Water Division
Commission for Regulation of Utilities
The Exchange
Belgard Square North
Tallaght
Dublin 24
D24P XW0

11th January 2023

Dear Sir/Madam,

RE: IHBA SUBMISSION ON THE PROPOSED FIRST MOVER DISADVANTAGE IN CONNECTING TO WATER AND WASTEWATER INFRASTRUCTURE. UPDATE TO IRISH WATER'S CONNECTION CHARGING POLICY

The Irish Home Builders Association (IHBA), a constituent association of the Construction Industry Federation, are writing to provide a submission to the consultation on the policy to address First Mover Disadvantage (FMD).

Introduction

The First Mover Disadvantage (FMD) consultation by the Commission for the Regulation of Utilities (CRU) is welcomed by the IHBA. However, it is received during a time where the housing industry in Ireland faces various issues: delays in planning approvals, inflationary pressures, high construction costs. It is important that the agreed policy does not add to these issues.

Our key consideration when reviewing the proposed options is to focus on the impact this will have on our members and the delivery and cost of housing. Ultimately, these increased project costs are passed on to the consumer.

The proposals have been considered in line with the CRU's key principles:

a) Cost reflectivity – charges should be reflective of the associated costs when providing a connection to the developer.
b) Efficient use of assets – minimise the risk of stranding assets.
c) Equity and non-discrimination – charges should be equitable.
d) Stability – charges should minimise volatility.
e) Simplicity – charges and policy should be clear, transparent, and easy to understand.
f) Cost recovery – the utility should be able to recover the costs incurred.

Three options have been proposed by Irish Water and the CRU. These are as follows:

- Proposal 1: Shared Quotable Rebate (SQR).
- Proposal 2: Reasonable Cost Reduction (RCR).
- Proposal 3: Group Appraisal Rebate (GAR).

The CRU has stated its preferred policy choice is SQR, on the basis that this is considered the most 'fair, accurate and cost-reflective approach'. The IHBA holds reservations about this, namely the administrative burden this will place on Irish Water to deliver rebates efficiently, the expectation that First Movers (FM) still cover the cost initially (impacting scheme viability) and the time limit applied to the rebate. The IHBA's preferred option is the RCR approach; this addresses the financial burden placed on homebuilders when installing the initial asset, it is not time-limited (preventing the homebuilder from being further disadvantaged) and is fairer for the secondary homebuilder.

The IHBA has considered the various options proposed with feedback provided by members and responded accordingly. The submission considers the five key questions included within the CRU's consultation document, set out below:

1. Which proposal in your view most aligns with the CRU's Charging Principles and best addresses the issue of FMD?
2. Are there any of the proposals that you disagree with?
3. Are there any other approaches which you consider would address the issue of First Mover Disadvantage in a more appropriate manner?
4. Have you any other comments or considerations you would like to raise in your response to this Consultation?
5. Do you agree with the CRU's preferred option?

1. PROPOSAL 1 – SHARED QUOTABLE REBATE (SQR)

The SQR is based on a similar principle used within the electricity industry. The proposal would work by way of a rebate being applied to the original developer who facilitates the connection. The rebate is collected by Irish Water as an additional charge incurred by subsequent developers. The rebate period is for five years only, with the rebate being subject to a depreciation payment. The repayment to the original FM would be overseen by Irish Water.

The positives of this approach are recognised by the IHBA, being:

- The approach is used in another utility sector.
- The proposed calculation method is accurate, being based on the shared capacity of the connection asset (cost reflectivity and equity).

However, the IHBA holds concerns about this option, being:

- The proposed five-year rebate time limit does not reflect realistic development process timescales; life cycles of sites are greater than five-years, meaning subsequent homebuilders may avoid paying the rebate. This timeline should be extended (utilities sectors outside of Ireland have timeframes of seven and ten years). In this regard, it is considered inequitable.

- Whilst it is noted that this approach is used by alternative utility providers, there is no cost comparison provided (ESB's is typically much lower than Irish Water's per unit, particularly where the connection fee, bond and first mover upgrades are required). This should be used to provide a realistic comparison between the approaches in place across the utilities sector.
- Irish Water will oversee the repayment process for this option. This could result in delays in repayment for the FM, if this is not adequately resourced. An 'agreed rebating period' must be implemented, being a maximum of five years, otherwise, this approach would be considered 'unstable' in reference to the CRU's principles referenced above.
- The design life of infrastructure as per the European code is 60 years plus; the infrastructure provided by the FM will benefit Irish Water for in excess of 60 years which is not currently considered in the calculations. This must be factored into any rebate calculation.
- The initial investment into the network is still being made by the FM. This can impact scheme viability, which is already facing other pressures.

This option is considered unsuitable. However, if the CRU proceeds with this, the five-year time limit should be extended, the rebate calculation should consider the investment made by the FM in the infrastructure network, and an agreed rebating period should be set for repayment.

2. PROPOSAL 2 - REASONABLE COST REDUCTION (RCR)

This option gives the FM an up-front discount on the cost of connecting, with the compensation calculated based on the risk level of subsequent developers connecting.

