

1 August 2023

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Dear colleagues

ENVIRONMENTAL INCENTIVES TO SUPPORT SUSTAINABLE NEW HOMES

Thank you for the opportunity to respond to Ofwat's consultation to support the development of incentive mechanisms to encourage developers to build new homes that are more water efficient and protect the environment by installing sustainable drainage systems.

We will respond to each question in the order in which they are raised within the consultation document.

1. Do you agree with our proposed aim for environmental incentives?

South West Water supports the proposed aim to introduce environmental incentives for developers to encourage them to build water efficient homes which will support the objectives to reduce water usage thereby protecting water resources, reducing the discharge into waste water networks to protect the environment and to support customers with affordability.

2. Do you have comments on the characteristics of good environmental incentives?

We believe that the consultation document highlights the critical characteristics of a good environmental incentive scheme, and we particularly support the need for innovation in the future.

To do this it is critical that any scheme remains flexible to allow companies to work with other stakeholders to operate pilot schemes with developer customers, and to amend schemes for local circumstances. Too often we see a drive for market consistency conflicting with local circumstances and getting in the way of innovation. Ofwat have clearly thought carefully in this consultation about the process of developing environmental incentives and we welcome the approach proposed.

The relationship between Water Companies, Planning Authorities and Building Control departments needs clarity to ensure that each party is clear on its role in promoting new sustainable homes.

We believe that in addition to the incentive scheme there is a strong case that national representation should be made to encourage the further development of planning legislation to require all housebuilders to construct water efficient homes.

The suggestion that developers could make their developments water neutral by reducing water usage in the existing community is an excellent concept but is one that will require further engagement as recent experience related to the nutrient neutrality challenge, when one option was for developers to invest within the wider catchment to balance the increase from their sites, has strongly confirmed that developers were not happy being reliant upon the action of third parties to deliver interventions that they were dependent upon to meet their obligations.

Rather than through environmental incentives, we are developing a suite of progressive charging proposals, including the potential that we could work with developers, SLPs and NAVs to reflect alternative charges as propositions to communities (via planning authorities) or as choice options for individual customers. We are also exploring whether the retrofit potential could match the energy market, or be aligned with it. Therefore, we feel that the focus should not solely be on environmental incentives alongside infrastructure charges, and that these welcome proposals are not the only approach that water companies should be considering.

3. *Do you have any comments on the extent to which any environmental incentives could or should be adapted for implementation in Wales?*

We have no comments on the approach for Wales.

4. *Do you have any comments on the case studies outlined?*

The case studies from Thames, UU and Southern are very informative and we agree that a fittings approach is the easiest to implement and demonstrate compliance rather than the calculation approach. We hope that there will be some representation from product suppliers who would develop water efficient fittings to meet targets.

As highlighted within the consultation there is a risk that developers do not comply with the agreed measures, and we remain concerned about the level of policing this new approach might require. Feedback from our peers has indicated that some developers have claimed the incentive but have then failed to install the compliant fittings within their properties. Whilst this is outside of our current experience, we do not believe it will be economic or effective if companies have to employ significant resources to manage the scheme. A trust based approach with a consumer led approach to identifying non-compliance may be the most effective way of all being confident that the scheme is being adhered to by all parties.

It is disappointing that research with the companies operating schemes has shown that only a minority of properties met the targets that they were supposed to have complied with. There is scope to increase checking for compliance however this is likely to need additional resources and does not take into account potential customers replacing water efficient fittings at some stage in the future.

We also support the installation of retrofit and smart water butts, to support incentives to developers, but are also considering tariff choice that incentivises retrofit but could also apply to customers of new developments as an additional sales point. We see this as complimentary to developer incentives.

We note that Ofwat has consulted with the Home Builders Federation and Barratt Homes and the feedback aligns with engagement that we have undertaken with developers which indicates that developers support the installation of water efficiency measures but are less likely to install them where the capital outlay is significant making their homes more expensive than a direct competitor.

5. Do you have any comments on our proposed standardised incentive tiers?

We agree with the proposed standardise incentive tiers, this helps communication and understanding for all customers working across multiple water companies. We suggest that the bespoke incentives could be referred as “Platinum” or “Diamond” as a further reputational tier as these are going beyond the standardised incentives.

Further engagement could be undertaken with other stakeholders to understand whether achieving recognition through Water Company schemes would give developers an advantage when trying to attract prospective purchasers.

Within the consultation document there are suggestions that developers could be incentivised for installing mandatory requirements such as SuDS and Part G water consumption targets which must be managed through Planning legislation and Building Regulations.

To make the industry incentive scheme meaningful it must target exceedance of the statutory requirements that developers already have to meet. Whilst this might mean that some developers choose not to engage with the incentive scheme it would mean that there would be more reward for those who push themselves to outperform the targets by delivering positive environmental outcomes.

6. Do you have any comments on our proposal for a common methodology/technical standards to assess water efficiency?

We agree with a common methodology / technical standards approach but key is how it will be assessed and enforced as this is likely to be beyond capacity of Building Control/Planning Authorities.

We are aware that WRC has produced a water efficient calculator using a fittings-based approach which would appear to successfully meet the need to have a consistent and transparent approach to calculating water efficiency measures.

We are also aware that some companies already use this tool and therefore adoption across the industry seems a positive step. As this tool has been endorsed by Local Authority Building Control (LABC) it will help future alignment with Building Regulation compliance.

We understand that there has already been engagement by Water UK with smaller developers through their representatives at Home Builders Federation and House Builders Association and would encourage this to continue in the future to obtain their views and feedback on the proposals.

