

Piping up: Unlocking the potential of independent water companies

BRIEFING PAPER

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New Appointments and Variations (NAVs) were introduced in 1991 as a way of increasing levels of competition in the water sector. They serve an important role in infrastructure development, connecting a fifth of new homes to the water supply. Drawing on literature findings and insights from a range of in-depth interviews with experts, this briefing paper examines the challenges and opportunities these companies face, and outlines reforms that could help accelerate infrastructure development in the UK.

KEY POINTS

- New appointments and variations (NAVs) are independent water companies providing water and sewage services to new developments.
 - NAVs negotiate bulk supply agreements with incumbent water companies, charging end customers for water services, with charges capped at incumbent rates. Profits are determined by the difference between bulk supply prices and retail prices.
- The NAV Market has seen staggering growth in recent years.
 - More NAVs were appointed in the first quarter of 2025 than in total before 2020.
- NAVs provide a range of economic and environmental benefits to the UK.
 - NAVs play a key role in infrastructure, installing 25-50% faster than incumbents, supporting housing targets and growth.
 - Competition from NAVs pushes incumbents to improve services to developers.
 - NAVs' business model incentivises them to develop networks that minimise water usage, ensuring sustainable management of a key natural resource.
- Outdated regulations in the sector constrain residential and commercial development, but sensible reforms could help accelerate builds and boost growth.
 - The requirement for NAVs to apply for each site delays developments; government should consult on the introduction of national licensing for NAVs.
 - Inconsistent bulk supply charge calculations hinder NAV market entry; Ofwat should establish a clear, industry-wide methodology.
 - The Drinking Water Inspectorate's site-by-site regulation adds unnecessary costs; water zones should be merged where there is the same water source.
- To ensure a fair deal for all consumers, NAVs should be required to follow the relevant incumbent's social tariff regime.

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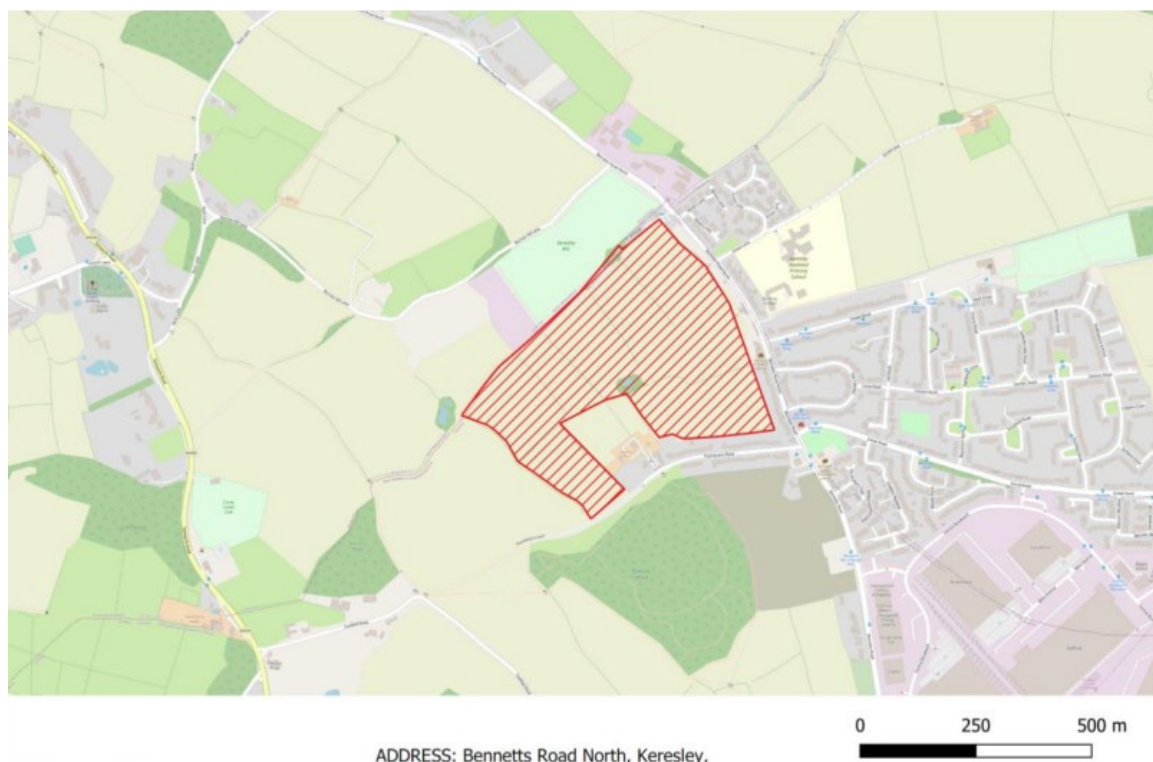
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WHAT ARE NAVS AND WHAT ROLE DO THEY PLAY?

