by a water company – fittings and fixtures are expected to support some reductions in annual average demand, but recent high summer demand events indicate peakier and longer summer demand are to be expected and may continue irrespective of the environmental incentives scheme – for example peak demands are often associated with stepped increases in external leisure uses like paddling pools and splash pools - which will not necessarily be impacted by environmental incentives for developers i.e. a more efficient home is still capable of using the same amount of water as existing homes for many types of internal and external uses that place the water network under greatest pressure during peak periods of demand.

2. COVID19 has demonstrated significant stepped changes in demand can occur, some linked to mobility of household occupancy and also changes in usage in the home - during 2019-20 we saw more people working from home and more families restricted from travelling and overnight stays away from home during summer peak periods. The impact of COVID19 in South East Water's region was a 13% increase in annual average household demand, with household peak demand as much as 20% higher than normal. It is important to identify how environmental incentives are best aligned with the need to design and fund increased capacity to meet higher standards of resilience.

3. We believe household demand has been permanently affected by the impacts of COVID19 – We expect more people in the future will spend more time working from home - even taking account and water saving benefits from more efficient fixtures and fittings, household demand is expected to increase simply by people spending more time at home.

4. Ultimately, people use water, not houses, fixtures or fittings. There will always be scope that water efficient fittings and fixtures are removed from homes. There is already evidence that people do not always use fixtures and fittings as they were designed or in the most efficient way. Therefore it is important to factor in some allowance for a lower levels of savings.

Whilst not helping developers directly it might be worth looking at the potential of offering pilot tariffs for incoming customers where houses have been deemed, or awarded, (super) efficient on delivery. Such a tariff might encourage customers to not immediately rip out all the efficient devices in the new property. If we could develop tariffs that reward customers with favourable “essential” water consumption tariffs, before increasing volumetric charges for higher (non-essential) use, we think that could be a good message. We could also link to our carbon net-zero efforts by encouraging customers that less water use is not only good for our net-zero aspirations, but also their own.

We acknowledge that such tariffs have been looked at previously with not much encouragement, and we understand the reasons why. However, with pending climate change issues pressing on, we think customers continue to be more aware of their own use of resources and therefore such ideas should continue to be looked at once again. Hence if somehow we could use this continuing (tariff) carrot to help developers design efficient houses, maybe with more on board property grey water recycling for their garden / non-essential use, customers can better stay in the lower cost part of the tariff.

Provided these areas are suitable considered and factored into an environmental incentives scheme we are in principal supportive.

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