

**AN INDEPENDENT REVIEW OF SOUTH WEST
WATER'S NEW CONNECTIONS CHARGES IN
RELATION TO THE SLP MARKET**

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Executive Summary

The growth of effective markets continues to be a key priority for Defra¹ and Ofwat². Analysis by Sia Partners and Ofwat in August 2021 indicated that the new connections market has developed over recent years - overall SLP market share grew from 26% of new connections made in 2018/19 to 34% in 2020/21. However, large regional variation in SLP activity is present, and charging arrangements are highly varied across the English incumbents.

South West Water commissioned Sia Partners to conduct an independent review to assess the extent to which - in applying Ofwat's Charging Rules for New Connections Services - its charges have been applied fairly, and appropriately balance the needs of its developer services customers, in particular SLPs. It also wishes to understand the drivers behind low SLP activity in Devon and Cornwall.

We have engaged with SLPs across England and Wales, interviewed key stakeholders within the South West Water Developer Services function, analysed both internal and publicly available data, and assessed issues raised by a stakeholder to assess the endogenous and exogenous factors that influence the SLP market in the South West Water supply area. We have included the views expressed by SLPs whilst retaining a recognition that they have their own interests in mind and do not always recognise the need for water companies to strike a balance between all their different stakeholders.

Summary of Key Findings

Our analysis has found that South West Water is compliant with Ofwat principles in both its Charging Arrangements and the support offered to the SLP market. Following a review of connection costs, it is our opinion that low costs are driven by efficient practices and high volumes of work.

There are steps that could be explored to further support SLPs in the region. These steps are set out in three areas; South West Water's Charging Arrangements, South West Water's support for the market, and other exogenous factors that may influence SLP uptake within a region.

South West Water's Charging Arrangements

South West Water's charges are amongst the lowest for customer-excavated developments (Ofwat's Worked Examples 3 and 5). This is driven by on-site connection costs, for which South West Water is cheapest across the sector. This could lead to the perception, which some SLPs have, that South West Water subsidises connections. Following a review of costs it is our opinion that low costs are driven by efficient practices and high volumes rather than cross-subsidies. Nevertheless, some areas of South West Water's charges could benefit from further consideration, namely barrier pipework compared to standard pipework rates. In addition, we recommend that the positive step taken to enable SLPs to procure AMR meters using South West Water's procurement framework is promoted to ensure SLPs are aware of its benefits.

Our analysis also concluded that the setting of a per-property mainlaying charge (which had been done in line with customer feedback that this approach enabled developers to easily calculate their potential site charges) and the resultant averaging of costs across sites has been a potential factor affecting SLP's ability to compete on certain sites. Although this approach is compliant with Ofwat principles we have recommended that South West Water consider, through further consultations with customers, adopting a per-metre on-site mainlaying charge and a broader set of internal pipe diameters.

South West Water have been challenged in the past due to limited explanatory detail regarding its charges, particularly in its published worked examples. Therefore, by providing further clarity on specific issues raised in this review, South West Water can improve the trust between itself and the market.

¹ <https://www.gov.uk/government/publications/strategic-policy-statement-to-ofwat-incorporating-social-and-environmental-guidance/february-2022-the-governments-strategic-priorities-for-ofwat>

² <https://www.ofwat.gov.uk/publication/letter-from-david-black-reviewing-incumbent-company-support-for-effective-markets-rise/>

South West Water's support for the market

South West Water's engagement with SLPs was evaluated on both an operational and non-operational level. The former was rated as excellent and even market-leading for some SLPs we interviewed whilst the latter Sia Partners considers to be compliant but with areas that could be developed. By starting consultations on the design of future charges much earlier in the process, increasing the quality and frequency of engagement mechanisms such as Developer Days and developing other pathways for direct relationships with SLPs to be built, we believe South West Water can improve relationships with SLPs in the region.

We have also found other forms of support for the market to be compliant. For example, the SLP option is clearly highlighted on South West Water's Developer Services website, SLP feedback on desired technical standards has been incorporated and it has offered other forms of help to reduce SLP costs (e.g. AMR meter procurement assistance). To improve support further, we have recommended that South West Water may also consider articulating the benefits of using an SLP to developers.

Exogenous drivers

Our report also takes note of the exogenous factors that may explain the discrepancy between SLP uptake in Bournemouth compared with Devon and Cornwall. The remote location of South West Water's supply area and its distance from central England, where the SLP market is most active, may contribute to lower SLP activity in the Southwest. The distances that SLPs need to travel to reach sites and the availability of different site types and the differences in the typical types of housing development could be driving differences between Bournemouth and Devon and Cornwall.