NAVs play a specific but important role in infrastructure development

New Appointments and Variations (henceforth referred to as ‘NAVs’) are limited companies appointed by Ofwat to provide water and/ or sewerage services to specific geographic areas within an incumbent water company’s region (e.g. Thames Water, Severn Trent Water). They exist to serve new infrastructure developments, such as housing projects or commercial units, and Ofwat appoints NAVs to replace the incumbent provider for a specific site. They are independent companies that own, operate and maintain the on-site infrastructure, essentially becoming the new monopoly water company serving the new development. Figure 1 below provides a topical example of how NAVs interact with incumbents geographically.

Figure 1: Site map of proposal to grant a variation of appointment to Independent Water Networks Limited - Bennetts Road North, Keresley, Coventry:



Source: Ofwat¹

The term ‘NAV’ comes from the process by which these water companies are set up. A ‘new appointment’ is made when Ofwat appoints a limited company to provide water/sewerage services for a specific geographic area. A ‘variation’ occurs when an existing appointed company applies to Ofwat to vary its appointment so that it can extend the areas to which it provides services.²

NAVs typically draw water supplies from, and discharge wastewater into, the incumbent’s network at the boundary of the site they have been appointed to, before providing ‘last mile’ water services to end customers on the site. These independent companies generally negotiate bulk supply agreements with the incumbent water

company that provides the water supply to a given site. Ofwat guidance states that bulk supply charges should be based on what an incumbent would normally charge to end consumers in the relevant area; but after deducting the costs the incumbents expect to avoid because the NAV is operating and maintaining the 'last mile' infrastructure.³ NAVs then install the physical water supply infrastructure into the new developments on sites they have been appointed to serve, and provide retail services to customers within these developments.

Under the 'no-worse-off' principle imposed by Ofwat, the prices NAVs can charge to consumers on their specific sites are capped against the equivalent charge of the relevant incumbent water company. This means that NAVs' profits are determined by the bulk supply price they pay to water companies and the retail price paid by consumers. As the retail price paid by consumers is fixed by the regulator, the bulk supply price set by incumbents is a crucial factor affecting the economics of NAVs' operations.

Alongside the 'no-worse-off' principle limiting consumer prices to what an incumbent would charge, NAVs must meet certain regulatory requirements in order to be appointed in a specific area:⁴

- The incumbent water company agrees to transfer the geographical area in question to the NAV.
- The area in question is 'unserved', meaning it does not contain any premises that are served by an existing water company. This means that NAVs only serve new developments.
- The appointment or variation relates to an area where each of the premises uses (or is likely to use) at least 50 million litres of water a year (in England) or 250 million litres of water a year (in Wales). As the average person in the UK uses roughly 55 thousand litres of water per year, this means NAVs only serve large developments housing several hundred people.⁵
- Ofwat needs to ensure that these independent companies possess the technical and financial resources to meet their legal responsibilities, and that they will deliver an acceptable standard of service to the customers it has applied to serve. A NAV must demonstrate to Ofwat and the Drinking Water Inspectorate (DWI) that it will be technically and operationally able to fulfil the functions of an appointee.

Recent reforms have contributed to steady growth in the sector

The development of the NAV sector must be seen in the context of the privatisation of the water industry in England and Wales, which took place through the Thatcher government's sale of Regional Water Authorities in 1989.⁶ This created the landscape of privately owned, regional water monopolies that we know today. NAVs came later with the introduction of the Water Industry Act 1991; as part of the then government's efforts to promote competition, efficiency, and customer choice in the water industry. The Act legislated that companies other than the existing incumbent could be appointed by the water regulator to provide water and/or sewerage services to specific sites in England and Wales.⁷

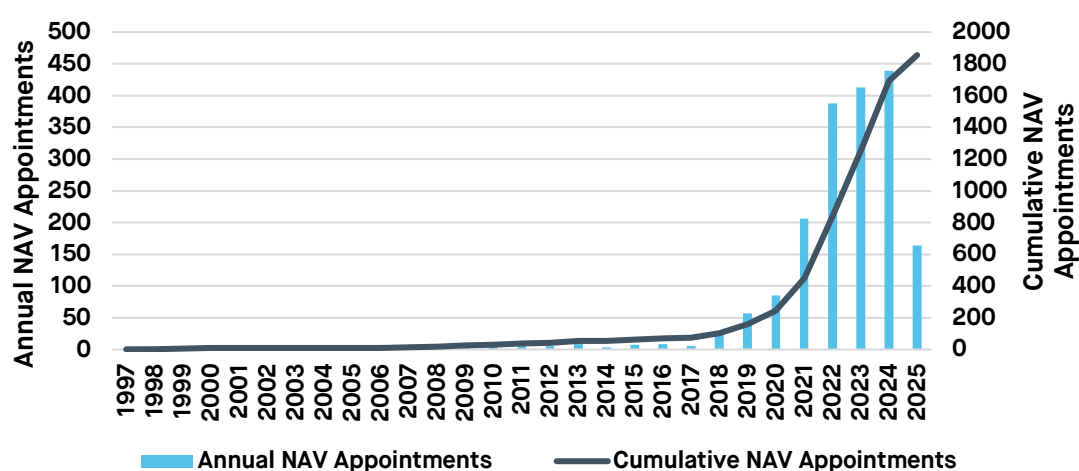
The sector saw limited growth initially, and by 2016, this prompted Ofwat to commission a report to identify potential barriers preventing NAVs from entering the market.⁸ The research identified two key issues that were acting as barriers to competition:

- ‘Process/behaviour’ – issues faced when applying to be a NAV for a specific site and the relationship between NAVs and incumbent water companies as part of that process;
- ‘Pricing’ – problems relating to the pricing arrangements reached as part of agreements between NAVs and incumbent water companies.