7. Do you have any comments on the details of our proposal for companies to offer bespoke incentives?

To ensure that the industry continues to work with other stakeholders to innovate and introduce new approaches to make new homes more sustainable and water efficient it is essential that any national incentive scheme should have the flexibility for individual companies to introduce bespoke incentives to allow pilots to be delivered between companies and developers. This will also allow companies to address regionalised challenges where they exist.

8. Do you have any comments on the potential for reputational incentives?

Whilst we support the idea of creating reputational incentives, we are unclear whether developer customers would see this as an effective marketing tool to give them a commercial advantage over similar sites within the same area.

Therefore, it is recommended that additional engagement is undertaken with developers and their representative bodies to assess how much value they would place in an endorsement from water companies that their site meets/exceeds water efficiency and sustainability measures.

9. We seek views on how the process for agreeing and paying environmental incentives might best be organised in practice, and whether this is consistent with existing developer services processes.

Infrastructure charges and currently the Income Offset payment become due once a connection is made. The environmental incentive should also apply at the same time as the infrastructure charge therefore. This will require developers to confirm the fittings that will be fitted prior to fitting although these will have been submitted to, and approved by, Building Control previously.

As it is anticipated that the large national housebuilders will incorporate water efficiency measures into their standard house types it should be simple to include the incentive amount when calculating infrastructure charges which is typically done at either site level or at construction phase level. Whilst not technically due until the connection has been made the majority of large developers pay infrastructure charges in advance.

To reduce administrative burden, it is proposed that companies could agree standard house type with developers on an annual basis with a mechanism to undertake further assessment should a developer change the installation arrangements or introduce new fittings. This would support the need for incentive schemes to remain innovative and flexible. The same process would apply to NAVs, and be accessible by SLPs, where the circumstances are the same.

Based upon water company audits to ensure compliance it is proposed that trust will be built between large developer customers and water companies to minimise the risk. These inspections will probably be undertaken by Water Regulation Officers

It is recognised that smaller developer customers may not construct standard housing types and therefore this is likely to require an upfront design review of fittings to calculate any incentive payment. Similarly, it would be necessary for companies to assure themselves that fittings had been installed prior to releasing any incentive payments.

As it is important that all developers are treated the same it is recommended that incentive payments are released within an agreed timescale after the installation of fittings has been confirmed either through inspection or sample audit. There are already examples of agreed payment terms within the D-MeX metrics such as the previous 28 days for asset payments,

following receipt of all required information, and therefore the incentive payments could follow a similar timescale.

10. Do you have any comments on how high levels of compliance with the incentive technical standards might best be achieved?

If the reputational incentive (like water efficiency labelling) was linked to the development, then this could be a strong incentive although as highlighted earlier it is recommended that further engagement is undertaken with the developer market to gauge their views.

We do not necessarily think the deterrent of disqualification will work although this could be an ultimate sanction should multiple non-compliance occur. There would need to be some leeway to address discrepancies due to things like a failure in the developers supply chain that can be readily corrected.

The audit approach has some strengths, and consistency of expectations (standardisation) would be required. We remain concerned that introducing additional site inspections and audits could be a resource hungry activity which would ultimately increase the cost of new connections thereby reducing an element of the incentive benefit.

The relationships between companies and Building Control is key to reducing the cost of post installation inspections as there will be opportunities to extend the scope of existing inspections by Building Control Officers to check water fittings as part of the current requirement to meet Part G of the Building Regulations

Additionally, companies could use their Water Regulation Officers to undertake additional inspections to ensure compliance with the requirements of the incentive scheme as well as the need to meet the Water Regulations.

Where developers do not deliver their onsite commitments, it is proposed that re-inspection fees are included within company Charging Arrangements so that companies can recover additional costs.

11. Do you have any views on whether environmental incentives are best funded as an environmental component of the infrastructure charge or as a separate charge?

We think it should be implicit within infrastructure charges, but just as a separate discount as the environmental component is replacing income offset.

The Ofwat approach is appropriate but we think it should simply be amended and rebalanced over time, with a running forecast vs actual difference between component and payment that is then spread out for recovery (positive or negative) over the future 5 years of the next infrastructure charge plus environmental component recalculation (annually with charges reset).

Adding an environmental element as shown in figure 6 seems like an excellent way of incentivising developers particularly as not meeting the new standards will result in developers paying more for their water connections. By penalising developers who do not meet the standards this will help to fund the incentive scheme and drive positive developer customer behaviours.

12. Do you have any comments on our proposal for guidance issued under the charging rules and how they are developed and maintained?

We agree that issuing additional guidance is an important element to ensure that water company charges remain transparent to developer customers.

This guidance will help to inform our customers which will provide them with confidence in our approach, consistency when working across company operating boundaries and increased awareness to support the industry through engagement to develop future charge changes.

It will also support the developer services markets to operate effectively by ensuring that new appointees and self-lay providers are compensated where they have worked with developers to deliver water efficient developments.

13. Do you have any comments on our approach for managing interactions with the regulatory framework?

We agree with the proposal not to include any specific metrics within D-MeX at this stage but believe that this should remain under review once a consistent approach has been introduced across the industry.

One area that could provide developers with confidence would be to introduce a quantitative metric to introduce a defined timescale for payment by water companies subject an appropriate level of assurance that water efficient fittings have been successfully installed.

We are happy to clarify any of our feedback and look forward to engaging on the future development of an industry environmental incentive framework.

Yours sincerely

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Director of Strategy & Regulation

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