PR24 final determinations

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PR24 Senior Director and Directors
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Overview

Chris Walters

The largest investment programme of any five-year period since privatisation

£11.9 billion
to reduce harm from storm overflows

£8.1 billion
to boost our water supply

£104 billion
total expenditure 2025-30

£6 billion
of upgrades to combat nutrient pollution

£3.3 billion
for nature-based solutions and to increase biodiversity

10.4 million
smart meters delivered in the biggest rollout to date

30
major projects will provide water security for over 8.5 million households

3x
the replacement rate of water mains pipes

17%
leakage cut to the lowest level since privatisation

28%
reduction in sewer flooding in homes

Water supply projects: New reservoirs and water recycling schemes

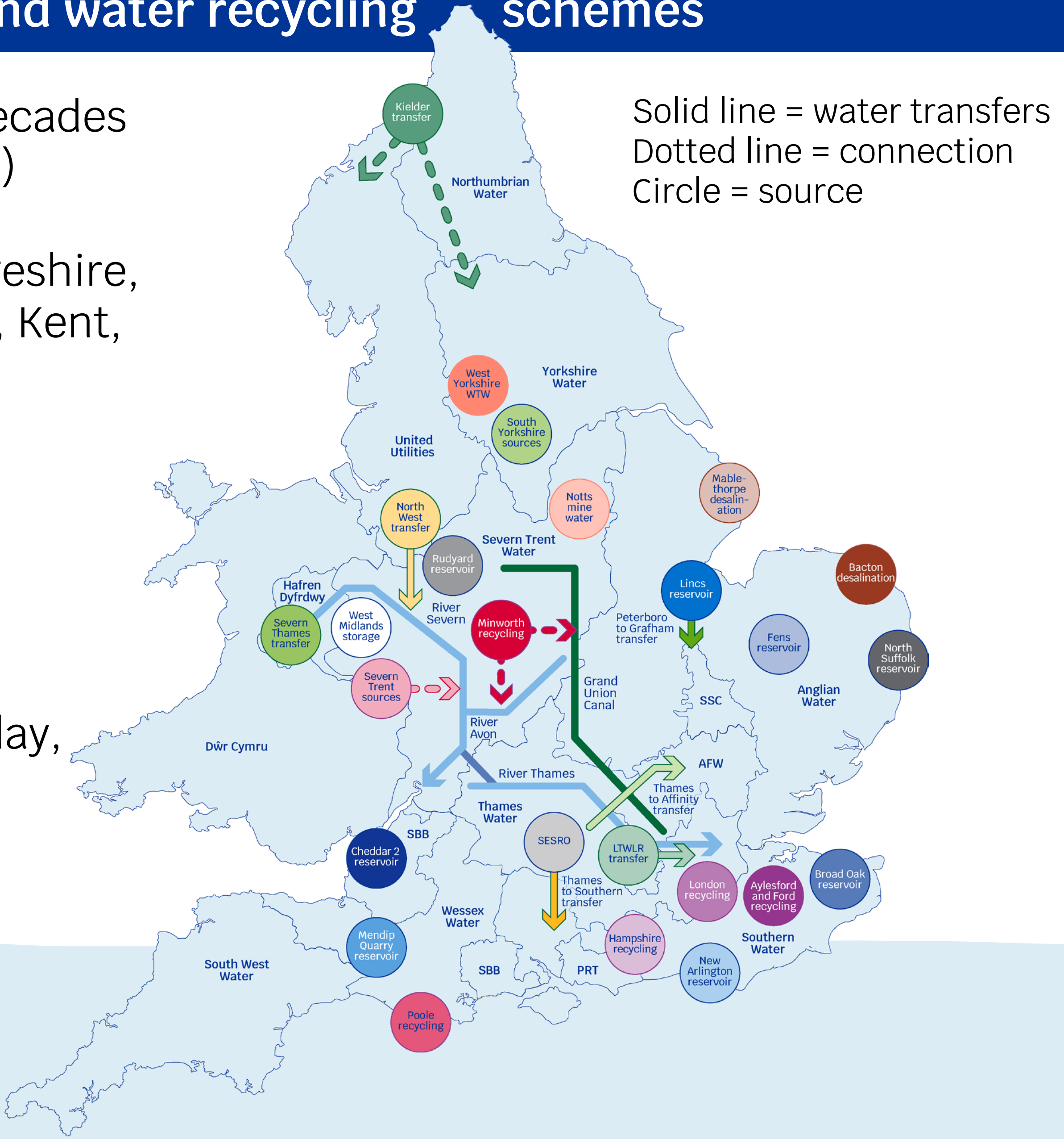
Biggest package of water supply projects in decades (£2 billion to unlock £50 billion for 30 projects)

Nine new reservoirs in Lincolnshire, Cambridgeshire, Hampshire, Oxfordshire, Somerset(2), Suffolk, Kent, and the West Midlands