This report in turn led Ofwat to introduce a number of significant reforms seeking to encourage entry into the market. The first came in May 2018, when the regulator issued guidance for how incumbent water companies should determine charges for providing bulk supply services to a NAV- guidance which was then further updated in 2021.^{9 10} In 2020, Ofwat removed the discount offered by incumbents on the costs of on-site assets charged to developers- a move considered necessary to create a level playing field with costs charged upfront to developers by NAVs. In the same year, Ofwat introduced the ‘D-MeX’ framework to assess developer satisfaction with water companies, as their customers. The framework rewards incumbent companies that perform well and penalises poor performers. Several other reforms were implemented by Ofwat over these years that sought to promote competition in the market for ‘last mile’ infrastructure.¹¹

These reforms certainly had the effect Ofwat intended. As Figure 2 depicts below, NAVs have experienced rapid growth in recent years, particularly after Ofwat’s 2018 and 2021 clarifications of the methodology underpinning bulk supply charges that incumbents are permitted to charge. More appointments and variations were granted in the first three months of 2025 than were granted in total in the years before 2020.¹²

Figure 2: Number of appointments and variations, 1997-2025¹³



Source: Ofwat, 2025 figures include January to March 2025 only.

The result of this growth is that NAVs play a growing but still relatively small role in providing connections to new developments in the water industry: Ofwat estimates

that the share of new properties served by NAVs increased from around 2% in 2017 to approximately 20% in 2021.¹⁴ This is especially concentrated in large housing developments, and NAVs are also important for industrial development. And the level of NAV activity varies around the country. One interviewee, representing a major UK water company in Southern England, told us that NAVs were responsible for a third of connections to new properties in their region.

However, as we will see later in this briefing, NAVs still face a number of pressing challenges preventing these firms from reaching their full potential.

THE IMPACT OF NAVS ON UK DEVELOPMENT

Throughout our engagement with experts for this research, we frequently heard a view that NAVs are generally much more nimble, efficient and innovative than incumbent water companies, and that the competition they provide in the water sector generates a range of economic and environmental benefits for the UK. Ofwat has stated that NAVs:¹⁵

“Provide a number of benefits for society, end-customers and developers. The benefits include serving a site at a lower cost, facilitating multi-utility developer service and encouraging innovation”.

That said, whilst the benefits of NAVs in the market for connecting new developments was reflected in their fast growth and the views of experts, there is less certainty on their impact on the end-customers. NAVs, as with incumbent water companies, operate a monopoly within their area of appointment; and so the impact on end-customers must be monitored accordingly as they become more established (see final chapter).

Economic benefits

One of the most pertinent advantages NAVs hold over the traditional water monopolies is the faster connection times they can offer developers. Ofwat reports that NAVs install water connection assets around 25%–50% quicker than incumbent companies do.¹⁶

These faster connection times enable more homes to be built in a shorter time period. There is evidence that delays in providing water and sewerage connections is a major factor contributing to the low level of new homes being built across Britain.¹⁷ In Northern Ireland, for example, recent reports have suggested that 19,000 new homes are on hold because they cannot be connected to wastewater services.¹⁸

With current rates of housebuilding falling significantly short of what is needed to hit the government’s manifesto commitment of 1.5 million homes by the end of this Parliament, NAVs could help to accelerate housebuilding in the UK. Faster construction in and of itself means greater economic growth; but with limited housing widely recognised as a key restraint on the UK’s economic potential, NAVs’ ability to accelerate development is also a boon in the longer term.^{19 20} It’s important to also note that NAVs serve commercial developments– such as new office spaces or data centres– which generates similarly large economic benefits to the UK.

NAVs are able to offer quicker connections to developments for several reasons. Unlike incumbent water companies, NAVs are solely focused on serving the market for new connections. Experts interviewed for this research highlighted that a major reason why developers prefer to work with NAVs is that they are able to provide a dedicated service for connections, an area incumbents have historically neglected as part of their business. By focusing on facilitating connections for developments, NAVs have built up expertise in technologies and processes, allowing them to gain a competitive advantage in the ability to serve this market. Developers also feel much more in control of the end-to-end construction sequence when using these independent companies.²¹ One expert we interviewed argued that, by working with NAVs as opposed to traditional incumbents:

“Developers get much more flexible service, but they also get a much more niche product offering.”

Another took the view that:

“From a developer’s perspective, NAVs offer a really much better service than incumbents can at the moment. Incumbents have been taking some steps to improve their developer service offer, but fundamentally it has been a neglected part of their business”.

