Affinity Water
Taking care of your water

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Consultation on the Changing Ofwat's charging rules to support the new developer services framework

Thank you for the opportunity to share our comments on the proposals for changing your charging rules to support the new developer services framework, which we very much welcome.

We are a 'Water Only' company. That means we supply clean water to our customers, but we do not manage or process wastewater or sewage. In fact, we are the largest Water Only company. We own and manage the water assets and network in an area of approximately 4,500km2 across three supply regions in the South East of England. We have been supplying water to the local community for more than 170 years.

We recognise that an effective regulatory framework is critical to enabling sustainable growth that benefits both customers and the environment. Our responses below are in alignment with our Strategic Policy Statement (SPS). These include:

Promotion of Collaboration on Large-Scale Developments:
We view the regulatory framework as an essential enabler for fostering collaboration between incumbents, the emerging market and new connections customers, including for large-scale developments. By facilitating the current and future emerging market, we aim to contribute to sustainable growth that also delivers environmental benefits.

Fairness and Transparency in Charging Arrangements:
We evaluate our charging arrangements to improve fairness and transparency and we consult our customers annually on all critical areas in our charges. The regulatory framework provides crucial guidelines for this, helping us to incorporate sustainability and environmental protections into our pricing models. We aim to offer a transparent breakdown of costs and in 2024/25 we are aiming to increase our water efficiency incentives to our customers.

Alignment with Government Ambitions on Housing Supply:
We believe that the regulatory framework also plays a pivotal role in our duty to support the government's ambitions for increased housing supply, in line with achieving sustainable development. Our focus is on adapting our services to create an enabling culture for sustainable water services in new housing developments.

1. What are your views on our proposal to link charges for different types of development through the use of tether ratios? What are your thoughts on the use of ratios based on industry maximum figures, not average or median figures?

We agree with the assessment and subsequent dismissal of options 1 and 2, which propose capping charges, either by CPIH or an alternative measure, to safeguard smaller developments and those not necessitating a new main.

In the event that tethering is selected for implementation, we support the concept of the maximum industry tether as an appropriate threshold to avoid historical challenges associated with evaluating efficiencies on a regional basis. By setting a maximum tethering limit, incumbents would be able to sustain their current cost-reflective stances, thereby upholding compatibility with the already established principles of transparent and robust charging.

However, while the maximum tether threshold presents a relatively straightforward boundary in principle, there are still some aspects that are unclear, particularly when it comes to its detailed application. We request further clarification regarding the frequency of tether ratio and associated scenario evaluation baselining. For instance, would the tether be reviewed on an annual basis or at the beginning of each AMP as an example. Each frequency carries its own set of advantages and drawbacks.

An annual review may closely align with existing cost-reflectivity and transparency principles, considering the latest operational materials costs and re-tender processes/timelines. Yet, it may introduce limitations and uncertainty regarding the stability and predictability of charges, which contradicts the charging principles.

An annual review of tether ratios could also introduce additional complexities into an already challenging environment for delivery partners, vendors, and operatives in the market. The tendering processes are highly dependent on stable charging frameworks to establish commercially viable rates. Introducing fluctuating or complicated cost structures might lead to market costs that are either inaccurate or difficult to predict. This could, in turn, deter participation in the self-lay market, as it may become increasingly challenging for entities to accurately anticipate incumbent charges when bidding for work.

If tether ratios are reviewed annually and efficiencies are driven by other market players, it may naturally reduce the industry maximum, thus encouraging a more efficient and competitive market. Conversely, reviewing tether ratios on an AMP-cycle frequency might still result in charges dictated by other market players and influenced by the supply chain.

If an AMP-cycle baseline is the selected frequency, and all incumbents sit within the current ratio parameters, it is unclear how efficiency and customer benefits would be promoted beyond the current market environment, especially if all incumbents opt to retain their current approach.

