



BARRATT

DEVELOPMENTS PLC

Consultation Response

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PR24: Consultation on our draft methodology for the 2024 price review

2. Regulating through the price review

Q2.1 Do you agree with the challenges facing the sector and the ambitions for PR24 we have identified?

On the whole, yes.

The timeframes and affordability of some of the objectives are an open question. This review is taking place against a backdrop of negative news about the water and sewerage sector - hosepipe bans, leakage, sewage discharges into rivers and the sea. We consider any price/bill increases will be difficult to sell. Rightly or wrongly, many people feel they have already paid for some of these works. It is important that any increased investment is funded fairly and with full transparency. Customers/developers should not pay twice or underwrite costs that sit with water company shareholders.

Q2.2 Do you agree that continuing to use our three building blocks helps push companies to meet our ambitions for PR24? (Please provide detailed comments on specific building blocks to the relevant chapters.)

Yes. However, it is essential to confirm companies have complied with extant statutory duties, duties for which water companies have been funded. A step change is required in water company outputs, which will not be easy to achieve in the short term.

Q2.3 Do you agree that we have struck the right balance between what's in and what's outside of the price control?

Not entirely. We do not agree with the proposal to remove some developer charges from the price controls. We discuss this issue in Section 3 below and in our general commentary document. Ofwat's proposal is, in our opinion, premature.

Q2.4 Do you have any comments on our approach to evaluating progress? What specific evaluation questions (based within the four key ambitions) do you think an evaluation should look to answer?

It is essential to have robust data regarding the efficacy of previous price reviews. For example, based on current Ofwat investigations and CSO discharges, is there a question about whether companies are currently effectually draining their areas? We think there might be a place for some external input in to assessing the effectiveness of previous price reviews. Such a move would make Ofwat a beacon of transparency and it would provide a second pair of eyes, which can encourage lateral thinking.

3. Design and implementation of price controls

Q3.1 Do you agree that in our final methodology we should commit to introducing either an adapted water trading incentive or a new water trading incentive at PR29? If you have a preferred approach, please provide reasons, including any thoughts on how the options we set out in Appendix 2 could be improved.

We do not have strong views regarding the two proposals. However, we consider creating new resources is more realistic. Furthermore, this is an opportune time to examine whether any regional water grids are practicable and economic. Water trading is unlikely to address the requirements for quantum leaps in the amount of stored water available.

Q3.2 Do you agree with our proposals to a) continue to include network reinforcement in the network plus price controls and b) remove wastewater site specific developer services from the wholesale wastewater network plus price control ?

Yes to point a.

Regarding point b, whilst we see Ofwat's logic, we are nervous about removing anything from the price control until the evidence base is deeper and more extensive. We accept very few sewers/drains are provided by the water company. However, the few occasions where a developer is required to requisition sewers often relate to complex and expensive infrastructure. Ofwat needs to consider the risks, as well as raw numbers. On balance, we would suggest Ofwat should proceed cautiously before any aspect of developer charges/services is removed from PR24. If Ofwat is intent on proceeding with this proposal, developers will require rigorous alternative protection for the limited cohort of customers who have to requisition a sewer or lateral drain.

Q3.3 Do you agree that the inclusion of network reinforcement in cost sharing would be enough to manage uncertainty around the volume and mix of network reinforcement work to be delivered?

We consider some of the asserted uncertainty is exaggerated. Local development plans provide a reasonable guide to where and approximately when housebuilding development will occur. Secondly, water companies have up to twelve years to recover contributions from developers regarding any water or sewer requisition that is needed to supply or drain the relevant site. We accept we have to finance any off-site augmentation to serve our sites. However, we should not be expected to finance the resolution of extant network deficiencies, which we believe on

occasions in the past has been the case. Any reconciliation of network reinforcements costs needs to be rigorous, i.e. what is the correct apportionment of the scheme costs between the various parties?