NAVs are also able to offer faster connection times by virtue of the multi-utility model that many operate. This model refers to the common practice of NAVs providing connections and services for multiple different utilities, such as electricity, gas, water, and telecommunications, to the same development sites. Bottlenecks in the connection process can substantially slow down the completion of developments. Coordinating all of this through a single supplier simplifies the installation process and the resolution of any issues that occur.^{22 23 24}

One interviewee working in the NAV sector explained the benefits of the multi-utility approach from a developer’s point of view:

“For them [developers], it’s a great opportunity, because they can do gas, electricity and water all in one go, in one dig, and they don’t need to deal with many different companies”.

Competition from NAVs can also push incumbent water companies to “raise their game” by improving their own services and potentially offering more competitive pricing to developers for ‘last-mile’ services. Even the threat of a competitor entering the market can challenge existing appointees to improve the service they provide to developers.²⁵

The most immediate beneficiaries of greater competition in the market for ‘last-mile’ services are developers, who gain from the cost-saving efficiencies. But it has been argued that these benefits in turn flow to residents and businesses occupying the NAV-served developments. And there is some evidence that suggests residents in these developments benefit from improved customer service, such as through the use of better billing processes that ensure bills are reflective of consumption; although a report prepared for Ofwat provides contradictory evidence, highlighting that water companies and a water industry body believe that NAVs do not have

regulations or incentives in place to install smart meters or provide usage data to their customers.^{26 27} But at least in the case of multi-utility providers, it's clear that consumers benefit from having a single point of contact when facing operational issues, such as leaks or interruptions to supply.²⁸

Environmental benefits

In addition to the economic benefits outlined above, NAVs can help make new housing developments more sustainable and water efficient, helping to meet the Government's environmental ambitions.

As before, these benefits can largely be attributed to the NAV business model. Put simply, under bulk supply agreements NAVs agree to buy water at the boundary of the site at the bulk supply price before supplying water to the end customer. As the amount of water a NAV receives from the incumbent water company represents a major input cost for these companies NAVs are naturally incentivised to reduce the amount of water they need to draw from incumbents' networks to fulfil the demand of the residents.²⁹ On the other hand, incumbent companies don't pay for water itself, and therefore don't see it as an input cost in the same way.

Ofwat's guidance on how incumbents should calculate bulk supply charges for NAVs makes this mechanism explicit. The guidance states that the incumbent should make an allowance for the amount of leakage that the incumbent would have incurred if they were operating the site. This discount consequently means that NAVs are highly incentivised to ensure leakage on their sites is below the level accounted for in the bulk supply charge calculation in order to increase the profit margin they make from operating the infrastructure of the site in question.³⁰

This pressure to reduce the amount of water drawn from incumbents' networks leads NAVs to be more actively focused on installing water efficiency measures for new developments than incumbents. With a growing population and climate change putting ever more pressure on the UK's water resources, the efficiencies NAVs are building into new developments are critically important to the sustainable management of this key natural resource.

Similarly, NAVs' business model incentivises them to limit the amount of wastewater that they discharge back into incumbents' networks. As most NAVs do not have their own wastewater treatment works, they must enter into bulk discharge agreements where incumbents charge NAVs for discharging wastewater into their networks. So, in the same way NAVs are incentivised to minimise the water they draw from incumbents' networks; they are also incentivised to limit the amount of wastewater they discharge into incumbents' networks in order to lower operational costs and increase profit. As with water efficiency, Ofwat's guidance helps to codify these incentives to minimise wastewater discharge, with the regulator stating that:³¹

"We consider that if the drainage system that the new appointee installs results in less surface water entering the existing appointee's sewers, this should be recognised in the price paid for the service".

This drive to reduce wastewater discharge leads NAVs to introduce measures such as sustainable drainage solutions (SUDs), which reduce the amount of rainwater flowing into an incumbent's network. One expert we interviewed contrasted NAVs' profit-driven focus to install SUDs on sites with incumbents' inability to do so:

"They [NAVs] are sort of filling a niche. They're adopting sustainable drainage solutions, and they're doing that because it's sort of difficult for incumbents to adopt SUDs, given that the schedule of the flood and water management act hasn't been enacted yet".

The installation of SUDs on new development sites comes with significant environmental benefits. These techniques reduce the risk of flooding by providing permeable surfaces for water to drain, help to prevent drought by recharging groundwater beneath developments and provide important habitats for wildlife.³²

It is important to acknowledge that not all interviewees shared the view that NAVs and the business model they operate is intrinsically sustainable. One argued that the incentives bulk supply agreements create to minimise water usage are not 'natural' and instead have to be designed into the structure of tariffs NAVs face. Furthermore, one representative of an incumbent water company explained that the growth of NAVs could have negative implications for the management of water resources due to greater 'fragmentation' of water networks. The interviewee argued that as more NAVs establish their own networks within the existing network of an incumbent water company, it becomes harder to conduct joined-up, long-term planning for water resources; making it more challenging for incumbent water companies to manage their systems effectively over the long term.