Nine large-scale water transfer schemes

Converting an existing quarry to a reservoir in Somerset

Potential 670 million litres of extra water per day, once completed after 2030



QAA
Andrew McGeoghan

Background

Purpose: Business plan incentive to encourage quality plans with ambitious service levels at efficient costs

Reminder of **QAA at draft determinations**:

- 3 components (figure 1)
- Rewards and penalties determined by assessments (figure 2)
- South West Water and Severn Trent Water had outstanding plans – to hold them to account they have to meet specific commitments to keep their rewards
- Ten companies had standard plans
- At draft determinations we still had concerns with the plans of South East Water, Southern Water, Thames Water and Wessex Water

Figure 1

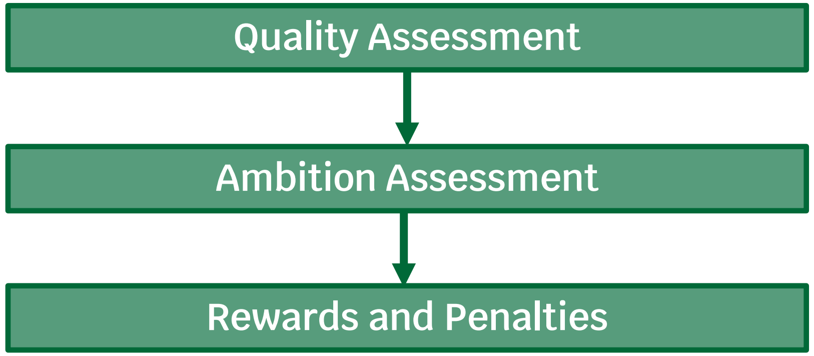
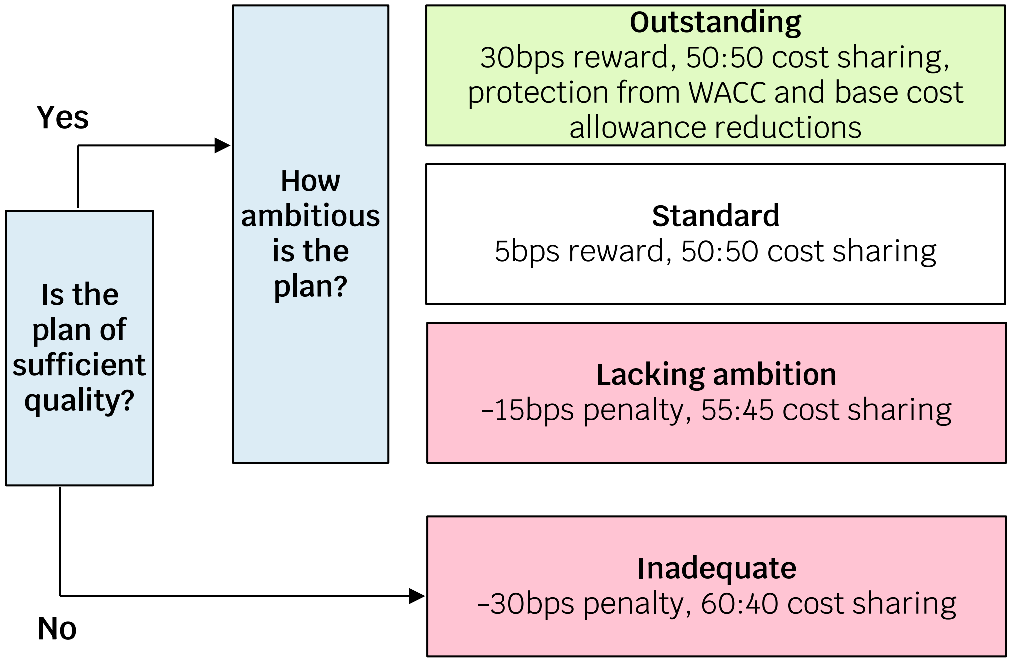


Figure 2



QAA at final determinations

Company	Draft determination category and penalty	Final determination category and penalty
South East Water	Lacking Ambition -15bps (£6million)	Conditions Met 0bps
Southern Water	Inadequate -30bps (£54million)	Conditions Met 0bps
Wessex Water	Inadequate -30bps (£32million)	Conditions Met 0bps
Thames Water	Inadequate -30bps (£141million)	Inadequate -30bps (£141million)

- Set conditions for these four companies at draft determinations – if they met them they would avoid penalties in our final determinations.
- All companies made some progress against their conditions.
- To reflect the progress made by South East Water, Wessex Water and Southern Water in the round, we waived their penalties.
- Remaining concerns we have with these three companies can be dealt with via routes other than the QAA.
- Still had material concerns with the information provided by Thames Water and we applied a QAA penalty in our final determinations.
- Thames is subject to our Turnaround Oversight regime (TOR). To further incentivise the company to improve, it can earn its QAA penalty back at PR29 if it demonstrates sufficient improvement.

