New Connection Services Charging

Consultation

25 September 2017

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1 Introduction

All water companies in England are required to change the way they charge customers for new connections. The water industry regulator, Ofwat requires that from next April, water companies publish charging arrangements that set out how they will charge for new connection services. Each company's charging arrangements must comply with Ofwat's charging rules.

The main change in the new rules is that in future, more of the charges for new connection services will be upfront fixed charges, and will be more predictable and stable. This is different from today where we charge for new connection services by recovering our reasonable costs or expenses incurred in delivering those services.

More information about Ofwat's new charging rules can be found in the publication 'Charging rules for new connection services (English undertakers)' available on their website[1].

Water UK, the water industry's trade association has already consulted on the new charging rules on a national basis. We have taken into account the results of this work in our thinking. Further information about this can be found on Water UK's website[2].

To plan for the new arrangements, we have considered how our current charging approaches would fit with the new regulatory rules and where we need to change them. We have considered different approaches and formed some preferred options. Before we finalise our approach to charging however, we want to discover what new connection customers and other stakeholders think about our plans. To help, we have set out what we think are the main questions to be resolved.

If you would like to contribute, please email your views to regulation@affinitywater.co.uk by 23 October 2017.

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[1] http://www.ofwat.gov.uk/publication/charging-rules-new-connection-services-english-undertakers/

[2] http://www.water.org.uk/news-water-uk/latest-news/new-connections-charging-water-uk-consultation

2 High level overview

Ofwat's new charging rules for new connection services apply to charges imposed on or after 01 April 2018. The rules are set with the aim of furthering four principles for charges:

- Stable and predictable charges
- Transparent and customer focused service
- Fairness and affordability
- Environmental protection

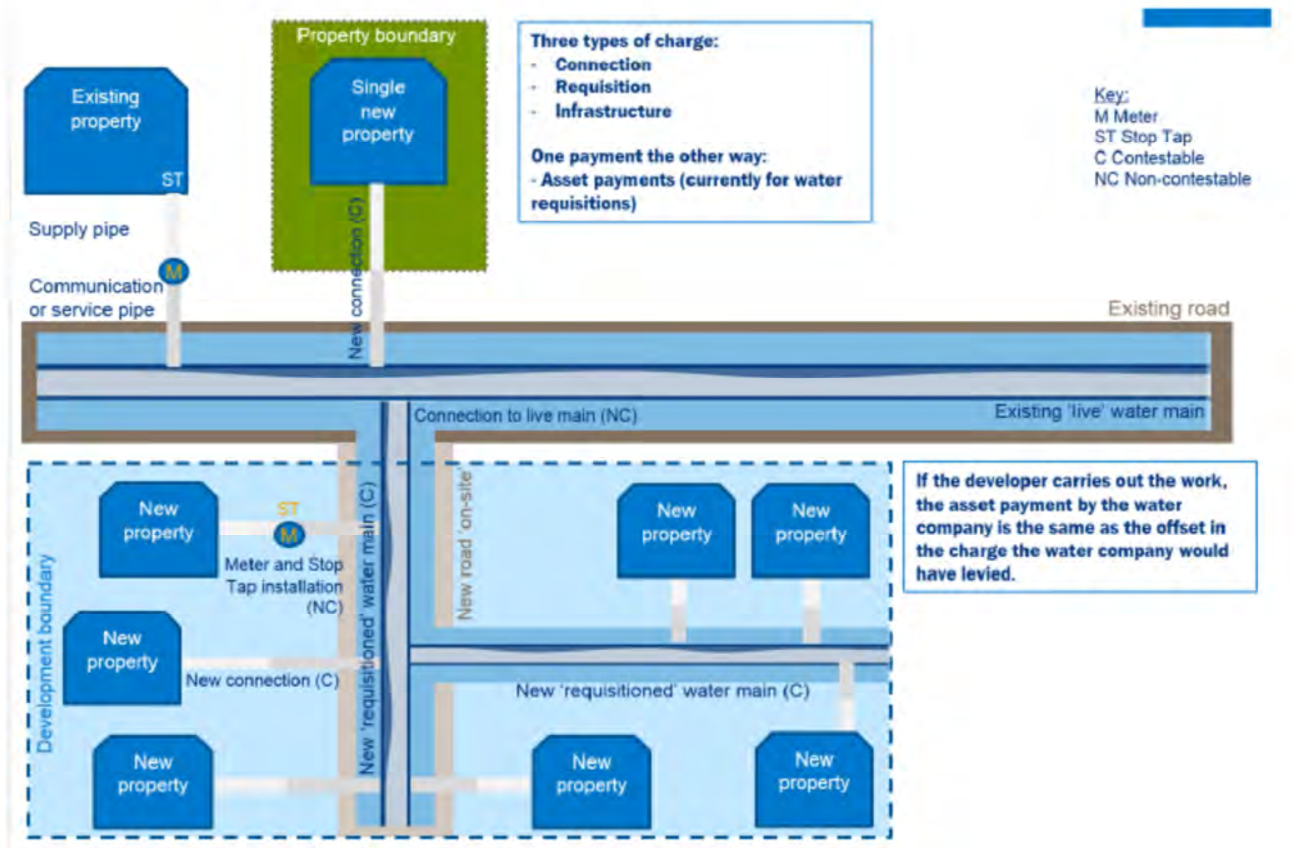
It is the responsibility of water companies to publish charging arrangements for new connection services that meet the requirements of the rules. Ofwat has legal powers to direct companies to change its charging arrangements if it believes a company's charging arrangements do not comply with the rules.

