South West Water
Peninsula House, Rydon Lane, Exeter, EX2 7HR
www.southwestwater.co.uk

8 June 2021

Charges Team
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

By email: charging@ofwat.gov.uk

Dear colleagues

CONSULTATION ON THE SCOPE AND BALANCE OF DEVELOPER CHARGES AND INCENTIVES

Thank you for the opportunity to respond to Ofwat's consultation on the scope and balance of developer charges and incentives. We are keen to engage in the debate on this complex and important topic.

We broadly agree with the proposals for the treatment of costs for strategic assets and the removal of the income offset and the balance of charges rule. While Ofwat has not specifically requested comments on its view on network reinforcements in 'remote' locations we have made some initial observations which we believe would need further consideration and on which we would be pleased to engage in the debate. We are mindful that the proposals represent further changes for developer customers and that as an industry we will need to carefully manage messaging and potential bill impacts, however we welcome that the lead time to 2025 will assist us to do so.

We have focussed the majority of our response on the proposals that incumbent companies provide incentives to NAVs and developers for sustainable development. For this to be truly effective and avoid unintended consequences, inefficient cost and wastage (for example of water efficiency devices being removed and discarded by new occupiers) we believe that the industry needs to move beyond historic approaches to water efficiency incentivisation and challenge itself to find new and innovative ways to ensure that any incentives deliver sustained benefit to the environment. Achieving this will involve companies working together and with developer customers to understand what developers will value in terms of incentivisation, and, more holistically, what offerings will result in society overall benefitting. We agree with Ofwat's view that this will take time and some experimentation to achieve and we would support the creation of an industry group to further the work.

We provide our responses to your questions in Appendix 1. If you have any questions, please do not hesitate to contact me.

Yours sincerely

[redacted]

Matt Crabtree
Engineering Director
D: [redacted]
E: [redacted]

APPENDIX 1

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

Through its comprehensive approach, and by highlighting the more nuanced underpinning issues relating to developer services charging, Frontier’s report supports a richer and more informed debate on the future charges framework.

However, while recognising the scope and content of the areas discussed, and the potential options presented in the report, we feel that some proposals would be infeasible in practice. For example, we cannot foresee an example whereby the use of a DPC framework would be appropriate for the effective operation of the networks. That said however, we broadly support the principles behind Frontier’s key conclusions, and that in making them Frontier also acknowledges the trade-offs that the industry will need to make.

Where we do have reservations, this is mainly on the basis of complexity and proportionality, and the trade-off with transparency and simplicity. In particular while we agree in principle with Frontier’s conclusion that developers should be charged for their share of costs for strategic assets, we question the potential cost to incumbents and complexity of allocation to developers. Additionally, given the uncertainty regarding cost causality, we also question the robustness of any charges for strategic assets and note the potential for challenge by developers. We support Ofwat’s proposal to retain the current framework in this respect.

To us, the remainder of Frontier’s key conclusions are reasonable and appear economically sound. We are mindful of the impact on developer customers’ bills, and how the industry will manage the transition from the current situation to a restructured framework while still supporting developers to deliver government’s housing ambitions, and we welcome being part of the debate.

2: 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 and network reinforcements

As we have stated above while we agree in principle with Frontier’s conclusion that developers should be charged for their share of costs for strategic assets, we believe that the complexity of allocating such costs will be significant and of questionable robustness. We therefore support Ofwat’s view to maintain the approach to strategic assets, but caution that this is dependent on the right level of population growth being funded for the appropriate locations.

With reference to network reinforcements, we support Ofwat’s proposal to allow companies to continue to set fixed, standardised infrastructure charges. While we do not disagree with Ofwat’s aspirations in relation to geographic infrastructure charges for what is termed ‘remote’ locations we believe further work would be needed to consider what we believe could be potential issues. For example:

- How would ‘remote’ be defined? Given the significant differences in companies’ areas would the definition need to be company-specific and developed by the company, and if so what references would Ofwat use to determine any disputes that may be referred to it.
- Additionally, as water is a relatively small element of the overall charges for a developer, would the incentives be sufficient to incentivise them to locate sites away from sensitive areas.
- Finally, how would or could this be aligned to the recently announced direction of travel in relation to planning rules.

Income offset

We agree that there is low economic rationale for the income offset and that its removal is reasonable. While we are mindful of the impact this will have on developer customers' bills, we also see it as an opportunity to utilise the value to develop environmental incentives, and in turn support our goals to create a more sustainable environment for generations to come.

Further work is required to assess the detail as to how this would work and we agree with Ofwat's view that it is likely it will take some time and some iterations to find incentives that can work in practice and that developers respond positively to. As noted above the relative cost of providing water and wastewater infrastructure compared to the total cost of a development is very small and therefore incentives will need to be clear, easy to administrate and make a meaningful impact to developer charges.

Balance of charges rule

In our view the principle of cost reflectivity is sufficient to ensure that the balance between household customers and developers is maintained, and we therefore support the proposed removal of the balance of charges rule in 2025.

3: 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?