Summary of QAA results at final determination

Company	Categorisation of business plan	Reward or penalty	Financial adjustment	Cost sharing rate*
Severn Trent Water	Outstanding	Reward	30bps (£93m)	50:50
South West Water	Outstanding	Reward	30bps (£36m)	50:50
Anglian Water	Standard (no intervention)	Reward	5bps (£13m)	50:50
Hafren Dyfrdwy	Standard (no intervention)	Reward	5bps (£0.2m)	50:50
Northumbrian Water	Standard (no intervention)	Reward	5bps (£7m)	50:50
United Utilities	Standard (no intervention)	Reward	5bps (£16m)	50:50
Yorkshire Water	Standard (no intervention)	Reward	5bps (£11m)	50:50
Affinity Water	Standard (no intervention)	Reward	5bps (£2m)	50:50
Portsmouth Water	Standard (no intervention)	Reward	5bps (£0.6m)	50:50
SES Water	Standard (no intervention)	Reward	5bps (£0.4m)	50:50
Dŵr Cymru	Standard (intervention)	Ineligible for reward	0bps	50:50
South Staffs Water	Standard (intervention)	Ineligible for reward	0bps	50:50
South East Water	Conditions met at FD	Penalty waived	0bps	50:50
Southern Water	Conditions met at FD	Penalty waived	0bps	50:50
Wessex Water	Conditions met at FD	Penalty waived	0bps	50:50
Thames Water	Inadequate	Penalty	-30bps (-£141m)	60:40

*Cost sharing rate applicable only to base expenditure, excluding business rates, abstraction charges and discharge consents and expressed as: % of overspend the company incurs: % of underspend the company retains.

Costs

Tim Griffiths

Total expenditure

Analysis of cost gaps

Before frontier shift and RPEs, we allow up to **£105.8 billion** of total expenditure, compared to business plan proposals of £113.7 billion

On applying frontier shift and RPEs, our total expenditure allowance for the sector is **£103.7 billion,** representing a **£8.4 billion (7%)** gap to costs in company business plans

£44.5 billion
Allowed enhancement expenditure[1]

£49.6 billion
Enhancement expenditure in business plans[1]

£61.4 billion
Allowed base expenditure[1]

£64.1 billion
Base expenditure in business plans[1]

1. Before frontier shift efficiency and RPEs

Protecting customers' interests

Removed around £8bn of proposed expenditure where it is either:

- inefficient
- unjustified
- previously funded

This has reduced bills from an average increase over the five-year period of £195 based on companies' representations to **£157**

Doubling of support for customers in need of a helping hand with bills

Strong safeguards for customers:

- gated allowances
- price control deliverables
- delayed delivery cashflow mechanism
- delivery mechanism

