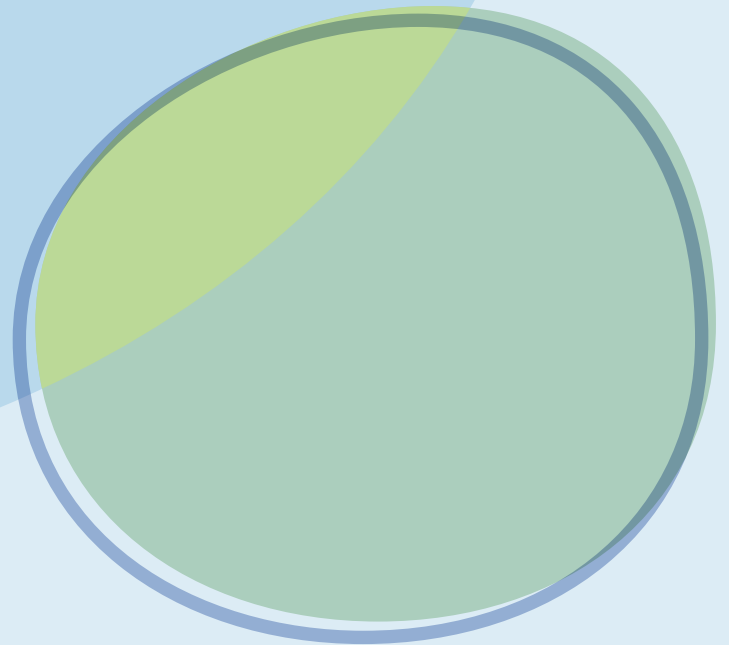


December 2024

PR24 final determinations

# Major projects development and delivery



## Summary

The water sector is facing significant challenges from climate change, population growth and aging infrastructure. Customers, regulators, and Governments are clear that change is needed; we need greater resilience to drought, significantly better outcomes for the environment and more responsive services for customers. Addressing these challenges will require major new investments including large infrastructure projects.

The Regulators' Alliance for Progressing Infrastructure Development (RAPID) was established to help accelerate the development of new water supply infrastructure and design future regulatory frameworks. The joint team is made up of the three water regulators, Ofwat, the Environment Agency and the Drinking Water Inspectorate. We now have a substantial pipeline of water supply resilience projects being assessed within the RAPID programme. The projects in the RAPID programme are often referred to as Strategic Resource Options (SROs); however, for the purposes of this document, we will refer to them as RAPID projects.

Projects which sit within the RAPID programme progress through a gated process. The purpose of the gated process is to enable the technical assessment of the projects to be carried out in parallel with the technical water resource planning work in order to bring the construction start date forward if necessary. This includes assurance that the project is indeed viable as these are large, complex projects. RAPID assesses the progress made in development of each project and provides recommendations to enable Ofwat to make decisions on continued ring-fenced funding for project progression.

The strategic planning frameworks set out the regional and local needs over the long term and the interventions required to meet these. Through the regional water resource planning and statutory Water Resource Management Plans (WRMPs), which are produced every five years, companies identify the actions that they need to take, including major infrastructure projects. The WRMP process establishes the "needs case" for the projects. The Department for Environment, Food and Rural Affairs (DEFRA) or the Welsh Government approves the WRMPs and so far, 15 companies' WRMP24s have been approved. We have then assessed whether these major projects should be included within the RAPID programme. We define major projects as those with a total expenditure (totex) exceeding £200 million and meeting the criteria for delivery by competitively tendered models (either Direct Procurement for Customers 'DPC' or Specified Infrastructure Projects Regulations 'SIPR'<sup>1</sup>) and/or a RAPID project.

A substantial number of projects in the RAPID programme will be delivered by DPC or SIPR.

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<sup>1</sup> The full name of the regulations is the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013.

There are a small number of major projects that are Rapid Projects but are not eligible for delivery through either the DPC or SIPR competitive tendering models and these will be delivered in-house by relevant companies using their own procurement processes but will still have RAPID oversight. The development of the commercial and procurement process, along with oversight of the delivery phases post-RAPID Gate 3, is managed by our Major Projects team through the major project stages as detailed in their DPC guidance<sup>2</sup>. Please see Annex A1 for further details of how projects will move through the RAPID gates and Ofwat Major Project stages.

In our draft determinations, we set out a portfolio of 25 major projects in total with 21 to be delivered by way of a competitive delivery model, either DPC or SIPR. Three major projects did not meet the criteria for either DPC or SIPR and were proposed for in-house delivery. RAPID and Ofwat have had further engagement with companies and reviewed their Draft Determination responses.

In our final determinations, we accept a portfolio of 30 major projects in total with 27 to be delivered by way of DPC or SIPR and 3 for in-house delivery which did not meet the requirements of DPC or SIPR, but which will still need RAPID oversight. This change has been driven by seven additional projects joining the portfolio, two no longer being considered suitable for delivery by DPC and one project merging with a new one.