As we have stated above, SWW is fully committed to its environmental obligations and doing its part in protecting the environment. We therefore fully support the proposal that incumbent companies provide incentives to NAVs and developers for sustainable development.

We also agree that it is reasonable for environmental incentives to recognise those developers that develop in an environmentally responsible and sustainable way, while those that do not pay correspondingly more.

However, thought needs given over the longer-term and over the life cycle of the property to consider the potential actions of both developers and occupiers and to ensure that the incentives offered are, and remain, effective. To avoid resource and cost implications for companies to monitor sites, in the first instance incentives should be awarded against activities that are measurable and sustainable, that cannot easily be reversed or circumnavigated; for example sustainable drainage solutions, grey water recycling and rainwater harvesting. These solutions are both easy to evidence that the developer has conducted the work, while also considerably reducing potential negative behaviour by occupiers. For this second reason we are cautious of offering discounts against the installation of water efficient devices, which can easily be removed once the property is occupied. While there may be an argument that this is a secondary issue which is for incumbents and not developers to address, it is illogical to not look to sustainable solutions in the first instance. Additionally, the carbon and waste impacts of producing devices which are then discarded must be considered. We discuss both issues under the sub heading 'Current and future good practice' below.

Ofwat asks how it may better support companies in this area. In our view the Environment Bill and the tightening of Building Regulations present an opportunity to underpin the intentions behind the proposals and Ofwat lobbying for top-down pressures to complement companies' bottom-up incentives will aid the development of an effective framework. Within the industry, we agree that untapped value can be unlocked by companies collaborating on lessons learned in terms of environmental incentives and Ofwat could facilitate this in a similar way to other industry working groups that have recently been created. We can also see merit in an industry approach to developing and working together on a transparent framework that works for companies, developers and the environment whereby companies would apply their own costs within a given structure. For example, we would be interested to explore the question of the whole water cycle and where the incentives lie in terms of value delivered, for example the value to the environment of preventing both abstraction and returning waste to the environment.

Related to this, the proposed changes to the charging rules appear at this stage to be reasonable, but we question whether an industry group could also work to test the draft rules, with the aim of establishing how best to ensure that they are effective and deliver their intended outcome.

We agree with Ofwat's view that experimentation will be necessary to establish incentives that are effective for the environment, companies and developers and that companies should collaborate to learn from previous pilots and initiatives. Similarly, the engagement of developers, either directly or through representative bodies, is essential to fully determine whether incentives will be attractive enough to encourage uptake, and ultimately deliver the intended environmental benefits. .

Finally, we agree that in developing any incentive it is crucial that the level playing field with NAVs and SLPs is maintained.

<u>Current and future good practice</u>

In terms of experience to date, feedback from companies that have previously launched incentive schemes suggests that effectively monitoring schemes can be difficult. Anecdotal evidence shows developers not actually installing the fittings and appliances that had been agreed under incentive schemes; or that the installations have facilitated the future homeowner to remove the initiatives, thereby removing the benefits that the incentives were designed to deliver. These experiences align with our own views (above) that for schemes to be effective incentivised activities should be measurable and sustainable, and should not be easily reversed or circumnavigated. Any scheme should also be easy to implement and not result in administration and cost that could otherwise be avoided.

SWW has engaged extensively with developer customers on their views on how we could work with them to deliver water efficiency measures when new developments are under construction. In terms of installations within properties, options discussed have ranged from the provision of water efficiency devices (e.g. shower heads) through to SWW potentially supporting developers through the bulk purchase of water efficient appliances such as washing machines. However, the conclusions we drew from the feedback received was that some developers would not be incentivised by these initiatives unless they were confident that installing devices would provide a commercial sales advantage.

Whilst this is possibly an unfair reflection on all developers it does provide insight about the challenges that need to be addressed to make environmental incentive schemes attractive to developer customers. Consequently, as we have stated above, we believe that there are other top-down influences that will support the environmental benefits that are being sought.

Having considered further we also believe that there is opportunity to develop environmental incentives with developers to provide offsite infrastructure to support the sustainable discharge of surface water flows where the SuDS hierarchy cannot be met. For example, to avoid occasions whereby we have to reluctantly permit connection to a combined drainage network where connection to surface water sewer or watercourse is not economically viable for the developer. This is something that clearly results in the reduction of available sewer capacity and increased risk of flooding and pollution. Whilst care would be necessary to avoid unintended consequences, for example developers seeking to avoid their site obligations to discharge surface water flows effectively, we believe that a well-designed incentive could bring significant benefits, particularly in relation to brownfield developments with existing connections.

In conclusion, to avoid unintended consequences and cost incurred without tangible benefit we believe that any environmental incentive scheme should focus on rewarding exemplar practice by developers, with incentives significant enough to drive different behaviours in respect of supporting water companies to deliver environmental performance improvements. This then raises the question of how 'exemplar' practice could be defined, however we believe that this is another example of where the industry could collectively work together and with developer customers to co-create an industry standard which is unambiguous, effective and will work for both companies and developer customers.