Oversight of poorly performing companies

£8 billion

saved for customers by removing inefficient costs

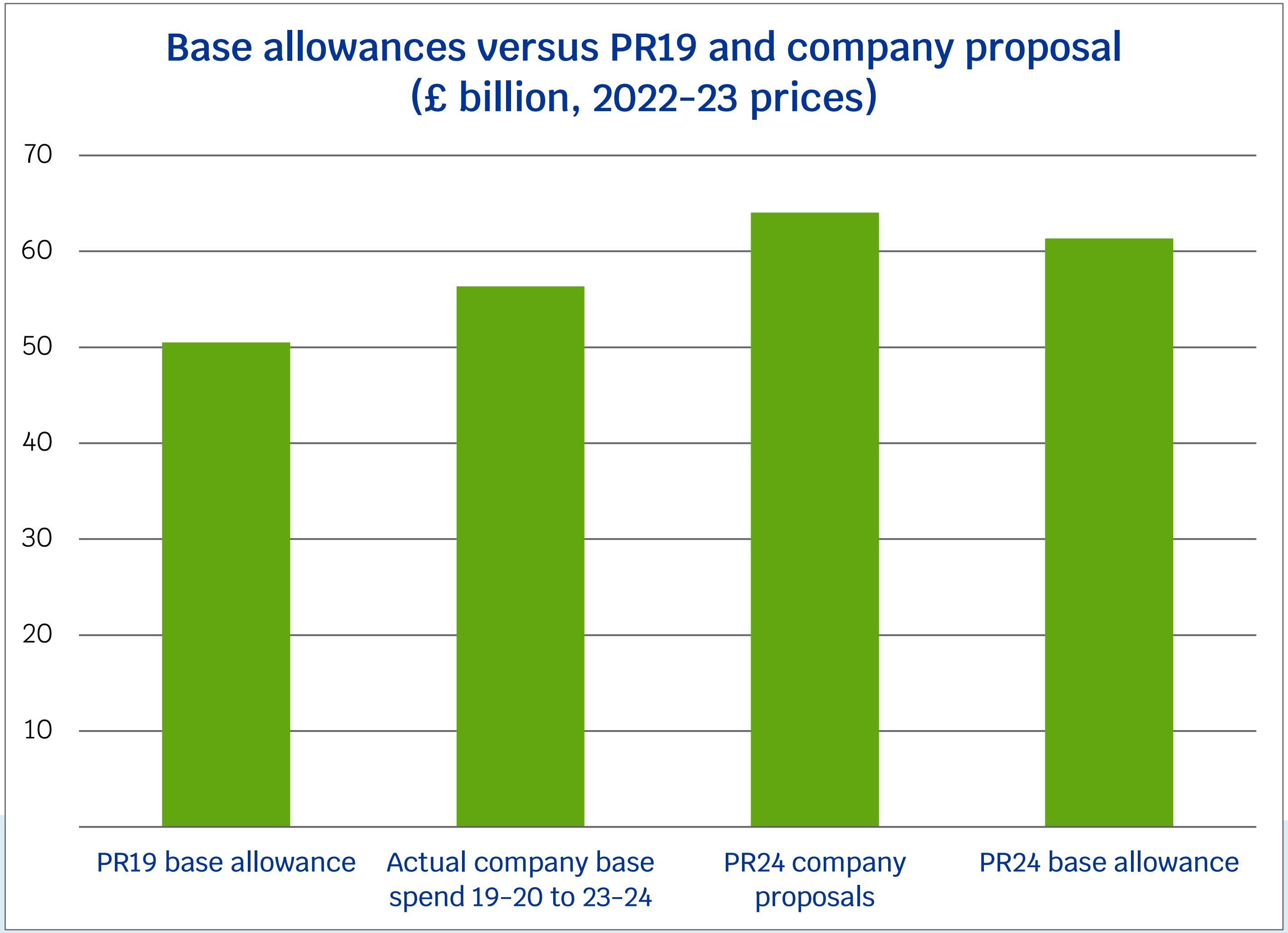
9%

customers paying social tariffs in 2025-30

Base expenditure allowances

Base expenditure allowances are:

- **22%** higher than PR19
- **9%** higher than actual spend (2018-19 to 2022-23)
- **4%** lower than business plan proposal



Enhancement expenditure allowances

Enhancement allowances will deliver

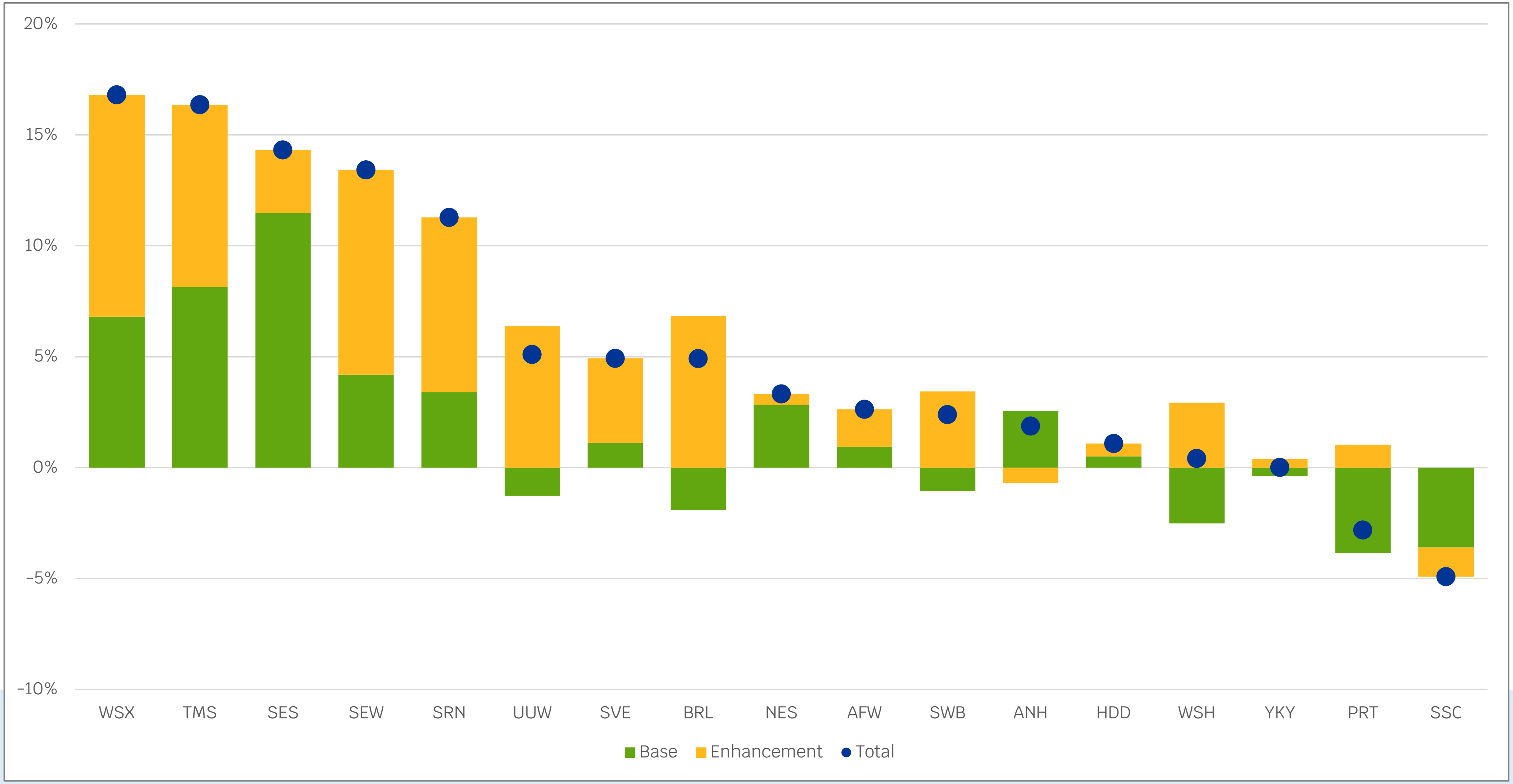
- 28,000 WINEP/NEP actions
- 2000 actions to address declining condition or failure to meet good condition, improving the condition of 15,000km of rivers.
- 2,884 storm overflow improvements
- Nutrient improvements at over 1,000 sites
- Start to build 9 new reservoirs, 12 water recycling plants, and deliver 500+ km of interconnectors – with total 912 Ml/d of benefit, 349 Ml/d of this delivered in 2025-30.