Our charges that will be affected are for:

- New connections
- Mains requisitions
- Infrastructure charges
- Income offsets
- Mains diversions
- Traffic management charges
- Other charges related to new connections work

The following diagram has been produced by Ofwat to assist understanding of the terminology around water connections.

Figure 1: Overview of new connections charges



3 New Connections Charges

We make connection charges to recover the costs of connecting properties to our water mains. Typically this work involves our tapping into the existing water main, laying a pipe from the main to make a connection to the property's supply pipe, provision of a boundary box, a meter, outside stop tap and the reinstatement of excavated surfaces.

This work is usually simpler for new developments than for work in the public highway and typically costs more if we need to dig through paved surfaces rather than unmade surfaces. Paved surfaces are also more costly to reinstate at the end of the job. Our costs also differ because water mains are not usually laid in the centre of the road so the distance from the main to the property can be long or short, depending on which side of the road a property is located. It costs more to connect properties on the long side because a longer pipe is needed. The diameter of the connecting pipe and the type of main being connected are also relevant factors.

Ofwat's charging rules require that from April 2018 we must offer the option of an upfront fixed connection charge. One way to achieve this could be to publish a fixed charge per property. This could be a uniform charge set at our average actual cost per connection measured over the past few years. It would be the simplest option, however it would mean that new connection customers would each pay the same price per property even if their particular developments were the least costly type of connections.

Table 1: Simplest option – uniform £ per connection charge

	£/connection
Cost per connection	…

This approach could be developed to reflect that work is simpler for on site works in new developments than off-site work in the public highway. It could also reflect the size of connection as in the table below.

Table 2: £ per connection charge, limited variation

Connection diameter	Cost per connection on site, new development £/connection	Cost per connection off site, public highway £/connection
25mm	…	…
32mm	…	…
50mm	…	…
63mm or greater	…	…

As an alternative we are considering differentiating our charges further, according to the parameters of each connection. This would work by our publishing a small table of charges, similar to that below, that had a different price per property depending on whether;

- the surface was paved or not
- the connection was on the short side of the road, or required additional pipe length
- the connecting communication pipe was of large diameter or not
- the job required more expensive pipes and fittings to protect against contaminated soil

Whilst this would allow charges for each particular connection to be more reflective of cost differences, it would introduce more complexity to our pricing.

