

Request for stakeholder views on charging for developer services in Wales

Hafren Dyfrdwy response

September 2020

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Summary of response

While the request for stakeholder views was clearly directed at developers and other service providers rather than companies, we feel that it would be useful to set out our view on future changes to charging for new development in Wales.

In broad terms, we would support an alignment between the charging rules in England and Wales. We believe there would be significant advantages to stakeholders within the market if there were fewer differences in rules for customers to understand, since many developers undertake work on both sides of the border.

There are some disadvantages to the way that the “income offset” is now set off against infrastructure charges rather than requisitions in England. This operates to the advantage of some smaller developments, but to the disadvantage of developments that requisition a main. There is also a cashflow impact from later receipt of the “income offset” compared to the previous approach, including the asset payment formerly made to Self-Lay Providers. On balance, we think these problems are outweighed by the benefits of a harmonised approach for developer customers.

From Hafren Dyfrdwy’s perspective, there is one significant area where the approach from England would need to be modified; there is now an expectation that infrastructure charges should be matched to reinforcement expenditure over five years. With a large company such as Dŵr Cymru or Severn Trent, this will probably work out as there should be some reinforcement activity on the network in any given year. For HD this will not always be the case, particularly for our wastewater service which serves only 18,000 households.

With a service this small, the approach breaks down: in the next 5 years we are not expecting to do any reinforcement activity on HD’s wastewater network. In time, the accumulation of new connections will give rise to a need for investment, but in AMP7 they will not. If we applied the new infrastructure charging method, developers connecting in AMP7 would pay nothing, but - in a future period – other developers will bear a disproportionately higher cost when new investment is actually required.

We would suggest that an alternative approach to infrastructure charges should be adopted for HD – certainly for the wastewater service. This could compare charges against expenditure over a larger area or a longer time period; if this is not done then future developers will end up paying for all the new connections undertaken today.

Brief answers to the specific questions raised in the request are included below.

Kind regards

Shane Anderson
Director of Regulation and Strategy

Response to detailed questions

1. Do you have any specific concerns with the current approach to charging for developer services by the Welsh water companies or features that you want to see retained?

The current regime in Wales is similar to the approach in England prior to Ofwat's reforms. In our view, the main concern with that framework related to reinforcement costs. Across the industry companies adopted different approaches, with some including an element of these costs as part of the requisition charge. Understandably, this gave rise to a concern that developers were being charged twice, as the infrastructure charge also applied.

Ofwat has clarified that reinforcement costs should be covered by infrastructure charges. We think that this - together with rules around the cost-reflectivity of charges – would have been sufficient to resolve most concerns about the old framework. However, given that developers now have to deal with different systems on each side of the border we broadly support alignment in order to improve the customer experience.

2. What are your views on retaining the current approach to charging for developer services by the Welsh water companies?

As noted above, we are broadly supportive of a transition to the system which operates in England. This would simplify discussions with developers who generally operate on both sides of the border.

3. Would you prefer charges for developer services to reflect the actual cost of providing each particular service or be more predictable?

Our experience is that developers generally prefer predictable charges. As noted in the request, this will lead to a reduction in cost-reflectivity. We think that this can be managed if the basis for charges is properly explained; differences in actual cost will result from variations in activity and ground conditions.

4. What are your views on the income offset?

There are some disadvantages to the way that the "income offset" is now set off against infrastructure charges rather than requisitions in England. This operates to the advantage of some smaller developments (which now receive an "income offset", when they would not previously) but to the disadvantage of developments that requisition a main – at present we lay these for free in most developments where they are required and developers only need to make a contribution when costs are particularly high.

There is also a cashflow impact from later receipt of the "income offset" compared to the previous approach. This includes the position for Self-Lay Providers, where we made an asset payment when we adopted the mains they had constructed.

We think these problems are outweighed by the benefits of a harmonised approach for developer customers. There has been a great deal of change within the area in a short period of time, especially when compared with the period from privatisation to the end of AMP5. On balance, we think that customer experience for our developer customers would be better if there were fewer differences in regulation between England and Wales.

5. Are there any other features that you want to see in the way that charges for developer services are set and the rules that govern them?

We would be content for the same features as England to be implemented in Wales - with a modification to the approach on the infrastructure charge, as explained below.

6. Are there any other points that you would like to raise with us that are not covered by the previous questions?

Under Ofwat's new approach there is an expectation that infrastructure charges should be matched to reinforcement expenditure over five years. With a large company such as Dŵr Cymru or Severn Trent, this will probably work out as there should be some reinforcement activity somewhere on the network in any given year. For HD this will not always be the case, particularly for our wastewater service which serves only 18,000 households.

With a service this small, the approach breaks down: in the next 5 years we are not expecting to do any reinforcement activity on HD's wastewater network. In time, the accumulation of new connections will give to a need for investment, but in AMP7 they will not. If we applied the new infrastructure charging method, developers connecting in AMP7 would pay nothing, but - in a future period - other developers will bear a disproportionately higher cost when new investment is actually required.

Last year we connected 64 new residential and 2 business properties for wastewater. If this rate were replicated in an AMP when we need to spend - say - £300,000 on reinforcement, this would imply that each connecting property in that 5 years should bear a cost of c£1,000. This would be the cumulative effect of developers in AMP7 (and perhaps more periods) enjoying a free connection to the system.

We would suggest that an alternative approach to infrastructure charges should be adopted for HD - certainly for the wastewater service. We think there are two alternatives: we could compare charges against expenditure over a larger area or a longer time period.

In order to look at a larger area, we would need to consider areas that are not served by Hafren Dyfrdwy - for example, the neighbouring companies. We suggest that the infrastructure charges for HD (especially wastewater) are set on a relative basis (i.e. they are pegged to the rate of either Severn Trent or Dŵr Cymru).

Relative controls are currently only used for new appointees, but it is worth considering that HD's wastewater service has a turnover of around £3.5m; if this was a stand-alone business, it would fall below Ofwat's threshold for small company reporting.