Enhancement expenditure allowances are around four times larger than in PR19

- Important that customers do not pay twice for improvements
- Most expenditure subject to some form of benchmarking
- Challenge on need, optioneering and cost efficiency

Enhancement	£bn
Water enhancement	
Supply demand balance/metering	8.1
WINEP/NEP – water	1.3
SEMD/cyber/reservoir safety	1.4
Drinking water quality	2.4
Other water	2.6
Total water enhancement	**15.8**
Wastewater enhancement	
WINEP/NEP – storm overflows (inc monitors)	11.9
WINEP/NEP – nutrients	6.0
WINEP/NEP – other	4.8
Industrial emissions directive	1.3
AMP7 WINEP carry over	1.1
Other wastewater	3.7
Total wastewater enhancement	**28.7**
Total enhancement	**44.5**

Cost challenge per company at final determinations



Cost sharing, real price effects and alternative delivery mechanisms

Revised cost-sharing approach

- Cost-sharing now included for bioresources
- Cost sharing rates for base costs determined by QAA outcome – 50%-60%
- Enhancement costs – 40%
- Enhancement areas with higher uncertainty – 25%
- Investigations and water quality monitors – 40% (overspend), 10% (underspend)
- Business rates – 10%

Contingent allowances - 13 large schemes covering £1.8bn and PFAS of £0.2bn

Real price effects – cover around 55% of costs, up from around 30% at PR19

Aggregate sharing mechanism to cover totex, returning 50% of financial impacts beyond 200 basis points RoRE

A programme of 27 major projects, attracting £48 billion of new investment to be delivered by direct Procurement for Customers (DPC) and the Specified Infrastructure Provider (SIPR) model

27

major projects worth c.£48 billion delivered through DPC/SIPR

Delivery incentive and monitoring arrangements for AMP8

Price Control Deliverables (all): Financial incentives attaching to enhancement spend which return money to customers if outcomes not delivered in full or on time

Delivery plans (all): Published output due Apr/May 2025 setting out yearly PCD targets for 2025-30, and interim milestones (where targets are back-loaded). We will require companies to publish updates on plan progress every 6 months via the Delivery Plan Progress Report

Delivery Mechanism (SRN & TMS): Contingent budget for a defined package of enhancement spending which will be released subject to adequate evidence of ability to deliver spending on a year-ahead basis. This will be supported by a delivery plan with enhanced reporting, and a Delivery Action Plan – setting out plans to expand delivery capability

Delayed delivery cashflow mechanism – DDCM (all): A mechanism to return 50% of underspent enhancement totex in years 4 and 5 of the control above a 'trigger threshold' of 50% at the end of year two and 65% at the end of year three

Uncertainty mechanism for storm overflow improvements. **Reopener** for PFAS and changes to cyber threat level

£1.8 billion

of funding to Thames and Southern covered by delivery mechanism (TMS £1.2 billion, SRN £0.6 billion)

13

Gated allowances for larger, complex projects

Roadmap for enhancing asset health understanding in the water sector

In the FD, we discussed some of the key issues faced when assessing additional capital maintenance requirements for a wider range of assets. These issues are predominantly driven by information asymmetry between Ofwat and water companies. This includes not having workload data for different assets, used to establish 'what base buys,' and whether companies have done enough to maintain asset health historically.