CHALLENGES HOLDING BACK THE SECTOR, AND POLICY SOLUTIONS TO OVERCOME THEM

Whilst recent Ofwat reforms did help address some of the main challenges facing NAVs, there is further to go. Fortunately, the government has tools at its disposal that can overcome these remaining barriers and facilitate NAVs to play a greater role in housing and infrastructure development in the UK.

The following section outlines these key barriers and sets out policy recommendations for how government can alleviate them.

NAV licensing

Burdensome site-specific licensing requirements

One issue that recurs throughout the literature on this topic, and that was unanimously described by experts interviewed for this research as a significant impediment to NAVs, is the site-by-site process for appointing independent companies to serve new developments.³³ For an independent water company to be appointed to become the water supplier for a given site, they must apply to Ofwat for a license to serve that site. This contrasts with Ofgem's licensing process for Independent Electricity Distribution Networks (IDNOs) and Independent Gas Transporters (IGTs), which grants a license that allows companies to operate on a nationwide basis.

This approach to licensing is set out in the Water Industry Act 1991, which only permits the replacement of one appointee by another for specific geographic areas.³⁴ These rules were drawn up to ensure that each NAV is compliant with the necessary regulatory requirements to operate on a particular site.

However, this site-by-site licensing process has negative implications for the NAV sector. One of which is the administrative burden imposed on NAVs as a result of going through this process. NAVs need to submit a separate application for each site they plan to serve, with Ofwat assessing each of these applications individually, and the process is considered a significant source of administrative costs for NAVs operating across multiple locations.³⁵ One interviewee working for a NAV clearly considered the site-by-site nature of Ofwat's licensing process to be an unnecessary burden:

"We have varied now our appointment 61 times because we've got 61 different sites... it's nonsense, because it is so much work".

Another representative of a NAV we interviewed explained how the site-specific nature of the licensing system imposes burdens both on their business and on Ofwat, which is tasked with processing the license applications:

"We have something like eight full time employees working 100% on doing license applications and providing the information to Ofwat. And there are similar numbers of people on the Ofwat side, going through the information we provide them and checking it, so it's very bureaucratic".

In addition to the administrative costs, the length of time it takes to go through the licensing process, and the risk of delays, can significantly slow down appointments to new developments. The timeline Ofwat says is needed to complete a new appointment for a specific site is 85-90 working days, but in practice the application process often takes much longer. Ofwat stops counting the working days that have elapsed since the application was started if it is waiting for information to be provided by NAVs, even when they are in turn waiting for incumbents to share information.

Overall, the site-by-site nature of Ofwat's licensing process imposes significant costs on NAVs and slows the rate at which these companies can serve new developments, curtailing the extent of the benefits NAVs deliver to the UK's environment and economy.

The government should review the NAV licensing system

Ofwat has acknowledged the issues presented by the current system of site-specific licensing for NAVs, recognising that it does create a disproportionate administrative burden.³⁶ Ofwat published a consultation in September 2024 which set out proposed changes to the licensing of new appointments and variations.³⁷ But the changes proposed would sit within the site-by-site framework required by government legislation. A number of experts interviewed as part of this work suggested that replacing the site-specific licensing regime with a national system of licensing for independent water companies, as is the case for independent electricity distribution companies regulated by Ofgem, would be a step in the right direction.

However, whilst emulating Ofgem's national approach to licensing independent network companies is, in principle, likely to be the best approach to reform, Ofwat should nonetheless retain the right to make assessments and intervene on specific sites. Several interviewees made the point that whilst lessons should be learned from the energy sector, water supply networks and electricity distribution networks cannot be considered like-for-like, not least because the implications of regulatory breaches in water carry much greater risk to public health than is the case with electricity networks.

Furthermore, it is currently unclear how a national licensing system for NAVs would work in practice. At the time of writing, there is an absence of evidence as to how Ofwat would implement such a system. And given that the legislative underpinnings of the site-specific licensing system for NAVs lie within the Water Industry Act 1991, this is not a change Ofwat can make independently of central government.

As such, there is a role for government to set out a path forward for a system of national licensing. The Department for Environment, Food and Rural Affairs (Defra), the department with policy ownership over the water sector, should launch a formal consultation on how a national NAV licensing system could be implemented to reduce the burdens on both NAVs and Ofwat, whilst ensuring that consumer and environmental protections are upheld to the highest standards.

Finally, experts interviewed for this research suggested that even if a national licensing framework cannot be established, then there is still considerable scope to alleviate the burdens imposed under the current licensing framework. For example, more of the NAV licensing process could take place at the company level rather than on a site-specific basis. This is already the case for other NAV assessments, such as on financial stability.³⁸

Policy recommendation: Launch a consultation on national licensing for NAVs

As the Water Industry Act 1991 does not allow for the issuance of national licenses for water and sewerage services in the same way as in the energy sector, it is clear that moving to a system of national licensing would require legislative amendments to the 1991 Act.

Defra should consult on how a national licensing system could most effectively work in practice, and be open to the case that the costs of implementing such a reform outweigh the benefits. In such a case, Defra should work with Ofwat to find alternative ways to reduce the administrative burdens imposed on NAVs under the current site-specific licensing system, such as by carrying out more of the elements of the licensing process at a company-wide, national level.