Table 3: Connection Charges varies by type of job

	Paved surface		Unpaved surface		Contaminated Ground Uplift
	Short side < 2m	Additional charge per metre of pipe	Short side < 2m	Additional charge per metre of pipe	% Uplift
Communication pipe diameter (under 25mm to 32mm)	…	…	…	…	…
Communication pipe (50mm to 63mm)	…	…	…	…	…
Communication pipe (greater than 63mm)	…	…	…	…	…

Q1: Do you think it better for us to have a simple, uniform fixed charge for connections across our whole area, or should charges reflect particular developments more, being different according to surface type, pipe diameter and whether the connection is long side or short side?

4 Mains Requisitions / Site Specific Charges

Sometimes there are no existing water mains near to a development that can be used to supply the new connections. This is usually when properties are being developed on greenfield or brownfield sites that are not currently supplied or where a number of new connections are required and need to be supplied by a new common main.

When we provide new water mains we make site specific charges to recover our costs. Typically, site specific work involves our laying new water mains on the development itself and may also require mains laying in the public highway or across private land in the immediate vicinity of the development. It may also include provision of other infrastructure such as district meters, access and inspection chambers, hydrants, valves and booster pumps.

The costs of laying new mains differ according to the type of ground that the mains are to be laid in, the length of mains to be installed and the diameter of pipes needed. Projects cost more if other items of infrastructure, like those listed above are also needed.

Ofwat's charging rules require that from April 2018 we must offer the option of an upfront fixed charge for site specific work. We have considered how best to offer upfront fixed charges given that the infrastructure requirements for each site can vary substantially. We propose that we price for site specific work according to a look up table such as that below, that sets a charge for each cost driver. By using the look up table and estimating what site specific infrastructure their development required, developers would be able to predict their charges.

Table 4: Indicative look-up table for site specific infrastructure

	Paved surface	Unpaved surface
Charge per property to be connected	£/prop	£/prop
Charge per metre of small diameter main less than 150mm	£/m	£/m
Charge per metre of large diameter main, 150mm or greater	£/m	£/m
Charge per district meter	£/unit	£/unit
Install sluice valve	£/unit	£/unit
Install in-line fire hydrant	£/unit	£/unit
Install end type fire hydrant	£/unit	£/unit
Remove end hydrant and piece through	£/unit	£/unit

Provision of new mains is usually a contestable activity, which means to say that the service can be provided by Affinity Water, or by another party. Property developers sometimes employ their own contractors to construct the majority of site specific infrastructure. In these cases, site specific charges will be limited to the costs of site specific work necessary as part of the adoption or connection.

Protected land is the land owned by railways and other utility companies that has special legal protection. Our normal legal powers to access land and carry out works for mains laying are subject to the consent of protected undertakers, and such consent may be subject to any reasonable conditions the protected undertaker wishes to impose. Where new mains need to use protected land or the work to lay new mains otherwise directly or indirectly interferes with protected undertaker works or property in such a way as to require protected undertaker consent, we would not apply the upfront fixed charges listed above. Our approach would instead be to follow the look up table as far as possible, for example for the elements of new mains construction not made in protected land, and we would add supplementary charges to pass through the compensation payments to protected landowners and additional costs that we might incur as a result of meeting any conditions imposed by a protected undertaker.

Q2: Do you agree with our proposed approach to pricing for site specific infrastructure? Have we identified the correct cost drivers in our proposed look up table?

5 Income Offset

When a new water main is requisitioned, we currently reduce our requisition charges to recognise the income from water bills that we expect to receive from new houses connected to the new main. This is called the income offset. Although it is not compulsory under the new rules, we propose to continue offering a system of income offsets in the future.

Currently we calculate income offset values for each development on a case by case basis. We count the expected number of properties to be built in a development each year and add up the expected water bill revenue we are likely to receive each year for the next 12 years. We calculate what this future stream of bill income is worth in today's money – its present value – and deduct this amount from the requisition charges for providing the new mains.

