WATER & SEWERAGE SECTOR

MARKET REFORM/CHARGING RULES

HBF CONTRIBUTORY DISCUSSION PAPER – AUGUST 2015

In a general context the 'reform' proposals currently under consideration by both Defra and Ofwat offer a unique opportunity to introduce greater clarity and consistency when seeking the provision of water and sewerage infrastructure to serve new development. Indeed, if we are to meet the Government's objective(s) in terms of new housing provision the need to have in place, fair, equitable, proportionate and mutually agreed charging rules is essential. If this principle is not allowed to inform any future intended consultation then the risk (or unintended consequence) may well be compromised project viability, leading to reduced housing provision.

As the main industry body representing UK house builders responsible for providing over 80% of the UK's new housing stock in England and Wales, HBF has been closely involved with the Water & Sewerage Sector for the best part of 50 years. Moreover, throughout this period the HBF has been one of relatively few sectors of industry that has experienced and had to deal with the transition from statutory water and sewerage authorities to a monopoly privileged privatised water and sewerage sector, albeit with statutory responsibilities – see EU Upper Tribunal decision 2015.

Since the Public Health Act 1936 and Water Act 1945 respectively we have witnessed several iterations in water and sewerage legislation, the most notable perhaps being the Water Act 1989 and the Water Industry Act 1991. Moreover, since the early 1960's HBF has played an active and integral part in crystallising the intent and content of subsequent changes in primary and secondary legislation. Similarly, any supporting technical guidance. Consequently, the experience and evidence within the HBF places it in a strong position to offer a balanced and informed perspective specific to a number of fundamentally important matters. In response to the collective call for information HBF has already articulated to both Defra and Ofwat a raft of issues that it believes should be included in any intended consultation. This short discussion paper provides more detailed evidence in this regard and emphasises the need to work from the whole to the part.

Since the early 1960's and until the coming into force of the Water Act 1989, the house building industry operated in a relatively benign legislative/commercial environment. In essence, all partner/stakeholder interests knew precisely what was required. More importantly, there was consistency in both the approach (rights and obligations) and the costs that were to be reasonably incurred when house builders were making key investment decisions specific to new land and development opportunities. On those few occasions when water and sewerage authorities were challenged the Courts more often than not re-affirmed the mutually understood and accepted statutory obligations imposed on such bodies, in particular their *prima facia* responsibility to provide the necessary infrastructure (water and sewerage) to service the needs of new development. In many respects, this basic tenet of water and sewerage law has been upheld in subsequent Court decisions, but during the last eight years, there has been an exponential increase in the number of disputes and referrals to the Regulator Ofwat.

The catalyst for this increase in referrals appears to stem from differing interpretation(s), by WaSCs, of both extant legislation and more recent High Court/Supreme Court decisions. The outcome has been a growing number of demands for excessive developer contributions for network analysis and/or reinforcement.

Sometimes, developers have been placed under duress in terms of having to accept inequitable terms and conditions in the interests of commercial expediency. In addition, with more WaSCs trying to use the planning system to leverage additional payments for network reinforcement from developers this has resulted in many tensions and conflicts, some of which have resulted in development either not going ahead or being seriously delayed. In the latter case HBF has a considerable body of evidence.

In many respects this is not an appropriate way forward especially when WaSCs do not appear to have a sufficient understanding of planning law, especially in relation to the National Planning Policy Framework and in particular, what constitutes an appropriate and legally enforceable planning condition. Conversely, planning authorities are not being made aware by WaSCs as to what statutory obligations and rights exist under prevailing water and sewerage legislation – the evidence for this being numerous LA planning committee reports.

The house building industry has no difficulty in paying its way but HBF genuinely believes that we have reached the stage when all aspects of the Water & Sewerage Sector charging regime would merit a root and branch review. Moreover, with a growing number of instances whereby inequitable and disproportionate terms and conditions are being imposed upon house builders, the design and procurement process for delivering on-site and off-site water and sewerage infrastructure is taking longer than it should, largely as a result of compromised project viability. This is counter-productive and wasteful of limited resources.

In terms of the basic costs paid by house builder per dwelling a useful starting point is a like for like comparison with other utility services. Ignoring the growing demands for house builders to pay for network reinforcement/improvement (both water and sewerage infrastructure) the basic cost for a water connection alone is around £950/dwelling, excluding other peripheral on-costs, for example an additional cost of around £50/m for any water connection over 2.0m in length. By comparison, gas and electricity connections are in the region of £350 - £400/dwelling for each connection). Once we start to 'factor in' developer funded off-site reinforcement costs, (both water and sewerage infrastructure) network analysis fees, sewer connection fees and sewerage infrastructure charges, the cumulative cost to a developer easily exceeds £2000/dwelling – in certain parts of England this can be the equivalent of 5% of total basic construction cost and with little prospect of off-setting part of this cost by way of a compensating reduction in land value and/or selling price. As a result, compromised viability equates to fewer new homes being provided.

Clearly, we have reached the stage when a number of important issues should be included as an integral part of the proposals for market reform, including the intended charging rules. If this could be extended so as to give Ofwat greater powers, with WaSC performance KPIs being defined by statute, then all the better. However, at this stage we will confine the contents of this discussion paper to the following important matters that we believe should be included and which build upon the comments previously articulated:-

1. Re-affirmation of the statutory duty placed on all WaSCs under Section 94 of the Water Industry Act 1991. Similarly, the rights of connection to the public sewerage system by virtue of S106 of the same 'Act'.