We suggest Ofwat takes account of how water companies historically apportioned network reinforcement charges. Since 2011 Ofwat has investigated and determined a plethora of water and sewerage reinforcement cost apportionment disputes. Nearly all of these determinations resulted in developers paying significantly less than the water company's initial charge. The historic practice was for water companies to recover the whole cost of the reinforcement from the first developer. The network reinforcement costs were calculated by use of notional charges i.e., it was a desktop exercise. Ofwat's approach to apportionment of network reinforcement charges is based on the additional percentage flow required to serve the specific development. We note Ofwat takes a slightly different approach to apportioning sewerage reinforcement charges. However, Ofwat's approach is still broadly related to the individual capacity to serve a specific site. We believe Ofwat's casework provides solid evidence of the structural overcharging developers endure.

Q3.4 For water site-specific developer services:

a) Do you agree with our proposal to exclude new developments of more than 25 properties from the wholesale water network plus price control at PR24, but with transitional arrangements for companies with low levels of competition?

No.

b) Do you think that new developments of 25 properties and fewer should remain in the wholesale water network plus control or be removed? If they were removed from the price control, what alternative protections could we introduce to protect new connection customers from monopoly power?

No. We do not agree with this proposal.

In our opinion the proposal is premature. Competition in the water connections market is still in its relative infancy. There are large variations in the level of competitive activity across England. The reasons for this divergence are not fully known. Even in regions with significant competition the markets are very young. Competition might be a mile wide but only an inch deep. Ofwat is suggesting some form of backstop protections, should certain charges be removed from price control. We are concerned we would end up creating confusion and another layer of regulation. The connections market should be expanding and allowed to further mature. We consider self-lay operators should account for at least 50% of the water connections market before price controls are removed. Whilst we accept water company understanding and compliance with competition law has improved, it is still far from perfect. Removing price controls might be risky.

Q3.5 Do you agree with our proposals:

a) To raise the size threshold above which companies should deliver schemes through DPC to around £200m lifetime totex?

Yes.

b) For companies to deliver schemes through DPC by default above this threshold?

Yes, we agree with the proposal.

In our opinion there is scope for shaking up water company procurement. Water companies should see themselves as custodians of the network. Less emphasis on relationships with contractors might be beneficial. A water company term contractor should not be seen as preferential to a self-lay provider. What should be key is ensuring the best deal for the end customer.

Q3.6 Do you have any views on any other aspect of our proposals in relation to:

- a) The design of price controls;**
- b) Water resources;**
- c) Developer services;**
- d) Retail activities;**
- e) Bioresources;**
- f) Other controls;**
- g) The revenue forecasting incentive mechanism; or**
- h) Direct procurement for customers?**

The price control should positively ensure customers do not pay again for things financed in previous periods. It is essential this price review ensures new capacity is created, whether by storage reservoirs or other means. Leakage remains a difficult and sensitive issue. Are the current economic level of leakage assumptions correct? It is important water company leakage remains visible in terms of the price review to ensure public confidence and credibility.

We invite Ofwat to reconsider its proposed approach to income offsets. We appreciate this issue has been aired thoroughly. However, we believe we have new evidence that challenges the assumptions used reinforced by the work of Frontier Economics. In significant parts of Southern England actual water connection charges are between 20% to 40% lower than the estimated upfront payment. Actual charges are usually only reconciled if a customer makes a specific request. In many cases we suspect statutory interest is not calculated or paid, unless and until a customer requests it. Furthermore, water companies usually receive payment upfront. This upfront payment and the default policy of not reconciling post construction creates very weak incentives for water companies to ensure customers are not overcharged. Our figures are hard, empirical facts. The levels of over-recovery outlined above is based on actual costs derived from numerous sites. We would be happy to discuss this issue further with Ofwat if deemed useful.

We invite Ofwat to reconsider its post-2025 blanket approach to income offsets. First, developers are gifting assets free or at a discount. In addition to the asset, a new customer is also provided to the water company. We accept that over time the asset may deteriorate. However, the water main is either made by the utility or its term contractor, or installed by a self-lay organisation. If the water company installs the main, it controls the quality of the work. If the asset is provided by a self-lay company, the utility will only vest the asset subject to stringent quality and inspection. These arrangements are privileged, compared to other commercial activities. The position is even more stark in relation to sewerage infrastructure.