This means that customers who requisition mains receive a discount that reflects the parameters of their development. There may be little discount for instance for developments where little water income is expected, but site specific costs are large. The discount could be 100% for large developments where a significant water income is expected, for example a high density housing project being constructed close to existing water mains that have plenty of spare capacity.

We could continue with the current system, but this will require us to continue with case by case calculations of income offsets. It may continue to be difficult for developers to predict income offsets in advance. Instead we could simplify our approach by offering a fixed percentage reduction to site specific charges, based on the actual average percentage discounts we have made over the past few years. If we did this, all developments would be eligible for equal percentage discounts for income offsets regardless of each individual development's parameters. We would no longer need to make detailed calculations of expected revenues for each development and it would allow developers to predict the discount with greater accuracy, more quickly. It would mean however that all site specific infrastructure customers would receive an equal percentage income offset, albeit not related to the size and speed of development.

As noted above, developers do not always wish us to install the site specific infrastructure and choose other parties to do this work instead. This is called the self lay option; the contractors carrying out the work are called Self Lay Providers (SLPs). Where infrastructure is self laid we usually adopt the assets, provided they have been constructed to industry standards, and we make an asset payment to the SLP equal to the income offset amount. We propose to continue this approach, so in future, if we use the fixed percentage approach, SLP asset payments would be calculated as a fixed percentage of the site specific costs that we would have charged had we installed the infrastructure.

Q3: Do you think that the simpler, fixed percentage discount approach is an improvement on the current approach?

Q4: Do you think the fixed percentage discount approach has any implications for competition between Affinity Water and self lay organisations?

Q5: Would you prefer that we continue with the current approach of calculating income offsets, and why?

6 Infrastructure Charge

We make infrastructure charges when we provide a supply of water for the first time, where the supply is to be used for domestic purposes. The funds we collect from infrastructure charges pay for improvements we need to make to our pipe network. These are works, essential to meet the extra demands that new properties place on our system. Today, we set infrastructure charges at a fixed £ per property price that is the same across our entire supply area, currently £361. Regulatory rules allow us to increase the charge each year at the rate of inflation.

In future, the new charging rules require us to set infrastructure charges that will recover our actual investment costs measured over a five year period. This means that after April 2018, infrastructure charges might change by more or less than the rate of inflation. How much will depend on the value of network reinforcement investment that we need to carry out to ensure our network can operate properly with new demands.

The simplest option is to continue with the uniform £ per property charge that we have today, adjusting this each year to make sure that receipts measured over a five year rolling period will match closely our actual costs of investment. This would produce a workable and simple solution.

We also considered whether infrastructure charges could vary. For example, we considered whether a higher infrastructure charge might apply to new properties that are likely to require higher water use, for example those that have more than 1 bathroom, or properties that have a garden. A lower infrastructure charge could apply to properties in developments that make use of water efficient systems such as grey water recycling. This would send environmental price signals to property developers and could encourage water efficient buildings.

Infrastructure charges could also vary regionally. We could set them to be higher in areas where network capacity is most scarce, offsetting this with lower charges in areas with greater available network capacity. This could send locational price signals to developers and deter development in the most capacity constrained areas.

Whilst attractive in principle, and also in line with Ofwat's principle of environmental protection, there is currently a lack of evidence to show that varying infrastructure charges in this way is an effective incentive towards water efficient buildings or geographical location. We also considered that since infrastructure charges form such a small component of the overall costs of developing new homes, we doubt whether the differentiation we might reasonably introduce to infrastructure charges would be an effective locational incentive.

Q6: Do you think that infrastructure charges should be different for new properties where demand is expected to be low compared to those where demand is expected to be normal or high, or should infrastructure charges be the same for everyone?

Q7: Do you think that infrastructure charges should be different in different areas? Should they be higher in areas where network capacity and water availability is most scarce, or should they be the same across the company area?

Q8: Do you agree that infrastructure charges should move in line with actual expenditures, rather than with general inflation uplift?

