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31 January 2022

Dear David,

Letter of Assurance from Portsmouth Water Board with respect to Developer Charges 2022/23

This letter is addressed to our Economic Regulator, Ofwat, Portsmouth Water customers and other interested parties, including Developers, Self-Lay Providers (SLPs) and New Appointed Variations (NAVs).

This letter, together with the resultant examples as shown in Appendix D of our Charging Arrangements document, provides Board assurance in relation to the 2022/23 developer tariffs. The letter of Board assurance follows the regulatory guidance over the publication of charges schemes as explained below and set out in more detail later in this letter.

The Board of Portsmouth Water considers that the Developer Charges, published on 31 January 2022 for the next charging year (2022/23), comply with the Company's relevant regulatory requirements as set out in the "Charges scheme rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991" dated December 2018 (the Charges Scheme Rules).

The charges also adhere to charging guidance provided by Ofwat specifically for new connections. This includes, as required by, the "Charging Rules for New Connection Services (English Undertakers) issued by the Water Services Regulation Authority under sections 51CD, 105ZF, 142B and 144ZA of the Water Industry Act 1991 – Effective from April 2022".

The Board have been involved throughout the progress of this Charges Scheme. Final approval was signed off by the Chief Financial Officer following a board sub-committee on 31 January 2022.

The Board therefore considers it is in a position to confirm the following:-

- a) That the Company complies with its obligations as documented in the Ofwat publication Charging Rules for New Connection Services published in October 2021.

We confirm that our Charging Arrangement document explains how our charges have been calculated, is written in clear and accessible manner reflecting the Ofwat guidance, will allow developers to confidently work out a reasonable estimate of the likely charge for a water supply and provides worked examples to aid understanding.

We also confirm that the charges reflect the five principles of a) fairness and affordability, b) environmental protection, c) stability and predictability, d) transparency and customer focused service and e) costs of the relevant service.

Finally, our document is clear on how the charges to requisition a water main or to connect to the water main are to be raised and provides details on how the developer may pay for the connection.

During 2021-22 we have undertaken normal business as usual engagement with our developer customers and specific stakeholders such as Fair Water Connections who represent the SLP community.

We held our annual Developer Customer Forum in November 2021. This is an opportunity for representatives from all stakeholder groups to attend and engage with us regarding all aspects of our services, our proposed charges and any changes to processes we are proposing.

In preparing our Charging Arrangements for 2022/23 we have relied on engagement and previous feedback including Ofwat, CCW and Fair Water Connections. Their views helped formulate our charges for 2021/22, the principles of which are applied again in setting these charges for 2022/23.

In December 2021, we consulted our Developer Customers on our approach to environmental protection, transitional arrangements and third-party activities associated with new service connections.

As required by the Charging Rules for New Connection Services we have provided worked examples quantifying the impact of the new charges on developer customers. The Board can confirm that the effect of the changes results in one example with an increase in charge of more than 10%.

The one example which exceeds the 10% price increase guideline is a single connection to a block of flats from an existing main delivered by Portsmouth Water. For this example, there is a 32% increase in cost compared to last year. This increase is driven by (i) inflation; and (ii) a reduction in the income offset payable in 2022/23, which particularly affects the percentage change in charges where a small amount of service is delivered. This change in the income offset also means that, using Ofwat's examples, credit payments to SLPs in all examples will reduce between 33%-53%. For example, a medium size housing development, undertaken by SLP, will result in a credit payment to the SLP moving from £4.0k in 2021/22 to £6.1k for 2022/23.

The reduction in income offset is a result of increased SLP and NAV activity, and is implemented to comply with the Balance of Charges Rule.

With the cost increase being of relatively low monetary value and only a very small number of new connections being covered by this scenario, we are not proposing any particular handling strategies, other than to make Developer Customers aware through our Charging Arrangements document.

- b) That the Company has appropriate systems and processes in place to make sure that the information contained in the charges scheme and the associated additional information is accurate.

The Board acknowledge the importance of having appropriate systems and processes in place to determine the charges and denominators underpinning the Developer Charging Arrangement

We have developed an in-house model to establish the final charges for these activities. The charges are cost reflective and are based on the costs of our outsourced partner, Cappagh, who generally undertake this activity on behalf of Portsmouth Water, plus a sum to recover appropriate overheads.

- c) How the present balance of charges between Developers and other customers is broadly maintained.

The Company has determined its general charging policies and value of individual charges to recover a similar wholesale revenue for 2022/23 to that implicit in the Final Determination of Prices, December 2019.

The Final Determination quantified the revenue we should expect to receive from infrastructure charges, developer contributions and end user customers. The balance of charges between developers and other customers is maintained by setting charges such that the expected value of revenue from developers and end users complies with the Final Determination.

Further, we have compared the expected revenue we will recover from developers in 2022/23 to that in 2017/18, the last year before the new charging rules came in to operation. Charges in 2022/23 have been set to ensure the percentage recovery in the forthcoming charging year is the same as before the new charging methodology applied, thereby confirming the balance of charges (between developers and other customers) is unchanged as a result of any change to charging methodology.

We have engaged Frontier Economics to review our charges and they have provided external assurance that the proposal is compliant with the principle of the balance of charges. The Board believe Frontier Economics are well placed to give this assurance given their knowledge and experience of the water industry.

Conclusion

The Board of Portsmouth Water considers that the Charging Arrangements for Developers, to be published 31 January 2022, complies with the Company's regulatory requirements.

This statement will be published on our website on 31 January 2022, along with the Charging Arrangements and sent to Ofwat on that date.

A handwritten signature in black ink, appearing to be 'CM', with a long horizontal line extending to the right.

Chris Milner
Chief Financial Officer