The IHBA recognises the positive aspects of this approach, being as follows:

- This is fair from a cost-reflective perspective as the FM is not financially disadvantaged when making their initial investment. Whilst it is Irish Water that will fund the initial cost, this would be recovered when subsequent connections are made.
- This approach enables the homebuilder to deliver viable and affordable homes where they do not have to invest in the infrastructure network at the commencement of a housing delivery scheme. This has a knock on effect on affordability of homes, with home ownership becoming more achievable.
- The approach is not time-limited, adequately reflecting the realistic timeframes of development cycles. In this regard, it is simple and stable.
- The subsequent connection fee is only charged as and when an actual connection is made; this is fairer for the secondary homebuilder too (again, we consider that this offers a stable, simple and equitable option).
- Whilst Irish Water do have to cover the initial cost, this will be recouped through subsequent charges, and ultimately, their network benefits from the new infrastructure.

The approach, however, does have some issues, being:

- The rebate calculation is complex and based on a risk factor (the percentage chance of subsequent connections happening). This should be replaced with an accurate calculation that factors in the probability of subsequent connections on a case-by-case basis. This would better reflect the nature of different development types. This is therefore not a simple or stable calculation and is not considered fair from a cost recovery perspective.
- The risk factor basis will initially be set at a low percentage chance of subsequent connections. This has been set according to Irish Water, who have reported no instances of FMD occurring since data collection started in 2019. This approach is inaccurate given that limited development happened between 2020 – 2021 due to the CV-19 pandemic. This should be revised, otherwise, this will leave FM homebuilders at a financial disadvantage. It is advised that the 'R' factor used within the calculation is reviewed in the future once further data and historical evidence becomes available.

An alternative funding method should be considered. For example, the costs for the first mover could be deducted from Irish Water's connection charges; Irish Water effectively own the infrastructure once it has been installed so they are able to then recover this charge from subsequent parties connecting to the asset. This would reduce the administrative effort of calculating and charging rebates and still ensures Irish Water is not at a loss when subsequent assets are connected.

This option, subject to key amendments, is preferrable. Whilst it requires some revisions, it directly addresses the financial impact of FMD at the outset, through providing a financial discount when the initial connection is made. It is not time-limited. Also, the subsequent connection fee is only charged as and when an actual connection is made; this is fairer for the secondary developers too.

3. PROPOSAL 3 - GROUP APPRAISAL REBATE (GAR)

Under this option, the FM will receive a capped rebate based on subsequent assets that are developed from the original asset by the end of a five-year period. The rebate is calculated based on the potential network capacity (i.e. the potential number of houses that it could serve). It would be funded by Irish Water initially and then recouped through network infrastructure contributions collected as part of the standard connection charge paid.

The positive aspects to this approach are:

- This is an accurate approach given that the rebate only happens as and when FMD occurs. This is positive from a cost reflectivity perspective.
- Subsequent connection fees are only paid as and when this happens; this promotes efficient use of existing assets.

However, there are issues with this approach:

- It still leaves the initial FM having to invest from the outset. This again increases scheme costs, ultimately impacting home prices and delivery costs. Yet, Irish Water also benefit from the investment in the infrastructure.
- The rebate repayment (with no time limit) will be overseen by Irish Water, placing additional administrative pressures on them.
- This option places a cap on the rebate paid to the FM, disadvantaging them as they invest in the network.
- There is a five-year time limit for subsequent connections.

Should the CRU proceed with this option, it must ensure that the rebate is not time limited, and without a financial cap. The IHBA recognises that Irish Water is publicly funded body, but they benefit from the investment the FM makes in the infrastructure network; the rebate must reflect this. The five-year time limit should also be extended to reflect realistic development timeframes.

Conclusions/Recommendations

The IHBA welcomes a reform to address FMD which impacts its members, provided this doesn't impact housing supply. The RCR option, subject to key amendments, is the IHBA's preferred choice. This option addresses the main problem with FMD for home builders: the additional delivery cost. This does not put Irish Water at a disadvantage as their costs can be recouped through connection charges. There is also no time limit imposed on the rebate, which is fairer and more equitable. However, the rebate calculation needs urgent review before implementation. It should also recognise the complexity of housing delivery schemes and the various scenarios that may arise when infrastructure is required; the final approach should review and cater to these different situations (for example, self-lay schemes).

An additional recommendation which has been received from members is for a mechanism to cover instances where a group of homebuilders cover the initial connection charge. They should still be reimbursed for their investment and treated in the same manner as individual FM. Any policy to address FMD must include this to avoid issues arising here. Consideration should also be given to the indirect cost implications resulting from FMD. For example, the investment in infrastructure made by the FM is reflected in the house prices for that individual site. However, those prices then set the local market value for the area. This means when a nearby site is completed, the house prices for that site are higher, even though the site may have benefitted from the new infrastructure investment, ultimately impacting purchasers.

FMD needs to be addressed to prevent further issues with the delivery of housing supply, and should align with national housing policy, including Housing for All; ensuring every citizen in the state has access to good quality homes. The IHBA welcomes the implementation of such a policy, but the final proposal should not add to delivery costs and the cost of a new home.

Yours faithfully,

Conor O'Connell

Director - Housing, Planning and Development Services