There are challenges surrounding the use of scenarios to establish comparison across the industry. Each incumbent's scenarios are calculated seemingly differently, where the detail is veiled within the main body of their new connection charging arrangements. We note, that if such challenges exist for incumbents, and subject matter experts, then it is our assumption they will be amplified for customers. With this challenge, we request the provision of detail on how the determination of scenario costs and associated tether ratios have been undertaken. We note concern over the accuracy and transparency of the scenario data potentially distorting the tether thresholds.

Additionally, we suggest further consideration be afforded to mitigating the potential difficulties in communicating the concept of tethering and cost ratios to customers and developers. Effective communication and terminology are pivotal in translating these concepts to customers and articulating the value added to them.

Where the consultation refers to 'substantial' movements in tethering by incumbents, it remains unclear what this is deemed to be. We request clarification to ensure we have complete transparency of such expectations.

While we understand the motivation to eliminate the need for complex cost assessment and reconciliation mechanisms, the proposed tethering methodology appears intricate and challenging. This complexity warrants consideration, particularly if the current 10% threshold is deemed robust. If it is deemed not to contribute toward such goals, it could be considered for removal if tethering is introduced.

2. What are your views on option 5 that companies should individually charge for separate activities involved in making service connections? Do you agree with our proposal to implement via changes to the wording of the CTWE?

It is our view that Option 5 and Option 6 both have the potential to exacerbate customer information overload. Where both options result in the inclusion of more comprehensive information, but consequently also lend to lengthier and potentially confusing charging information. On balance, we view the extension of the charging arrangements, and associated summary 'customer friendly' documentation, will provide limited benefit for customers.

For smaller developments, we feel it is important to recognise that they predominately represent one-time customers, making it unlikely for them to engage in cost comparisons or experience recurring charges. As such, more detailed and complex charging arrangements are unlikely to strongly benefit this customer type. Alongside the potential for more overwhelming charging arrangements, these options further risk unnecessary customer contact and dissatisfaction with the upfront portion of the customer journey.

We note our reservations regarding the clarity of the proposed wording amendment. Although we support the consideration to reduce bundling of charges, albeit only to a more median approach, we believe the wording proposal may still not achieve the goal. Incumbents who currently bundle the full spectrum of works within their connection charges, may continue to present their costs in a similar manner, as their costs would still encompass all the listed items. We note, the changes to the wording surrounding the requirement of published charges in relation to the scenarios should be considered in line with the final unbundling approach.

Our preferred approach to the reduction of charges bundling would be to establish a 'maximum' bundling threshold that aligns with the prevailing industry practice, akin to how the majority of incumbents currently present their charges, as noted in Figure 8. This entails bundling connection fees and meter-related costs while separately publishing the charges associated with pipework and traffic management. We note this will help to align incumbent charges, simplify the approach whilst allowing space for further transparency to be provided should an incumbent currently, or in the future wish to, generate and publish their charges as such.

3. Do you have views on our proposals to add two new worked examples with the aim of providing additional protection for developments with limited choice? What are your views on suitable new scenarios?

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Option 6 introduces the consideration of two additional scenarios which, if agreed and required for publication, we would request suitable advance notice to ensure the provision of accurate and complete data. However, we note there remain existing challenges surrounding the non-comparability between the current published scenarios. We believe scenario data shows distortion and misalignment across the required elements including fittings, pipe lengths, infrastructure charges, and associated incentives within these scenarios.

As such, there are challenges surrounding the use of scenarios to establish comparison across the industry. Each incumbent's scenarios are calculated seemingly differently, where the detail is veiled within the main body of their new connection charging arrangements. We note, that if such challenges exist for incumbents, and subject matter experts, then it is our assumption they will be amplified for customers. The introduction of two further scenarios may result in an exacerbation of such nuances lending to further difficulties in the utilisation of the scenarios. We support the introduction of unbundling of charges, to the previously explained level, to somewhat mitigate these challenges.