Key findings

Level of charges

- Based on analysis of worked examples, South West Water's charges appear low only for medium and large customer-excavated developments (Scenarios 3 and 5). This is driven by on-site connection costs, for which it is the cheapest across English incumbents.
- SLPs told us that it can be difficult to compete with South West Water's on-site connection cost and there is the perception amongst some SLPs that South West Water must be subsidising lower on-site connection charges with higher charges elsewhere.
- However, Sia Partners sees South West Water's connection charges as compliant with Ofwat's charging rules - they are built bottom-up, with direct alignment to contractor rates, and are subject to sufficient scrutiny.
- Previous scrutiny of contractor costs has indicated to us that the low on-site connection charges are likely to be driven by efficient practices and high volumes of connections completed each year.
- However, we recognise that there are some areas of the Charging Arrangements that may require increased scrutiny, such as the noticeable difference in rates for barrier pipework compared to standard pipework. We recommend that South West Water gets a tighter understanding of the drivers of these charges through a systematic review.
- South West Water's recognition of the issues that SLPs were facing in procuring AMR meters, and the new initiative to provide these to SLPs at cost is a positive step and will be well received by SLPs. We recommend that this scheme is strongly promoted so that SLPs are aware of the benefits

Structure of charges

- South West Water is unusual in its setting of a per property mainlaying charge although this

approach is compliant with the Ofwat charging rules. It can result in charges that under-recover costs on larger, more complex sites, potentially reducing SLPs' ability to compete for these types of sites. The bundling of pipe diameters creates further areas for under- or over-recovery of costs.

- There is a widely held view across SLPs that bundling, and in particular the per-property charge, make it harder for SLPs to compete in the region albeit that bundling may be favoured by developer customers.
- We recommend that South West Water consider the adoption of a per-metre on-site mainlaying charge and a broader set of internal pipe diameters, and undertake engagement to garner developers' views on these options.

Communication and explanation of charges

- For the most part, South West Water have clear and rational approaches to the specifics of the worked examples but have not published all of this information.
- We view the use of off-site rates to calculate on-site excavation charges as counter-productive and this may result in stakeholders being unclear when the per-property charge applies and when it does not.
- We recommend that South West Water consider how mainlaying charges are apportioned for mains of different diameter and determine if the current approach is an accurate representation of the costs to deliver.
- To add further clarity South West Water should seek to fully demonstrate their approach to composing each worked example to enhance trust between South West Water and the market.
- It should be noted that, over the last few years, South West Water have been responsive around issues raised regarding clarity provided alongside Charging Arrangements.

Support for the market

- In our survey of SLPs, 'relationships with incumbents/NAVs' was on average ranked the second most important factor influencing the choice of a location/region to operate in. This relationship is formed through SLP engagements with South West Water
- South West Water's operational engagement is excellent with SLPs commending the team for being responsive and accessible
- Non-operational engagement, especially in the formation of charges, would benefit from a change in approach.
- SLPs have indicated they would value more pathways for direct engagements with members of the South West Water Developer Services team (e.g. through developer days or strategic consultations) and would benefit from engagements on the nature of Charging Arrangements beginning earlier in the process of their formation.

Exogenous drivers

- The relative remoteness of Devon and particularly Cornwall may result in fewer sites being attractive for SLPs travelling into the region from elsewhere.
- The increased availability of flats and apartments in Bournemouth may be contributing to the higher SLP activity in the area since South West Water's per-property charge makes these sites more desirable for SLPs to compete on.
- South West Water is distant from the concentration of SLPs in central England and distant from London which may be a factor contributing to the higher uptake in Bournemouth when compared to Devon and Cornwall.

Recommendations

Whilst our analysis has found that South West Water is compliant with Ofwat principles in both its Charging Arrangements and the support offered to the SLP market, we have made ten recommendations where it can further support SLPs in the region. These recommendations cover charging arrangements, support for the market, and wider exogenous drivers.



1.1: Ensure that AMR shared procurement rates are well-understood and promoted across existing SLPs with existing/historic sites in South West Water's network. South West Water could also promote this new arrangement to any SLP registered as operating in the Southwest.

1.2: Processes are already in place for scrutiny of contractor rates but there are areas of charges, chiefly connections charges, where a systematic review would be useful. This is particularly pertinent for less prevalent charges (e.g. barrier pipe).

2.1: Consider adoption of a per-metre on-site mainlaying charge to provide greater cost-reflectivity. To incorporate developers' views, South West Water could undertake engagement to understand if customers in the Southwest have different wants compared to other parts of England.

2.2: Undertake detailed engagement as part of the formation of 23/24 charges that looks at utilising a broader set of pipe diameters, which more closely reflects the costs to deliver them.

3.1: Provide better communication on how mainlaying charges are apportioned for mains of different diameter. Moreover, where there is more context that could be provided, we recommend that this is included in South West Water's worked examples for clarity.

3.2: Further clarify any confusion between Scenarios 3 and 5 versus Scenarios 4 and 6, regarding South West Water's requirement that all customers carry out excavation and reinstatement on land they own and occupy. This could be achieved by clearly stating South West Water's approach on the relevant worked examples or by working with its incumbent contractor to provide a rate for on-site excavation that would more accurately represent the costs of delivery.

4.1: Commence consultations on the design of future charges, e.g., 23/24, much earlier in the process.

4.2: Increase the quality and frequency of engagement mechanisms such as Developer Days and find greater pathways for direct engagement between SLPs and South West Water.

5.1: Consider including greater articulation of the comparative advantages of a developer using an SLP rather than an incumbent. Best practice on website communication includes not only making the SLP option clear and accessible to developers but also articulating the potential benefits of using an SLP.

6.1: Undertake engagement with developers across their two supply areas and assess if there is a variance in the views that developers have towards South West Water or SLPs. The survey should include a mixture of developers e.g., those operating across Devon/Cornwall compared against those in Bournemouth and similarly, those who have predominantly used South West Water over the last three years vs those who are increasingly using SLPs.