Bulk supply agreements

Opaque and inconsistent bulk supply pricing

As we have seen, NAVs rely on bulk supply agreements with incumbents to operate on new developments. Yet despite positive moves from Ofwat, namely the issuance of guidance in 2018 and 2021 that set out how incumbents should determine charges for providing bulk supply services to NAVs, there is no detailed and consistent methodology for calculating these charges, leading to significant variations between different incumbents across regions.

Ofwat advises that incumbents should set bulk supply charges for NAVs using a ‘wholesale minus’ approach. This means that charges to NAVs should be based on the relevant wholesale tariff, less the avoided costs of providing ‘last-mile’ services. This guidance, however, does not constitute a detailed methodology for calculating these charges, and NAVs report a lack of transparency in the way charges are set. One expert we interviewed for this research argued that:

“It’s very difficult to see exactly how incumbents have come to that number [the bulk supply price]”.

Whilst acknowledging that there is some variation in network costs across the country, one interviewee argued that:

“The disparity in discounts between the different areas around England and Wales can’t possibly reflect differences in that last mile cost base”.

And this inconsistency makes it difficult for NAVs to predict their costs and assess the viability of serving a site, meaning that in some areas it is simply uneconomic for NAVs to seek to compete to serve new developments.³⁹ One interviewee, in the employ of an independent water company, explained the implication for the ability of NAVs to serve new customers in different areas:

“In some areas, you can make quite a big profit, but in others you can’t make any... and you wouldn’t even go there”.

The vague, or as one interviewee described, “fairly woolly” nature of Ofwat’s guidance leaves open the potential for incumbents to put up strategic barriers to entry; and this likely forms part of the explanation as to why charges vary as much as they do. Due to their monopoly position and control over the water networks that NAVs draw supplies from, incumbents have the potential to use bulk supply charges as a strategic barrier to prevent or limit NAV entry into the market. Additionally, there are concerns that some incumbents do not offer bulk supply terms to NAVs that are as favourable as the terms they offer to developers directly.⁴⁰

Overall, the opaque and inconsistent nature of bulk supply pricing is a significant obstacle hindering NAVs’ ability to compete effectively and deliver benefits to developers and end-consumers. The lack of regulatory clarity in respect to bulk supply charging effectively imposes a barrier to entry into the market for new water connections, curtailing competition and preventing NAVs from operating in areas where they could offer better value.

Establish a common, explicit, and industry-wide methodology for bulk supply charges.

Across the literature and throughout our engagement with experts, we found that a key solution to the opaque and inconsistent nature of bulk supply pricing is the development of a common, detailed, and industry-agreed methodology for calculating bulk supply charges.⁴¹ Ofwat has been moving steadily in the right direction on this, particularly with the 2021 update to guidance on bulk supply charges.⁴² But insights from the electricity market demonstrate that further efforts to clarify how charges should be calculated would serve to significantly enhance transparency and consistency across the water sector, streamlining interactions between incumbents and NAVs.

Ofwat could go further and introduce statutory charging rules for bulk supply services provided by incumbents to NAVs, as provided for by the Water Act 2014.⁴³ Doing this could provide a more enforceable framework than guidance alone.⁴⁴ However, it seems reasonable to recommend that this option should be only considered once the unclear nature of bulk supply charging guidance has been addressed, and if it is evident that issues remain.

Policy recommendation: Establish a common, detailed, and industry-wide methodology for bulk supply charges

Vagueness and inconsistencies in bulk supply charging guidance are leading to large variations in 'avoided cost' discounts between regions of the country and therefore limiting the potential of NAVs to compete.

The government should work with Ofwat and the relevant industry stakeholders to establish a common, detailed and industry-wide methodology for calculating bulk supply charges, to streamline interactions between incumbents and NAVs and remove the barriers to NAVs operating in more areas of England and Wales.

Drinking Water Inspectorate regulation

An inappropriate and unnecessary site by site approach to managing water quality

Another challenge impeding NAVs is the way the Drinking Water Inspectorate (DWI), a regulatory agency that ensures the safety and quality of drinking water, regulates these companies' activities.

A significant issue that came up across the literature and throughout our engagement with experts is the approach DWI takes to managing water quality zones, and the sampling requirements it imposes on independent companies as part of that approach. In short, DWI treats each site that NAVs have been appointed to as an individual water quality zone, even when there is a single source of water which might come from incumbents' reservoirs. This can be contrasted with the treatment of incumbent water companies, which can incorporate new developments into their existing zones.⁴⁵

NAVs must conduct a minimum level of sampling for each site, regardless of its size or proximity to other NAV sites drawing from the same water source. This means that NAVs are required to meet significant sampling requirements. And in cases where a NAV is operating on multiple sites within a single incumbent water company's water zone, this means that NAVs are required to do significantly more frequent sampling than that incumbent – despite the NAV drawing its water supplies from that incumbent's network. As an individual with expert knowledge of DWI's regulatory approach explained:

“In a perverse way, if all of those [NAV sites] actually sit within a big [incumbent company's] water zone, the incumbent company might actually be doing less sampling on that one zone than the NAVs are having to do for all of those [sites] in total”.