We request consideration be made with the understanding that several incumbents already provide an additional scenario: an amended version of current scenario three, in response to requests from the self-lay market. Introducing the two new proposed examples would necessitate the publication of a total of nine examples for such incumbents. We feel this may not be proportionate to the information provided nor the value offered to customers. Additionally, it remains unclear whether these scenarios have proven useful to customers or broader market participants.

Within our region we do not, as standard, provide designs of 25 single connections without pairing their delivery with a new main. For developments with 25 single connections, fire supplies would be mandatory, requiring the addition of hydrant accessories. This, in turn, would necessitate the installation of a new main. Given these considerations, we believe the suggested scenario is not in line with established design principles and safety guidelines we adhere to for the well-being of our customers and the integrity of our network.

As neither of the above options provide a suitable, safe, nor realistic delivery of a 25-plot development. As such, we propose excluding this 25-plot scenario from consideration to avoid misalignment of safety standards and delivery feasibility, increased administrative costs and limited value add for customers. It is essential to align the purpose of these examples with the aim of benefiting our customers.

We agree with the proposal of any newly introduced scenarios being untethered, as the relationships between existing scenarios and customer types are yet to be demonstrated. However, we expect over time they will naturally become tethered due to the interconnected nature of charges.

In the event of introducing new scenarios, we request consideration be made in the provision of accompanying designs and/or drawings by Ofwat to ensure incumbent alignment, charging transparency and accurate data publication.

4. Do you agree with our proposed general guidance for RAG2 regarding a fair allocation of all relevant overheads across ALL expenditure areas, including developer services?

We are pleased to see this is being consulted upon and we agree with the proposal. We consider the introduction of this guidance will strengthen the alignment between charging principles and the operational practice of incumbents. This is an activity we anticipate embedding into our 2024/25 new connection charges.

Nevertheless, it is crucial to acknowledge the potential risk associated with the absence of specific prescription for the calculation of these overheads. Such flexibility will likely lead to varied interpretations and diverse approaches among incumbents.

5. Should RAG2 specify methods of overhead recovery for developer services? Are there any disadvantages to doing so?

As noted above, we believe there to be an inherent risk of divergent approaches without the provision of clear overhead recovery methodologies. We agree Ofwat should equip incumbents with the appropriate details under which successful coverage of all required overheads can be effectively captured.

Self-lay and NAV companies currently enjoy the advantage of not bearing the same administrative burden as incumbents. This contrast poses a challenge to water companies in terms of increased overhead capacity requirements and their associated costs. The administrative responsibilities include, but are not limited to, responding to Ofwat consultations, participation in regulatory working groups, fulfilling complex data returns and requests, conducting customer experience surveys, engaging in customer consultations, liaising with the Consumer Council for Water (CCW), and associated Price Review work.

Although we support the inclusion of attributable overheads to our charges in order to provide reflective costs, it should be noted such overhead commitments represent a considerable workload for incumbents. Consequently, when these overheads are factored into the calculation of developer services charges, it is unclear how incumbents can effectively position themselves as the most cost-effective option for customers. The accumulation of administrative obligations and their associated costs present a challenge for incumbents striving to offer truly competitive and optionable pricing to their customers.

6. Do you agree that RAG2 could be extended to cover the recovery and allocation of overhead costs between developments with and without a mains requirement? Do you have any suggestions as to how this should be done?

We do not support the proposal for a split of overheads attributable to connections to existing and connections to new mains.

We consider this to be a future improvement that will rely upon the clear differentiation between customer segmentation and effective embedment of the guidance across the whole of developer services in the first instance.

It is important to note that challenges may remain under the initial concept whereby not all incumbents employ standalone developer service contracts. This can inadvertently obscure cost structures and promote cost-shifting onto other segments of the wholesale business. In contrast, a separate contract arrangement ensures that all incurred costs are attributed solely to developer services operations, without any subsidy from residential customers, especially moving into the new AMP and price control allocation.