7 Diversions

Diversions are works needed to disconnect and abandon existing water mains and to build new mains and associated infrastructure that follows a different route. Typically diversions arise when developers wish to build on private land that already contains a water main, but where it is necessary to move the main to allow the building work to happen.

Currently we charge for diversions by recovering our reasonable expenses incurred on a case by case basis. The expenses we incur will vary depending on the length and diameter of pipes needed, the type of ground the mains are to be laid in, the costs of additional infrastructure such as valves that might be necessary as well as other costs such as traffic management, if needed.

Ofwat's charging rules allow the option of upfront fixed charge for mains diversion work in private land. We have considered whether we should change our current approach to one of offering upfront fixed charges given that the infrastructure requirements for each diversion could vary substantially. There are however similarities between providing new site specific mains and providing new mains to give effect to a diversion. We propose then that we price for mains diversions in private land according to a look up table such as that below, that sets a charge for each cost driver, similar to how we plan to charge for new mains. By using the look up table and estimating the parameters of planned diversions, developers would be able to predict their charges.

Table 5: Indicative look-up table for Diversions in private land

	Paved surface	Unpaved surface
Charge per property to be connected	£/prop	£/prop
Charge per metre of small diameter main less than 150mm	£/m	£/m
Charge per metre of large diameter main, 150mm or greater	£/m	£/m
Charge per district meter	£/unit	£/unit
Install sluice valve	£/unit	£/unit
Install in-line fire hydrant	£/unit	£/unit
Install end type fire hydrant	£/unit	£/unit
Cut and cap of existing main	£/unit	£/unit
Remove end hydrant and piece through	£/unit	£/unit

Protected land is the land owned by railways and other utility companies that has special legal protection. Our normal legal powers to access land and carry out works for mains laying are subject to the consent of protected undertakers, and such consent may be subject to any reasonable conditions the protected undertaker wishes to impose. Where diversions need to use protected land or otherwise directly or indirectly interferes with protected undertaker works or property in such a way as to require consent, we would not apply the upfront fixed charges listed above. Our approach would instead be to follow the look up table as far as possible, for example for the elements of diversions not made in protected land, and we would add supplementary charges to pass through the compensation payments to protected landowners and additional costs that we might incur as a result of meeting any conditions imposed by a protected undertaker.

The charges above apply to diversions in private land only.

Q9: Do you agree with our proposed approach to pricing for mains diversions in private land? Have we identified the correct cost drivers in our proposed look up table?

8 Traffic management

Certain works, whether new connections, site specific works or diversions are more expensive to build because of the need for traffic management. Traffic management activity can include preparation of plans for the highway authority, signage, temporary traffic lights, suspension of parking and bus stop bays, road closures and lane rental charges levied by highways authorities. It may involve weekend and out of hours working if access to the highway can only be given at certain times of day, week or year. Different jobs require different traffic management activities according to the circumstances of the locations being worked and it is not always needed.

Today we recover the costs of traffic management as part of our reasonably incurred costs or expenses.

We have considered how best to make traffic management costs more transparent and how they can be accommodated within our regulator's requirement that we offer more upfront fixed charges.

Perhaps the simplest method is to apply common percentage uplift to all connection, site specific and diversion charges based on our estimates of volume of work and traffic management costs for the year. This would spread our traffic management costs across all new connection customers. We would then adjust the percentage each year to reflect actual traffic management costs incurred to ensure that the uplift was in line with actual costs. It would be a simple system, and easiest for developers to predict their charges. However it would also mean that all new connection customers pay a contribution towards traffic management costs, even if their own particular developments did not require traffic management activity.

As a refinement to the above option, we could set common percentage uplift, but this would only be applied to new connections, site specific charges and diversions charges where traffic management activities were actually needed. This retains the simplicity of common percentage uplift and it would mean that only customers who make use of traffic management services would have to pay towards them. However it would not distinguish between customers where significant traffic management activity is required versus those where less activity is needed.

Alternatively, we could publish a schedule for traffic management activities, and charge uplifts to be paid for each of the traffic management activities actually carried out as listed in the schedule. Developers could estimate for themselves which activities are likely to be needed for their own developments and in that way be able to predict their charges.