Over the 2025-30 period, we will work with the sector to try and eliminate these issues on a broader set of assets. This will involve defining a common asset inventory and collecting comparable workload and condition grade data, building on the assets already assessed at PR24 and enhancing understanding of asset health ahead of PR29.

In the FD we set out a roadmap for the 2025-27 period. During this time, we will work with the sector to establish a priority list of assets to collect this information on. This plan was developed alongside our Asset Management and Operational Resilience team. We begin our engagement with the sector in January 2025.

We will also assess whether there are any sector wide issues that need to, and can be, addressed before PR29 for the priority assets. We will work with the sector to find the most appropriate solution to address any potential issues. We stated that we are open to considering the provision of additional base expenditure allowances or allowing companies to accelerate 2030-35 capital maintenance spend. We will consider this further through our engagement with the sector.

1 Early 2025

Asset inventory

- Develop an updated asset inventory and define asset classes.

2 2025

Engagement with companies and wider stakeholders to decide:

1. Assets to focus on
2. How to quantify 'workloads' (eg renewals)
3. How to assess asset condition

Information request issued to companies ahead of analysis.

3 2025 to 2026

Companies to undertake asset condition surveys, and complete information request to allow us to understand:

1. What base buys (workloads)
2. Asset condition

4 2026 to 2027

Ofwat, companies and wider stakeholders to analyse information provided by companies and discuss findings in a series of workshops to explore what solutions are needed.

5 2027 onwards

As this is an iterative process, revise and refine the approach to asset health assessment.

Outcomes

Thea Hutchinson

Outcomes

High-level decisions at PR24

Incentive design		PR24 draft determination
Performance commitments	Common vs bespoke performance commitments	24 common performance commitments for whole sector (plus seven bespoke performance commitments for specific companies).
ODI rates	Size of rates	Rates set by Ofwat using an approach that is consistent across more performance commitments and at least as strong at PR19 across all areas.
	Symmetry	Symmetric ODI rates except where penalty only.
	Financial incentives	Financial incentives for all performance commitments except for river water quality. Extra ODI rewards for per capita consumption, leakage, internal sewer flooding, external sewer flooding and water supply interruptions.
PCL setting	Stretch of targets	Achievable yet stretching PCLs that push companies to improve performance beyond current levels and reflect relevant cost allowances to improve performance.
Risk protections	Caps and collars	Caps and collars on just over 70% and 80% of all common performance commitments respectively.
	Deadbands	Deadbands on compliance risk index, discharge permit compliance, repairs to burst mains and serious pollution incidents performance commitments.

Outcomes – performance commitments

30% ▼ Reduction in total pollution incidents	**29%** ▼ Reduction in customer contacts about drinking water quality	**20%** ▼ Reduction in water consumption per person per day (2038 target)
17% ▼ Reduction in external sewer flooding	**27%** ▼ Reduction in sewer flooding in homes	**17%** ▼ Cut in leakage – to the lowest level since privatisation

2024-25 to 2029-30 comparison

MPCorrespondence@ofwat.gov.uk

Storm overflows

- £11.9 billion expenditure on storm overflows (including monitors)
- **2021-29 – target 45% reduction in spills**
- **2,884 storm overflows to be improved**
- Performance target for companies in England of an average of 16 spills per CSO by 2029-30
- Ongoing enforcement action: First three cases progressed in August – £168 million proposed penalty

£11.9 billion

Expenditure on storm overflows

MPCorrespondence@ofwat.gov.uk

Risk and return

Andrew Chesworth

Overall package of risk and return

Enduring protections:

