Environmental incentives to support sustainable new homes

8th August 2023
(agreed extension)

Q1: Do you agree with our proposed aim for environmental incentives?

Thames Water agrees with Ofwat's aim that developers should be incentivised to build water efficient homes and that environmental incentives can contribute to this.

However, we note in section 2.4 that Ofwat state that any surcharge or discount should not be funded by general customers but by Developers, and we would therefore question why the PR24 methodology includes them in the price control? There is a risk that as the surcharge and discount regime is introduced by Water companies there will be a significant degree of estimating volumes of take up, which would result in general customers being impacted if the surcharge and discount do not balance to neutral over the AMP.

We also note that whilst environmental incentives administered through wholesale water companies is a positive step in increasing the on-ground delivery of water efficient building stock, ultimately Defra's proposed strengthening of future building regulations and planning process, as outlined in the Environmental Improvement Plan (2023), will become the primary mechanism to ensure future homes are designed and built with greater sustainability outcomes. The strengthening and standardisation of environment incentives for developers, via water company charging arrangements, can play an important role in being an early driver of water performance levels in new buildings, that could become standard requirements in the future.

Q2: Do you have any comments on the characteristics of good environmental incentives?

Thames Water believes that the environmental incentives should be simple to understand and accessible to all. Having a common approach by all Water companies will help Developers understanding.

We also believe that any incentive mechanism should be based upon appropriate performance metrics that are well evidenced and can be measured.

Q3: Do you have any comments on the extent to which any environmental incentives could or should be adapted for implementation in Wales?

Thames Water believes environmental incentives should be available in Wales on the same basis as in England as the net impact on revenue is expected to be nil. Ofwat can implement changes to allow the surcharge and discount to be made though the charging rules and licence conditions.

Q4: Do you have any comments on the case studies outlined?

Thames Water supports Defra's roadmap to strengthening building regulations such as encouraging the water fittings approach is already part of Thames Tier 1 incentive, and we support the further plans on mandatory labelling which will drive water efficiency in fittings/appliance design and procurement across all manufacturer and developer stakeholders. We believe the incentives should support developers move towards these, and a discount should only be given where the developer goes above and beyond what is already required of them as part of building regulations, so these will need to be flexible over time to consider changes in regulations.

Incentives which are linked to per capital consumption are much harder in practise to achieve, as the developer can only install the water saving devices/re-use technologies but cannot actually influence the amount of water the homeowner will actually use, and our smart metering data has shown that the existing regulations of 125 lppd (litres/person/day - PCC) are not being achieved in new developments. This is further supported in the case studies by the WRc case study where every property failed to achieve the required PCC.

We advise that any environmental incentive mechanism and/or criteria used with developers, does not base itself on a per capita consumption method (litres/person/day). Our smart meter data analysis of actual water use performance in homes that were specified and built to certain l/p/day levels, do not reach such water usage levels in practice. We recommend that any incentive aiming to improve water efficiency, focuses on actual water 'fittings/fixtures/appliance' flowrate and volume performance levels. Using flowrate/volume metrics (as per our Tier-1 method, which uses Table 2.2 from Part G, Building Regulations) can be assessed and confirmed at the time of connection quote/application with the developer, whereas PCC cannot be actually measured, nor does it guarantee that water efficiency fittings/appliances will actually be installed.

Focusing any standardised incentive methodology on a 'fittings approach', as per Table 2.2 of Part G Building Regulations, would help align the process with Defra's panned introduction of mandatory water labelling - helping future-proof the incentive methodology.

We also support the expansion of incentive options that deliver water performance benefit across existing housing stock, which is by far the largest user of water in every water resource zone. This option can be in the form of water offsetting to achieve water neutrality / positive status for new homes. Thames Water has already introduced water neutrality through offsetting within the Tier-3 of our environmental incentive for developers and can investigate if this can be expanded to include retrofitting SUDS in the future where a developer cannot avoid a surface water connection on their new development.

The low audit pass rate experienced by United Utilities is also a concern. Environmental Incentives should not place a high audit demand on the Water company to enforce what the developer has committed to deliver. We agree with the principle that developers who have repeat failures should be banned from being entitled to environmental incentives for a period of time, with an increasing length of the ban should be applied if failures are encountered after an initial ban.

Q5: Do you have any comments on our proposed standardised incentive tiers?

Thames Water agrees with the tiered approach to incentives which is largely in line with our current offering. However, as mentioned in Q4 we recommend not using litres/person/day PCC metric as the incentive's target metric. We recommend using a 'fittings approach' (as per Table 2.2 of Part G Building Regulations) for the Bronze level.

SuDS will be mandatory on all developments over 100m^2 when Sch3 is enacted so there will be reduced need to incentivise the use of SuDS. However, some surface water strategies will still require a connection to the sewer at maximum discharge rate (tbc in the Sch3 Tech Standards), we could incentivise restricting flows further to reduce the impact on our network. For example, intercept an initial rainfall volume on site and only discharge the equivalent of a 1yr storm with the rest being stored for gradual release.

Q6: Do you have any comments on our proposal for a common methodology/technical standard to assess water efficiency?