Interviewees widely viewed this as a counter-intuitive and outrightly inappropriate approach to monitoring water quality because under this approach, NAVs are subject to greater regulatory checks than incumbents, despite having considerably less relevance to the problem of substandard water quality. One expert went as far to say that:

“The Drinking Water Inspectorate is probably the source of most of the regulatory problems for NAVs”.

The main implication of higher sampling requirements is that NAVs face increased costs, with higher per-customer sampling costs for NAVs compared to incumbents. But there are also negative implications for public health, as the level of regulatory checks that ensure water quality should correspond to the scale of the relevant actors' influence on factors affecting water quality.

It is interesting to note that, as explained by the interviewee with expert knowledge of DWI's regulatory approach, there is little rationale for this site-specific approach beyond the fact that it is a regulatory relic from a time before the significant growth in the NAV sector that has occurred over recent years. The potential for local contamination does exist; even if multiple NAV sites source their water from the same incumbent's supply, contamination could still occur within each NAV's distinct distribution network (from pipes, storage and other infrastructure within a NAV area). However, this is equally the case across an incumbent's considerably larger network.

Merge water zones where there is a common water source

The Drinking Water Inspectorate is aware of the burdens imposed on NAVs as a result of the current rules on sampling and would like to see change. An interviewee privy to DWI's internal thinking on this matter explained that:

“The sampling regime in the regulations is set up for the big, traditional water companies, where they've got fixed large areas, and they're generally geographically linked... whereas with the NAVs, you've got tiny little areas dotted around the country, and the sampling regime in the regs doesn't work properly for them”.

In the NAV context, a more appropriate approach to ensuring water quality standards would be to amalgamate different water quality zones when there is a single source

of water which passes through the same treatment works. This would substantially reduce the sampling burden imposed on NAVs, with a negligible impact on public health according to the water quality expert we interviewed. The benefits of this reform would be particularly beneficial in highly populated parts of the country because many NAV areas are likely to be supplied by a single water treatment works and sit within the same water quality zone. London, with numerous NAV areas supplied by the same water treatment works, is a prime example where this approach could help ease the burdens on NAVs. Above all, this move would satisfy the Government's desire for regulators to conduct a more risk-based approach to monitoring, as set out in Dan Corry's recently released independent review of Defra's regulatory landscape.⁴⁶

As is the case with Ofwat, however, DWI has a statutory duty to impose the rules it is responsible for upholding, and they have no power to change the sampling rules to allow this in the absence of changes to primary legislation. As such, Defra should work to amend the Water Supply (Water Quality) Regulations 2016, which requires DWI to treat each NAV site as a discreet water zone, in order to allow the merging of zones where there is a single water source.⁴⁷

Policy recommendation: Merge water zones where this a common water source

The Drinking Water Inspectorate's site-specific approach to regulating water quality is, in the context of NAVs, excessive. The regulations on this issue are out-of-date, having failed to catch up with the relatively recent development of this industry.

The government should work to change the regulations underpinning this barrier that NAVs are facing. Defra should amend the Water Supply (Water Quality) Regulations 2016 to allow the Drinking Water Inspectorate to treat different areas of appointment that share a common water source as a single water zone. Doing so will significantly reduce the sampling burden imposed on these companies, enhancing their ability to deliver new connections and speed up housing development.

ENSURING A FAIR DEAL FOR ALL CUSTOMERS

Experts interviewed for this project shared a common view that there were two distinct elements of the sector that policymakers should be concerned with. The first was the 'developer services' side, which relates to the role these companies play in facilitating housing and infrastructure developments. This element has constituted the focus of this report thus far.

The second element relates to the retail services NAVs provide to end-customers, on an ongoing basis, on the new developments they provide connections to. As we have

seen, once NAVs are appointed to a specific site, they become the monopoly provider for that site indefinitely. Regulatory attention must therefore be devoted to the interaction between these companies and the end customers they provide retail services to.

In the discussions we held with experts, there was near unanimity on the benefits that NAVs provide on the developer services side. The speed at which NAVs can install infrastructure relative to incumbents was frequently singled out as an obvious example of NAVs accelerating the delivery of infrastructure and housing developments, and the benefits to developers are evidenced by the considerable growth the NAV market has seen in recent years. However, several interviewees questioned whether NAVs are delivering positive outcomes to end-consumers to the same extent that they are on the 'developer side'. One interviewee made the point that:

"The benefits to developers of NAVs have been proven by the market penetration NAVs have seen over the past few years, but with respect to the benefits to end customers, the jury is still out".

Some NAVs are failing to meet their responsibilities to low-income customers

Several interviewees singled out the issue of social tariff provision as an area where NAVs are not meeting their responsibilities to end customers.