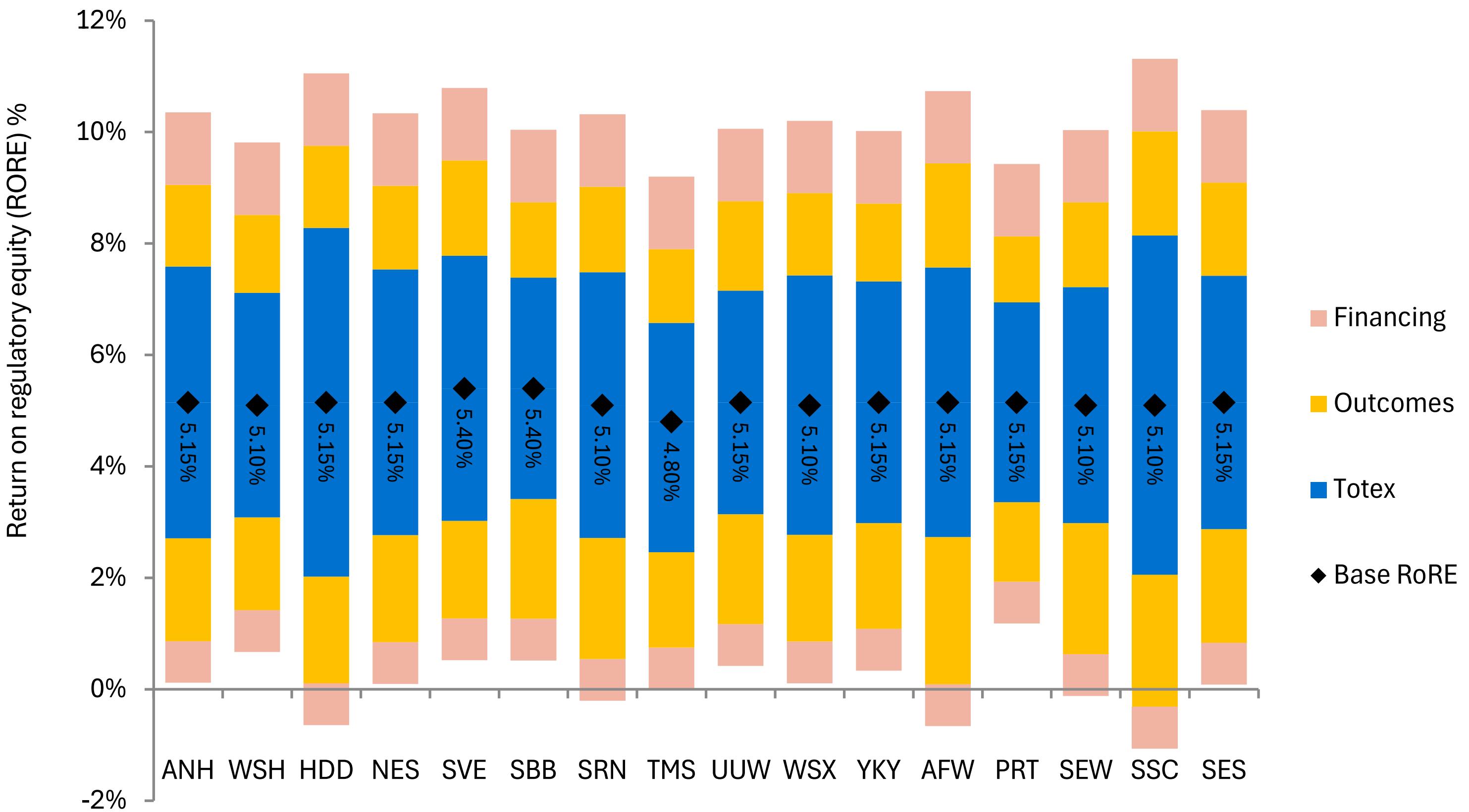
- Inflation indexation
- Revenue reconciliation
- RCV commitment

Structural features:

- Regulatory independence
- Five-yearly controls
- CMA appeal mechanism
- In-period reopening mechanisms

	PR19	PR24
Large projects – DPC/SIPR	5 projects	27 projects
Large projects – gated	1 company, 2 schemes	7 companies, 28 schemes
Return on equity	Midpoint	High point in the range
Debt indexation	Negative benchmark adjustment	Positive benchmark adjustment
Relative price effects – cost protection	c. 30% (labour)	c. 55% (labour, energy, and MPE for enhancement)
Sector wide reopeners		Storm overflows, PFAS, cyber security , landbank availability and potentially additional base allowances.
Standard cost sharing	Sharing rate: 50-75% Network controls Water resources	Sharing rate: 50-60% Networks controls Water resources Bioresources
Enhanced cost sharing	Business rates (20%)	Enhancement (40%) Areas with high risk of cost saving (40% companies and 10% customers) Areas with higher uncertainty (25%) Business rates (10%)
Outcomes	Benchmark - upper quartile	Benchmark – median
Other		Aggregate sharing mechanisms Outturn adjustment mechanism Timing of RCV reconciliations Customer funding of new equity listing

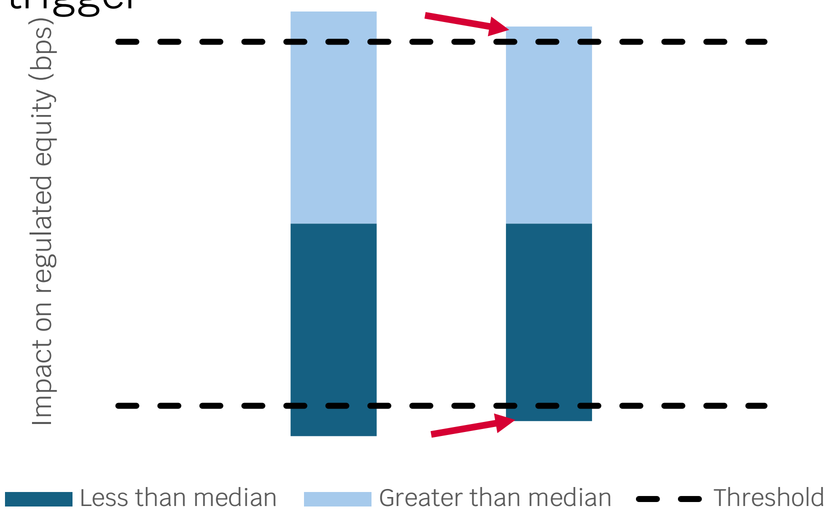
Balance of risk and return



Return adjustment mechanisms

Aggregate sharing mechanism (ASM)