English water companies can refuse to adopt sewers that do not meet the conditions recorded in a section 104 agreement. It is not unusual for water companies to charge a customer for a full sewerage service, despite it not owning and maintaining the customer's drains. The water company gets the full customer bill, without always providing the full service. By removing the income off-set Ofwat affects the economics for site development in a significant way. We have

purchased land based on the assumption an income allowance will be offered. We understand the economic rationale for not providing an income offset on every site. However, we believe there is a sound economic basis for offering the developer a financial incentive.

Going forward, we see merit in applying some form of income off-set to drainage as well as water. An income offset could incentivise novel and sustainable drainage schemes. Ofwat will be aware companies like United Utilities are concerned about the impacts of Ofwat's preferred post 2025 policy. This is an issue we would like to engage further with Ofwat. We are optimistic mutually acceptable solutions can be found. We do not consider it prudent to make infrastructure charges more site-specific. Such an approach will make sites unviable in locations a different part of government is promoting. We urge Ofwat to facilitate the coherence and consistency of all government targets including new house building targets. We need the various branches of government to work outside of their silos.

Whilst competition for connections is progressing, it is disappointing the new appointments and variations option is still a tiny part of the market. We have previously discussed with Ofwat some of the reasons hindering the development of new appointments. We urge Ofwat to review the application and appointment timeframes. Whilst difficult within the confines of competition law, we urge Ofwat to reconsider some of the financial incentives, in particular regarding smaller sites.

4. Reflecting an understanding of customers and communities

Q4.1 Do you agree with our approach to making sure that companies' price review submissions and our determinations reflect an understanding of customers', communities' and environmental concerns?

Yes. However, representation should be very broad, including all strands of opinion.

Q4.2 Do you agree with our proposal to conduct open challenge sessions?

It is a good idea.

Q4.3 Do you have views on open challenge sessions can align with the collaborative approach in Wales?

Yes – we consider this to be a good idea.

Q4.4 Do you have views on how the outcome of collaborative customer research can contribute in the context of the collaborative approach in Wales?

n/a.

5. Delivering outcomes for customers

Q5.1 Do you agree with our proposed package of common performance commitments? Is water demand best incentivised through separate performance commitments on household and domestic consumption and leakage or through a performance commitment measuring total demand?

We recommend separate commitments for the sake of transparency. Leakage is such a politically sensitive subject. Water company performance in this area is widely perceived to be deficient.

Q5.2 Do you agree with our proposed guidance for bespoke performance commitments?

In general, yes. As we have previously highlighted to Ofwat, we consider D-meX to be work in progress. It needs to be more than a measure of how companies administratively handle developer activity, rather than the level of charging etc. In our opinion, this is not the time to remove developer activities from the price review. We would welcome the opportunity to work further with Ofwat to develop D-meX.

Q5.3 Do you agree with our proposed approach to setting standard rates?

Yes.

Q5.4 Do you agree with our proposed approach to the measures of experience performance commitments, including to increase the size of C-MeX?

Yes.

Q5.5 Do you agree with our proposed approach to estimating marginal benefits for common and bespoke performance commitments?

Yes.

Q5.6 Do you agree with our proposed approach to incentivising asset health performance?

We are concerned asset health should be better than it is, based on water companies meeting their existing statutory duties for which they have been funded. Incentives should not reward previous failures.

Q5.7 Do you agree with our proposal to retain, expand and streamline enhanced incentives?

Yes.

Q5.8 Do you agree with our proposed approach to selecting performance commitments for enhanced incentives?

Yes. However, any commitments need to genuinely challenge the water companies.

Q5.9 Do you agree with our proposed approach to setting enhanced thresholds, rates and caps?

Yes.

Q5.10 Do you agree with our proposed approach to knowledge sharing?

Yes. Subject to any competition law requirements.

Q5.11 Do you agree with our proposal to set caps and collars on a targeted basis, and apply a two-sided aggregate sharing mechanism to all companies?