Thames Water agrees with Ofwat's proposal to use established existing methodologies where possible and agrees with the use of the fittings approach and also with adding a requirement that they are fitted correctly.
Water companies will not have any occupancy for these new homes, to verify post-build water performance. Following engagement with multiple housing developers and dozens of housing associations, we can confirm that occupancy data is not captured or recorded by any developer or housing manager. This makes the use of a litres/person/day metric unsuitable for any requirement to measure actual water performance against an incentive.
As noted in Q4 we recommend not using litres/person/day PCC metric as the incentive's target metric. We recommend using a 'fittings approach' (as per Table 2.2 of Part G Building Regulations) for the Bronze level. Using a litres/person/day method will make it impossible for the water company to measure or verify, undermining any potential value the environmental incentive is intended to deliver in practice.
As we have presented previously, the use of a litres/person/day as a metric or building regulations or incentives, does not yield the desired water use performance in practice when the new dwelling is occupied. The litres/person/day metric is a theoretical value, based on water use behaviour assumptions that a developer does not have the ability to influence or control. The increase in smart meter penetration and consumption data analytics across the sector from AMP8 onwards, is likely to quantify actual usage rates on homes build or incentivised to certain litres/person/day targets – potentially proving again that PCC is not an appropriate metric to use for a developer incentive.

We support the introduction of mandatory labelling. The introduction of mandatory water labelling will fundamentally change the manufacturing, retailing, and specifying of fittings, fixtures, and appliances, and benefit all housing and commercial building stock in the long term. The label has the potential to be integrated within future changes to building regulations (as highlighted in Defra's Environmental Improvement Plan 2023), and potentially benefit future incentive mechanisms. The use of a future water label would align well with any environmental incentive, if it were to be based on fittings performance levels, rather than litres/person/day methods.

Q7: Do you have any comments on the details of our proposal for companies to offer bespoke incentives?

Thames Water agrees with the proposal to allow for bespoke discounts as this will allow the incentives to evolve as technologies are developed and agree that once established, they should be incorporated into the common framework.

Q8: Do you have any comments on the potential for reputational incentives?

Thames Water agrees with the principle of a reputational element such as a label may be of interest to developers. However, whilst we agree that reporting on the take up of incentives will be required to understand how successful the schemes are, we do have some system constraints which means this is a manual process for us currently. Our systems do not allow us to track this in the detail being proposed, such as sector/developer type. We would need further detail on these proposals to be able to fully assess the feasibility.

Q9: 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.

Thames Water currently applies the environmental incentive at the same time as the infrastructure charge is calculated. This is when the developer requests a Service Connection quotation, and they are required to provide the evidence at this time. We believe that this best aligns with the surcharge and discount being applied to the infrastructure charges.
Applying the discount at the application stage also means that the price is calculated once. If it were applied at a later stage, then this would require duplication in administration of the calculation of the charges for the developer. This would not be efficient resulting in increased administration resources and drive-up costs.
Developers have previously advised us through consultation responses, that cost certainty is a very important factor when they are developing sites, so moving the calculation of discounts to after build would mean more uncertainty for them.

Q10: Do you have any comments on how high levels of compliance with the incentive technical standards might best be achieved?

Thames Water does not agree with applying the discount after conducting an audit following the installation of the fittings. Any incentive should not place a significant audit requirement on the Water company but should be more sample based. Compliance with any incentive needs to be kept as simple as possible, without creating additional verification burden upon both the developer and water company. Q9 refers to the administration issue of calculating and processing the discount at a later stage. However, we do agree with the proposal of a deterrent for those who fail any inspections.

There is opportunity to increase and improve the awareness of incentive mechanisms and their intended benefit. Standardising a consistent incentive approach across all companies will help convey a clear message to developers, and hopefully increase take-up rates.

Q11: Do you have views on whether environmental incentives are best funded as an environmental component of the infrastructure charge or as a separate charge?

Thames Water agrees that applying the surcharge and discount to the infrastructure charge is the most sensible approach to implementing these proposals. This would mean the same methodology would apply to calculating the number of properties eligible for the discounts as infrastructure charges and makes the process simple to understand.

However, as mentioned in Q1, this may need further consideration in relation to unintended impacts in relation to the revenue cap. Given there would be an inbuilt year on year adjustment mechanism there is a strong logic to exclude this revenue from the revenue cap, and to support this through transparent annual reporting of forecast vs actual volumes and year on year adjustments resulting from differences.

Q12: Do you have any comments on our proposal for guidance issued under the charging rules and how they are developed and maintained?

Thames Water agrees that the NCC working group would be best placed to consider how these guidelines are drawn up and maintained.
However, a risk to this approach, based on our experience of similar groups dealing with change proposals, is that the end-to-end process can take longer than expected, so potentially stifling, or delaying the benefits of innovative approaches from companies, NAVs, SLPs or from developer customers. These timing issues risk being a key frustration where alternative

approaches emerge in relation to live developments, where any notable delay in decision-making may effectively remove the opportunity (for example as it would be unreasonable to expect the housebuilder to be able to delay their projects). Companies may be best placed to assess whether or not to allow alternative approaches in a more reasonable timeframe, especially as the companies are managing the underlying environmental risks in their areas of appointment.
The working group should therefore adhere to an agreed set of timescales for dealing with change proposals that impact standard tiers, so as not to adversely impact timely changes being implemented to the charging rules.

Q13: Do you have any comments on our approach for managing interactions with the regulatory framework?

We agree that SLPs and NAV's need to have the same opportunity to benefit from environmental incentives as developers that come directly to the incumbent. While we support the need to encourage innovation right across developer markets in order to benefit developer customers, we have reservations about any suggestion that specific approaches be developed that may give a differentiated offering to NAVs. The onus is on incumbents to ensure they comply with Competition Law and there a strong risk of running counter to this as well as Licence conditions.
Ofwat may consider whether it is desirable to apply controls to ensure that incentives claimed by NAVs from incumbents are passed on to the NAV's developer customers to avoid confusion for developers in how such incentive schemes are intended to work acting as a disincentive. However, we recognise this is complex given the greater freedoms that NAVs have to agree different contractual terms with their customers.

In applying environmental incentives in SLP and NAV markets incumbents will need the same rights to validate claims, including the timely reporting of connections being made to ensure the correct environmental charges and discounts are applied.

Thames Water

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