Social tariffs are discounts provided to those on low incomes to make essential services like water, energy and broadband affordable. These schemes can play a major role in shielding the most financially vulnerable consumers from high essential costs. All of the UK's major water companies provide social tariff schemes to their customers, having been challenged by Ofwat to address customer concerns about the affordability of water bills.⁴⁸

However, concerns have been raised over the availability of social tariffs to those who live in developments served by NAVs. Recent research by Citizens Advice, for example, has found that NAV companies do not always offer a social tariff to their end customers, and the organisation reported several cases where advisers had come across clients who were missing out on social tariff support for their water bill due to living in a new build estate with a NAV water supplier.⁴⁹

A failure to match the social tariffs that an incumbent would offer stands in clear breach of Ofwat's no-worse-off principle, a requirement NAVs have to meet in order to be appointed to a site.⁵⁰ Furthermore, as an incumbent's retail tariff is structured to incorporate the cost of providing social tariff discounts to their low-income customers ('cross subsidy'), if NAVs do not provide the relevant incumbent's social tariff scheme, then that NAV is getting a subsidy for a cost it is not incurring. One regulatory expert working for a major English water company who held a broadly favourable view towards the role of NAVs, made the point that:

"Where a NAV doesn't replicate our tariff structure... then potentially a proportion of those customers are worse-off... and it is therefore recovering

across a subsidy that we have set within those tariffs to fund the discounts to other customers. So the NAVs are potentially trousering, if I can use that expression, that cross subsidy.”

The interviewee explained that NAVs might argue that the reason they may not be providing social tariff discounts to low-income customers is because they and the relevant incumbents do not share the same socio-economic mix across their customer base. They would likely point to the affordable housing requirements local authorities set that developers have to meet for new sites.⁵¹ These requirements, their argument goes, means that their customer base is likely to skew disproportionately towards the lower end of the income distribution, and therefore the costs they incur from providing incumbents’ social tariffs would be proportionately larger than what incumbents would incur, thus rendering many NAV sites uneconomical.

Overall, we consider this to be a poor defence. Firstly, affordable housing targets are rarely met in practice, with developers often finding clever ways to get around these rules, or simply refusing to build in the first place.⁵² Secondly, it’s hard to justify the failure to deliver social tariff discounts to vulnerable consumers when NAVs are being funded to do just that through the receipt of the relevant incumbent’s retail tariff.

NAVs should be required to follow the incumbent’s social tariff regime

Fortunately, it is reasonably straightforward for Ofwat to fix this issue, simply by providing clarification in its guidelines that NAVs are expected to follow the social tariff regime of the relevant incumbent water company, and that not doing so would be considered a breach of the no-worse off principle and thus a breach of the NAV license.

It is worth noting that there are ongoing discussions on replacing the patchwork of individual water companies’ social tariff schemes with a single social tariff that applies nationally. The Consumer Council for Water, for instance, has recommended that water companies, Water UK and Ofwat work together to create a single social tariff scheme, with pooled funding from all water companies’ customers.⁵³ Under this scenario, all water companies (including NAVs) would be required to contribute to the scheme on a proportionate basis, and the issue discussed in this section would consequently be addressed. Indeed, NAVs themselves are supportive of a national social tariff regime. The Independent Networks Association (the sponsor of this briefing) told us they recognise that for any affordability scheme to be effective, it must be structured in a way that fully integrates independent providers.

The creation of a national social tariff framework would certainly be a hugely positive development. However, given the relative simplicity of requiring NAVs to follow the social tariff regime of incumbents, Ofwat should not wait for the imposition of such a scheme to address the issue of low-income NAV customers going without the support they need.

Policy recommendation: Require NAVs to follow the social tariff regime of the incumbent they draw water supplies from

The fact that some NAVs are failing to provide social tariffs to their customers is a clear breach of Ofwat's 'no-worse-off' principle, a condition for NAV licensing.

Ofwat should provide clarity to NAVs that they are expected to follow the social tariff regime of the relevant incumbent water company, and that failure to do so would be a breach of the 'no-worse-off' principle and therefore the license of their appointment.

There is a more general point to be made in relation to NAVs and the retail services they provide. That is, as the market develops, NAVs should no longer be seen as the 'special case' regulators have perhaps deemed them to be.

For example, there are concerns over how well NAVs are being run financially. With relatively new networks, these companies currently incur low maintenance costs. However, these costs will grow in the future, and it is important that NAVs are subject to sound financial management to ensure they have the capacity to meet future capital expenditures demanded by the need to maintain increasingly ageing infrastructure.

One interviewee made the point that the largest NAVs are becoming the size of the smallest water companies, and whilst the focus on the 'developer side' has been justified, there is a growing need to dedicate policymaking and regulatory attention to the 'end-customer' side. To that effect, one interviewee suggested that:

"There's probably a bit of a need for a stock take about what is the right regulatory regime and oversight in place for NAVs".

We share this conclusion. And as this report has outlined, NAVs offer a range of benefits in accelerating housebuilding and infrastructure development. But policymakers and regulators must be acutely aware of the growing role NAVs play in providing retail services and must ensure that these companies uphold duties to their end customers.

Ofwat is clearly succeeding in its aim of developing the NAV market, and reforms outlined earlier in this report will spur growth in the sector further. But it must ensure that success on the 'development side' is matched by positive outcomes for customers who will be receiving services from these firms over the long-term.

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