Yes.

Q5.12 Do you agree with our proposal to not set deadbands on any performance commitment?

Yes.

Q5.13 Do you agree with our proposed approach to estimating ODI risk?

Yes.

Q5.14 Are there instances where providing greater clarity over our intended approach to incentive rates in PR29 would clearly be in the interests of customers? Please explain why and provide supporting evidence.

Yes - transparency may help the process.

Q5.15 Do you have any comments on our proposed approach to implementing and streamlining payments at PR24?

The suggested approach has merit. However, to be successful it will depend on companies improving their performance.

Q5.16 Do you have any wider comments about the ODI framework at PR24?

No. As with many things, the devil will be in the detail.

6. Setting expenditure allowances

Q6.1 Do you agree with our proposed approach to setting efficient expenditure allowances at PR24?

Yes. But ensuring companies are financed to meet their obligations, but not to be double-funded for activity previously provided in earlier price reviews, and therefore already paid for.

Q6.2 What are your views on how we can best align the treatment of third-party costs and revenues?

We note the cost sharing rates Ofwat proposes are quite narrow. Is there merit in penalising poor performance more than Ofwat proposes? Perhaps a ratio of 35:65 would create even greater incentives not to underperform.

Q6.3 Do you agree that companies that submit the most stretching and well evidenced business plans should receive the most favourable cost sharing rates at PR24?

Yes in principle. However, it's the delivery of the scheme that is most important. A polished and glossy plan is no substitute for efficient delivery.

Q6.4 Do you agree that resilience enhancement should be used to fund companies to manage increasing risks to specific hazards that are beyond their control and not covered by base expenditure and other enhancement areas?

Yes.

Q6.5 Do you agree with our proposed approach to setting performance commitment levels at PR24?

Yes.

Q6.6 Do you agree with our view on what performance commitments should be set using common or company specific performance commitment levels?

Yes.

Q6.7 Do you agree with our proposed approach to incentivising and funding efficient investment in reducing greenhouse gas emissions and reducing the use of storm overflows?

Yes. Subject to companies not being rewarded for works which were financed under previous price reviews.

Q6.8 Do you agree with our proposed approach to implementing nutrient neutrality in the PR24 regulatory framework?

Yes. Subject to affordability. We would like to understand the cost of this proposal in more detail.

Q6.9 Do you agree with our proposed approach to encouraging companies to deliver best value through our cost assessment?

Yes.

Q6.10 Do you agree with our proposed approach to removing the potential disadvantage that nature-based operating expenditure solutions may face in relation to the treatment of enhancement operating expenditure?

Yes. However, Ofwat should consider incentives for developers to construct this sort of nature-based scheme – perhaps through asset payments?

7. Aligning risk and return

Q7.1 Do you have any comments on our approach to the overall balance of the PR24 incentive package, our proposed guidance on producing risk ranges, and our view of the balance of risk facing the notional company?

In the current environment we wonder if the proposals will be affordable. We do not agree with removing aspects of developer charging from the price review.

Q7.2 Do you agree with our proposals on the regulatory regime for managing companies' exposure to uncertainty over 2025-2030?

Yes.

Q7.3 Is there value in introducing more prescriptive requirements and guidance for company-produced RoRE risk ranges? How might this be implemented for:

a. Interactions between performance on cost and service?

b. Interactions between performance on different ODIs?

Additional guidance would be helpful, and may provide greater assurance and transparency.

Q7.4 Do you agree with our proposed approach to setting the allowed return on equity?

Yes.

Q7.5 Do you agree with our proposed approach to setting the allowed return on debt?

Yes.

Q7.6 What are your views on the options we have set out for estimating the RPI-CPIH wedge for converting RPI-linked yields to a CPIH basis?

No views.

Q7.7 Do you agree with our proposed approach to the notional structure and setting allowances for corporation tax?

Yes.

8. Aligning risk and return: Financeability

Q8.1 Do you agree with our approach to assessing financeability?

Yes.