The full list of projects proposed for inclusion in the programme of major projects in the final determinations is set out in table 1, indicating for each project the proposed delivery model.

Projects which are delivered by competitive tendering (DPC or SIPR) must go through a process entailing four Ofwat approval stages. These are set out in detail in our DPC guidance<sup>3</sup>. This will include all projects being delivered by DPC or SIPR. Projects with RAPID oversight need to go through four RAPID gates<sup>4</sup> in addition to the Ofwat stages. For RAPID projects, the companies do not need to submit an Ofwat Stage 1 assessment as this is deemed to be passed through the RAPID gate one process. The RAPID Gates and Ofwat Major Project Stages are illustrated in Annex A1 at the end of this document.

As part of our PR24 final determinations we set allowances to fund the Gates and Stages associated with development of the projects. The funding for the detailed design, building, operation and maintenance of these projects sits outside the price review process. The remaining major projects which are not to be delivered by competitive models will be delivered in-house with all their funding determined by the price review process.

For these 30 major projects we are making available up to £2.15 billion (in 2022-23 prices) to fund development expenditure and DPC (or SIPR) related costs over the 2025-30 period. This excludes construction costs as those costs for projects being delivered under DPC or SIPR will be set through competitive procurement processes and thus determined and regulated outside of the PR24 process. This is an increase

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<sup>2</sup> [DPC guidance publication version 230323 FINAL-1.pdf](#)

<sup>3</sup> Ofwat, [Guidance for companies delivering DPC projects](#), March 2023

<sup>4</sup> [The RAPID gated process and the proposed water resource solutions - Ofwat](#)

from the £1.213 billion (in 2022–23 prices) we proposed to allocate in draft determinations, which is largely as a result of companies responding to our challenge at draft determinations to identify ways to derisk their projects by bringing forward relevant expenditure. Additionally, there has been increase in the number of projects and companies have provided us with more up to date estimated project capex numbers in their representations.

We have developed a project incentive aimed at de-risking projects through to construction. This incentive is designed to ensure the delivery of best value outcomes for customers in a timely manner.

This document sets out our response to company representations, changes since the draft determinations to the portfolio of projects, project development costs, major project incentives and the introduction of an uncertainty mechanism.

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# 1. Background to major projects

Major projects are more complex and challenging to develop and deliver than the business-as-usual capital programmes managed by water companies. Capital programmes managed by water companies are typically handled in-house within each five-year price control period. Major projects, on the other hand, will often take many years and can cross multiple Asset Management Periods (AMPs) to design, consent and construct, meaning that the benefits of the projects for customers might not be realised for several regulatory cycles. There are different risks and issues that need to be managed in major projects, but also opportunities to create long-term value. As a result, we recognised that a different regulatory approach is appropriate for major infrastructure projects.

We have been evolving the regulatory approach to support the development and delivery of major infrastructure projects through competitive tendering over successive price reviews, starting with the Thames Tideway Tunnel in PR09. The Thames Tideway Tunnel is being delivered by a third-party licenced infrastructure provider under the Specified Infrastructure Provider Regulations (SIPR)<sup>5</sup>.

In PR19, Ofwat developed the DPC approach building on the success of Thames Tideway Tunnel. DPC involves a water or wastewater company competitively tendering for services in relation to the delivery of certain major infrastructure projects, resulting in the selection of a third-party competitively appointed provider or 'CAP' who will design, build, finance, and in some circumstances operate and/or maintain the relevant infrastructure. DPC will result in water companies competitively procuring more aspects of an infrastructure project, including financing for the project.

Development of major infrastructure by competitively appointed third parties is expected to achieve significant benefits for customers. These benefits include both innovation and potentially lower whole life costs (WLC) of the project while maintaining quality.

For PR24, DPC applies by default for all discrete projects above a threshold size of £200 million whole life totex. Our portfolio of major projects is detailed in [section 2, 'PR24: Major projects portfolio'](#).

In general, the costs of detailed design, building, financing, operating and maintaining a DPC-delivered project will not be included within the price review, as those costs will be set via the competitive process and recovered from customers via an Allowed Revenue Direction (ARD) issued by Ofwat under Condition U of companies' licences. .

However, we will allocate funding in the price review for the efficient costs for companies to run the DPC procurement process when we set totex allowances for PR24.

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<sup>5</sup> [The Water Industry \(Specified Infrastructure Projects\) \(English Undertakers\) Regulations 2013 \(SI 2013/1582\)](#).

These are set out in [section 3, 'Setting development cost allowances for major projects'](#).

For projects starting construction in the 2025–30 period, such as United Utilities' HARP project, there will be an impact on bills during the period. For each project, the level of bill impact will be confirmed once final bids are received and evaluated, and we have approved that it is in customers' best interests to proceed with the project.