Table 6: Illustrative schedule of traffic management uplifts *(Note: figures are for illustrative purposes only.*

	New Connection Charges	Site Specific Charges	Diversions in private land
Temporary Traffic Lights	+100%	+25%	+25%
Road closure	+50%	+50%	+50%
Out of hours working	+50%	+30%	+30%

Q10: Which of the options for charging for traffic management activity do you prefer and why?

a) Apply a common percentage uplift to all connection, site specific and diversion charges
b) Apply a common percentage uplift to new connection, site specific and diversions where traffic management activities were actually needed
c) Charge uplifts based on a published schedule for each of the traffic management activities actually carried out

Is there an alternative way to charge for traffic management than the approaches outlined above?

9 Other charges

We currently set an upfront application charge for new connections. This recovers the administrative costs we incur to process a request for water connection, plan, design and schedule works to be done. In particular this charge makes sure that we recover our costs when customers make an application for a new connection, but then withdraw that application after the administrative tasks have been completed but prior to construction work being done. We propose to continue with the system of application fees after April 2018.

Our current system does not distinguish however between those seeking to develop a single property from those developing many properties. Therefore we are considering charging a basic application fee that would allow up to say 6 properties to be developed, but for larger projects, the fee would be the basic charge plus an amount for each property over 6.

Q11: Do you agree with our preference to charge an upfront application fee? Do you think that the application fee should be higher for customers wanting to develop many properties within a development than for customers with much smaller projects?

We currently charge for unmetered building water supplies, where developers request a supply for these purposes. This is so that ordinary water customers are not subsidising the costs of water used by developers for building purposes. We propose to continue with this approach after April 2018.

Q12: Do you agree with our preference to continue charging for building water where developers request that such a supply is made available?

10 Summary and next steps

10.1 Summary of consultation questions

Q1: Do you think it better for us to have a simple, uniform fixed charge for connections across our whole area, or should charges reflect particular developments more, being different according to surface type, pipe diameter and whether the connection is long side or short side?

Q2: Do you agree with our proposed approach to pricing for site specific infrastructure? Have we identified the correct cost drivers in our proposed look up table?

Q3: Do you think that the simpler, fixed percentage discount approach is an improvement on the current approach?

Q4: Do you think the fixed percentage discount approach has any implications for competition between Affinity Water and self lay organisations?

Q5: Would you prefer that we continue with the current approach of calculating income offsets, and why?

Q6: Do you think that infrastructure charges should be different for new properties where demand is expected to be low compared to those where demand is expected to be normal or high, or should infrastructure charges be the same for everyone?

Q7: Do you think that infrastructure charges should be different in different areas? Should they be higher in areas where network capacity and water availability is most scarce, or should they be the same across the company area?

Q8: Do you agree that infrastructure charges should move in line with actual expenditures, rather than with general inflation uplift?

Q9: Do you agree with our proposed approach to pricing for mains diversions in private land? Have we identified the correct cost drivers in our proposed look up table?

Q10: Which of the options for charging for traffic management activity do you prefer and why?

a) Apply a common percentage uplift to all connection, site specific and diversion charges
b) Apply a common percentage uplift to new connection, site specific and diversions where traffic management activities were actually needed
c) Charge uplifts based on a published schedule for each of the traffic management activities actually carried out

Is there an alternative way to charge for traffic management than the approaches outlined above?

Q11: Do you agree with our preference to charge an upfront application fee? Do you think that the application fee should be higher for customers wanting to develop many properties within a development than for customers with much smaller projects?

Q12: Do you agree with our preference to continue charging for building water where developers request that such a supply is made available?

10.2 Responding to this consultation

To have your say on the questions set out in this document, please email your responses to regulation@affinitywater.co.uk.

The consultation closes on 23 October 2017.

Following this, we will consider the views of the industry in finalising our approach and intend to publish a decisions document in late December, prior to publication of final charges in early 2018.

Affinity Water