Q8.2 Do you agree with the focus on the metrics outlined in section 8.4 for the assessment of financeability?

Yes.

Q8.3 Do you agree with our proposed approach to cost recovery, in particular that we set a narrow range for RCV run-off rates within which companies will be required to evidence their choice of rate which best achieves a fair balance between current and future customers?

Yes.

Q8.4 Do you agree with our proposed approach to resolving a financeability constraint?

Yes.

9. Promoting financial resilience

Q9.1 Do you agree with the proposed standard set of scenarios for testing financial resilience?
Yes.

Q9.2 Do you agree with our approach to how the Board of the company should approach its Board assurance statement?
Yes.

Q9.3 Do you agree with our proposed approach to dividend policies, performance related executive pay and voluntary sharing of financial outperformance?
Yes.

10. Companies' PR24 submissions

Q10.1 Are the PR24 submission requirements clear and sufficiently specified?
Yes.

Q10.2 Is any data missing, or included but not required or areas we need to look at again?
No.

Q10.3 Are the limits on the number and size of documents workable? Should we be more prescriptive in terms of file and folder structures etc?
No.

Q10.4 Do our expectations for company board's assurance and governance arrangements provide enough guidance to ensure that boards have sufficient level of 'ownership' and so ensure a high quality submission?
Yes. The question lies around whether board assurance is sufficient evidence to provide enough guidance. We are concerned previous board assurance has been rather formulaic and perfunctory. This time board assurance should mean something more robust.

Q10.5 Do you agree with our proposal to continue to apply revenue adjustments for past performance across all years of 2025-30, after the financeability assessment?
Yes.

Q10.6 Do you have any comments on how to best deal with the impact of shadow and non-shadow reporting in table BIO3 on other tables?
No.

Q10.7 Do you have any comments on the data we should collect in table BIO5?
No.

11. Encouraging quality and ambitious business plans

Q11.1 Do you agree with the framework we propose to encourage the best business plans? Specifically, do you agree

- **that we should first assess 'quality' followed by 'ambition'?**
- **with our proposed allocation of rewards and penalties for performance on each?**

Ambition yes, but deliverability and affordability too.

Q11.2 Do you agree with the proposed scope of our 'quality' assessment? Specifically, do you agree:

- we should have minimum expectations in the six areas described above?
- with the minimum expectations we specify in each of the six areas?

Yes.

Q11.3 Do you agree with the proposed scope of our ambition assessment?

Yes.

Q11.4 Do you agree with our proposed reputational, financial and procedural rewards and penalties, including the overall package of reward and penalty?

Yes.

Q11.5 Do you have any other comments regarding our proposed approach to business plan incentives at PR24?

No.

Appendix 6 - Performance Commitments

QA6.1 Do you have further views on whether the proposals laid out for C-MeX are appropriate?

N/A.

QA6.2 Do you agree that C-MeX needs to adapt to provide better service to vulnerable and worse served customers?

N/A.

QA6.3 What are your views on our proposal to introduce a single, combined common performance commitment ('BR-MeX') capturing the experience of both end business customers and retailers as intermediate customers?

N/A.

QA6.4 Do you consider evidence suggests that the current water supply interruptions performance commitment is inhibiting innovation? If so please provide it.

N/A.

QA6.5 Do you agree with our proposed definition for the biodiversity performance commitment?

Yes.

QA6.6 Do you agree with our proposal to have separate operational greenhouse gas emissions performance commitments for water and wastewater, which are based on a normalised measure?

N/A.

QA6.7 Do you agree with our proposal that the performance commitment on serious pollution incidents should only apply to water and wastewater companies?

N/A.

QA6.8 Do you agree we should focus the bathing water performance commitment on the outcome that customers have received and should continue to develop an alternative definition to do this?

N/A.

QA6.9 Do you agree with our proposal for the river water quality performance commitment to measure the reduction of phosphorus entering rivers?

N/A.

Appendix 13 - Data and modelling

QA13.1 Do you agree with our proposed approach to mechanisms at PR24?

N/A.