2. A clear and concise definition as to what infrastructure charges are meant to cover together with a comprehensive review of Condition C.

3. In order to dispel repeated assertions that developers/house builders are paying twice for the same thing, to have in place a clear and concise method of audit to show how infrastructure charge revenues have been or how they are to be invested.

4. In recognition of the obligations placed on all WaSCs by virtue of s94, in the event that existing foul sewer network analysis is required that this be funded by WaSCs and for any improvement(s) that are deemed necessary be also funded by the WaSC. The precedent for this is already established in a number of WaSCs as well has having synergy with the discharge of s94 obligations. (The requirement for a sewerage authority to effectually drain and maintain such drainage infrastructure in its operating area has existed for the best part of a hundred years). In addition, there is no reason why historic infrastructure payments should not be used for this purpose.

5. When undertaking network analysis for the provision of potable water to serve new development, to have in place an agreed and consistently applied approach to network analysis. Evidence held by the HBF shows considerable variance in this area. Demand criteria that is being factored into a number of network analyses far exceeds the demand/usage data that is being reported by WaSCs to both Defra and Ofwat. Table 1 below demonstrates the point being made.

Water Company	**Peak Daily Demand Used in Network Analysis**	**%age of Reported Demand**	**Comments**
Company 1	**400 litres/dwelling/day**	**0%**	Demand requirement that could be reasonably expected
Company 2	1447 litres/dwelling/day	**400%**	Deemed overly excessive
Company 3	2634 litres/dwelling/day	**750%**	Deemed overly excessive
Company 4	1847 litres/dwelling/day	**528%**	Deemed overly excessive

(Table A – daily demand figures used in network analysis)

In three instances the demand criteria used has far exceeded the demand usage reported separately to Defra and Ofwat by respective water companies. It is accepted that other hydraulic criteria will have some degree of influence but there would appear to be no justification for such excessive demand figures being used for network analysis. Moreover, if these figures include for leakage, then it should not fall to the developer to pay for the consequences of such. This is particularly relevant given that all water companies have signed up to the commitment to have zero leakage by 2050.

6. Related to the last numbered point there should be an acceptance that other affecting legislation must also be taken into consideration. For example Approved Document G of the Building Regulations that defines/limits water usage criteria. The current guidance that is being relied upon by water companies, namely the "Service Pipes Manual" is 22 years out of date and in many respects is unrepresentative of modern day water usage. Furthermore, WaSCs need to replicate the same commitment to environmental sustainability as the house building industry. In response to the recognition that drinking water is a scarce and precious resource, its use both during and after construction is becoming a key corporate responsibility measure for many house builders. However, with water and sewerage network analyses failing to reflect the significant reduction in water usage that is being driven through the Building Regulations, WaSCs are not matching the house builders' commitment to sustainable development. With WaSCs continuing to rely on outdated and unrepresentative network analysis criteria not only are they securing asset/capacity betterment at the Developer's cost but also infringing two of the principal elements that define sustainable construction.

7. On a similar note, to have in place an agreed and consistently applied approach/methodology for foul sewer network analysis. Developers should not be expected to pay for having to deal with excessive levels of infiltration associated with existing public sewers. This has nothing to do with servicing the needs of a new residential development. Moreover, with some WaSCs factoring into their network analysis overly excessive additional allowances for infiltration and illicit surface water sewer connections, the outcome is often a demand for developer funded network improvement that carries a significant cost. More importantly, a number of WaSCs are trying to lend credence to their demands by seeking to make such matters the subject of Grampian planning conditions. Again, environmental considerations do not appear to feature.

   Furthermore, the FWMA 2010 handed responsibility for better control of illicit connections to the various WaSCs with Ofwat allowing increases in domestic water and sewerage rates to off-set the cost of additional maintenance and intervention action associated with the private domestic sewer transfer.

   In summary, based on the body of evidence that has been collated by HBF, (see abstract at Appendix 1) it is becoming increasingly evident that WaSCs are relying on excessive and disproportionate rates of infiltration to justify foul and/or combined sewer network reinforcement at the developer's expense.

8. Greater recognition should be given to the fact that unlike the Scottish model that is at the core of the market reform proposals, house builders transfer over to WaSCs income generating assets for free. What is wrong with following the Scottish Water model? WaSC payment for the income generating infrastructure that house builders provide should form an integral part of the reform/charging rules consultations.

9. In the interests of introducing greater competition, the contribution that SLOs are able to make should be given increased recognition. At present and in a water supply context, this is taking place in only a limited number of locations with restrictions being applied by water companies by virtue of the dominant role they are continuing to assume. A fully functioning competitive market that is fair, equitable, proportionate and responsive is essential if we are to meet the Government's new housing provision objectives.

10. A fast track arbitration process outside of Regulator referrals to deal with disputes regarding network analysis/reinforcement, (water and sewerage infrastructure). At present, the referral process takes far too long.

These are 10 critical areas that the HBF firmly believes should form an integral part of the forthcoming consultation process. Moreover, in any forthcoming discussions HBF will be more than happy to share a greater proportion of the evidence that it holds.

HBF London

11th August 2015

Note:

This contributory discussion paper was updated on the 11th September 2015 following HBF attendance at the Water UK Workshop "Charging for Water & Sewerage Infrastructure" 8th September 2015