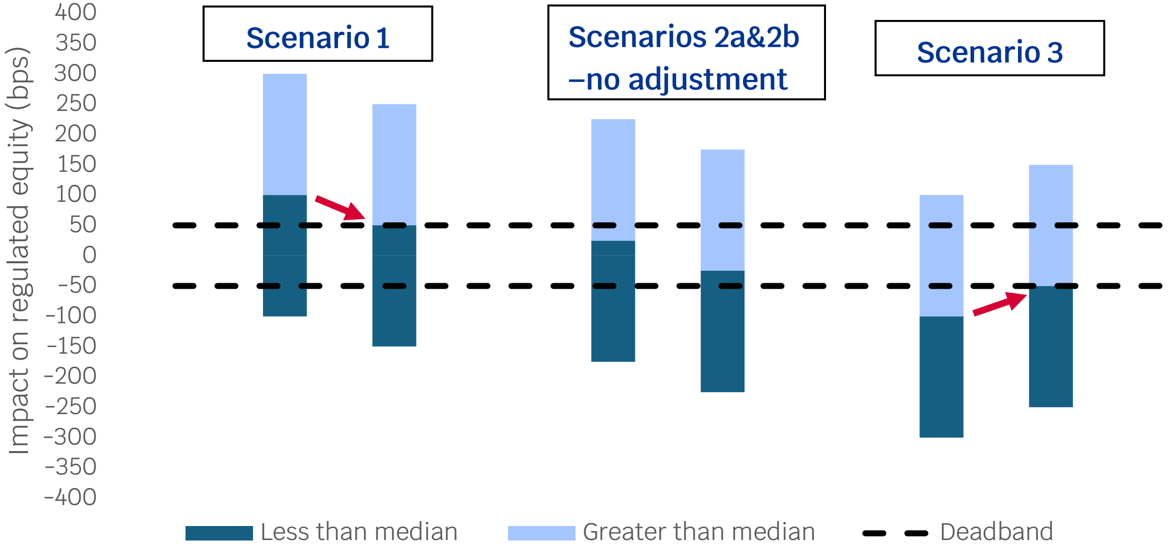
Applies separately to outcomes and costs – if individual company performance is beyond set return on regulatory equity trigger



- Wholesale cost trigger - 200bps
- Outcomes trigger - 300bps (secondary trigger at 500bps)

Outturn adjustment mechanism (OSM) –

Protection in the event of materially different sector performance than expected



Allowed return

Real, CPIH	PR19	PR24 methodology	Draft determinations	Final determinations
Gearing	60%	55%	55%	55%
Cost of debt	2.14%	2.60%	2.84%	3.15%
Cost of equity	4.19%	4.14%	4.80%	5.10%
Allowed return – appointee	2.96%	3.29%	3.72%	4.03%

4.03%

Allowed return

1.50%

Retail margin

Cost recovery and financeability

Cost recovery:

- PAYG – technical adjustments to reflect cost challenge
- RCV run-off – sector average 4.15% (4.00% at DD).

Financeability:

- Similar overall approach to previous determinations
- Notional company – 55% gearing, 33% index linked debt
- Target credit rating – BBB+/Baa1

To support funding of real RCV growth:

- Annual dividend yield of 4%
- £12.7 billion new equity
- £0.3 billion issuance costs (2.5% allowance)

55%

Notional gearing

Financial resilience

Equity financing:

- Likely to be higher than the c.£7bn forecast in company representations

Customer protections:

- 70% gearing remains our view of upper limit for financial resilience
- Our approach to financial resilience to be considered further as part of forward looking work on financial resilience

New equity listing:

- Commitment to provide for the efficient, net additional costs of obtaining an equity listing
- Encourage early engagement

Customers' bills

Water and wastewater companies	2024-25 (£)	2029-30 (£)	Change, 2029-30 vs 2024-25 (£)
Anglian Water	491	631	+140
Dŵr Cymru	455	645	+191
Hafren Dyfrdwy	392	557	+165
Northumbrian Water	422	510	+87
Severn Trent Water	398	583	+185
Southern Water	420	642	+221
South West Water	497	610	+113
Thames Water	436	588	+152
United Utilities	442	585	+142
Wessex Water	508	614	+106
Yorkshire Water	430	607	+177
Average	**440**	**597**	**+157**

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