7. What are your views on our proposal to carry out a market review prior to PR29?

We generally support the proposal of maintaining a consistent and periodic review process to safeguard customer interests and promote the growth of an open market, however, we request consideration be undertaken of the additional administration required of incumbents and to ensure the review delivers sufficient value to developers and the end-user.

We seek clarification on how this review would distinguish itself from historical assessments and what specific modifications or improvements will be introduced compared to previous undertakings. Providing this insight will enable incumbents to better understand the review's objectives and the potential outcomes for AMP9 and beyond.

The developer services landscape is expected to be significantly different from the current operational state and we would be supportive of a shift towards reviews that are more regionally focused. By segmenting the market review in this manner, may result in a greater understanding of variances between incumbents, rate of market developments and allow deep dives into tailored areas to be undertaken.

8. What are your views on our proposal that companies include historical variances between expenditure and revenues in setting infrastructure charges?

At present, customers who requisition mains typically do not provide upfront payments for infrastructure charges related to plots within their planned development. These are often the very developments that necessitate the building of network reinforcements either before or during their own construction to guarantee a sufficient water supply. Given this context, we acknowledge that there are frequent challenges concerning the timing and financial investment required for delivering the necessary reinforcements.

To alleviate these complexities, we recommend the adoption of a prerequisite for infrastructure payments in advance of connections, for instance as water mains are requisitioned. This proactive measure could rectify issues related to delayed installations and timing misalignments, which in turn negatively influence other performance indicators, like properties suffering from low pressure. By pre-securing the essential infrastructure and its accompanying funding before the onset of the development, we stand to streamline the overall process, benefiting all parties concerned.

One area of note is for our one-off customers and how this proposal will protect them. These customer types are people who are building a single home and only use our services once. Should historic variances be significant, for instances during or after housing market shift, then these customers may face paying a significantly increased infrastructure charge to cover under recovery in the past. This could have a significant impact on a customer who has budgeted at the start of their build and the payment of the infrastructure charge.

9. Do you agree with our proposal to enable companies to take account of upsized infrastructure when setting infrastructure charges?

While the proposed changes may have benefits, we feel it is essential to consider the potential impact on developer customers. Any significant swings in infrastructure costs could potentially disrupt operations and result in increased connection expenses. Large developer customers value the stability in infrastructure costs that they currently experience, as evidenced, and supported through our annual customer charging consultation process.

If the accounting for upsized infrastructure leads to increased infrastructure charges, we must consider how customer perception of such impacts the customer's experience of an incumbent and ultimately, on the DMEX scores associated. It is crucial to recognise that infrastructure costs are fundamentally derived from the wholesale portion of the business and should be intertwined with the scoring mechanism.

Without a clear way to segregate this and clearly remove the impact of the wholesale business on incumbent developer services operations leaves the market open to vulnerability driven from price-controlled outputs and deliverables. We would encourage consideration of how a fair assessment of an incumbent's performance without the influence of external factors be undertaken. Self-lay and NAV companies are unlikely to encounter these challenges when evaluating their customer experience services.

Fluctuations in infrastructure costs can have a more pronounced effect on overall operations and customer service. Furthermore, it's important to acknowledge that areas of high growth and development will be more profoundly affected by such changes and will face additional challenges in mitigating these impacts. This is particularly relevant in regions that are characterised by high water stress, such as the South East of England.

10. What are your views on our proposals relating to how we accommodate changes to the provision of income offset?

While we support the dissolution of the provision of income offset from the start of AMP8, it is crucial to acknowledge the potential risk it poses to incumbent revenue recovery. The transition in the net position between the two charging mechanisms, namely infrastructure charge and income offset, is expected to result in an increased incumbent debt position. This concern is further exacerbated by the pre-existing challenge of recovering infrastructure revenue in time for the delivery of infrastructure reinforcement schemes, as discussed in response to question 8.

Aside from this concern, we are appreciative of the clarification provided and are pleased this has been addressed ahead of the generation of developer services charging for the 2024/25 period.

Yours sincerely,

[redacted]

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