We said in our draft determinations that we would implement a focused incentive package for companies to run an efficient procurement process for DPC projects and outlined our proposal. Draft determination representations were generally supportive but requested some clarification and raised a few areas of concern. We have taken on board this feedback and propose some changes to the incentive package. We discuss the feedback and our changes in [section 4, 'Major projects delivery incentives'](#).

Costs for developing major projects can be uncertain, in particular, it can be hard to estimate the costs of land acquisition and enabling works (which are key to de-risking the delivery of the project) at an early stage. Additionally, new risks and issues can materialise on a project which also increase costs. To provide a route for the funding of efficient costs that could be material, but which are not sufficiently certain to include in the final determination, an uncertainty mechanism is proposed as detailed in [section 5, 'Uncertainty mechanisms'](#).

Large-scale investments that are unsuitable to progress through a competitive delivery model will be delivered in-house by the water companies and predominantly treated as enhancement expenditure<sup>6</sup> for price review purposes. However, we will oversee major projects that are expected to be delivered in-house given their scale and complexity, including existing RAPID projects and projects such as the Havant Thicket Reservoir. If a major project which is currently intended for a DPC or SIPR delivery route becomes unviable for a competitive delivery model we will consider bringing the costs back within the price review through the Interim Determination (IDoK) mechanism.

## 2. PR24: Major projects portfolio

### 2.1 What we said in our draft determinations

In our draft determinations, we set out a portfolio of 21 major projects to be delivered by way of DPC or SIPR with construction spanning multiple price control periods, between 2025–30, 2030–35 and 2035–40. We also said that there were some new schemes which had been identified at a late stage and required further evidence and information before we can confirm that they would be included within the RAPID programme.

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<sup>6</sup> Enhancement expenditure refers to investments that go beyond maintaining existing services and infrastructure. It includes spending aimed at improving or expanding services to meet future needs, environmental goals, or higher standards. An example of enhancement expenditure includes: improving resilience by upgrading infrastructure to better withstand challenges like droughts, floods, or other risks. Enhancement expenditure is set as part of PR24 costs.

We also set out a list of projects that were not deemed suitable for DPC and the reasons why.

## 2.2 Major projects pipeline

The full list of projects proposed for delivery through our final determinations is set out below, indicating for each project the proposed delivery model. The portfolio has increased to 30 projects with 26 of these proposed to be delivered by DPC or SIPR, 3 to be delivered in-house and one which will be a hybrid partially delivered by DPC and partially in-house.

Ofwat intends, with the consent of companies, to designate the DPC projects listed in table 1 below for delivery under condition U of companies' licences. For Thames Water and Anglian Water, it is envisaged that the South East Strategic Reservoir Option (SESRO), and the Fens and Lincolnshire reservoir projects will be specified for delivery under the Water Industry (Specified Infrastructure Projects) (English Undertakers) Regulations 2013 (although a final decision has not yet been taken).

The total whole life totex for the projects set out in table 1 is £49.68 billion. For the RAPID projects proposed for in-house delivery further details are available in 'PR24 final determinations: Expenditure allowances'. This pipeline includes some alternative projects which will only proceed if the preferred option cannot go ahead.

In addition, there are some large projects which currently do not meet the requirements for DPC, but which might, as they develop in the future. In this case we will engage with the companies involved to discuss further. These large projects are also detailed in the "PR24 Final determinations: Expenditure allowances – Enhancement Cost Modelling"

Table 1: Major projects portfolio at final determinations (£million, 2022-23 prices)

| Company(s)                                          | Project Name                                                                  | Project Type                 | Delivery Model | Whole life totex (£m) | Construction start date |
|-----------------------------------------------------|-------------------------------------------------------------------------------|------------------------------|----------------|-----------------------|-------------------------|
| <b>Projects originally in draft determinations</b>  |                                                                               |                              |                |                       |                         |
| <a href="#">Affinity Water</a>                      | Thames to Affinity Transfer (T2AT)                                            | Transfer                     | DPC            | 387                   | 2040                    |
| <a href="#">Affinity Water / Severn Trent Water</a> | Grand Union Canal (GUC)                                                       | Transfer                     | DPC            | 1,540                 | 2029                    |
| <a href="#">Affinity Water / Severn Trent</a>       | Minworth <sup>7</sup>                                                         | Water recycling              | In-House       | 640                   | 2028-29                 |
| <a href="#">Anglian Water</a>                       | Fens Reservoir                                                                | Reservoir                    | SIPR           | 4,071                 | 2029-30                 |
| <a href="#">Anglian Water</a>                       | Lincolnshire Reservoir                                                        | Reservoir                    | SIPR           | 4,158                 | 2031-32                 |
| <a href="#">Anglian Water</a>                       | Peterborough to Grafham (P2G)                                                 | Transfer                     | DPC            | 389                   | 2035-40                 |
| <a href="#">Anglian Water</a>                       | Bacton Desalination                                                           | Desalination                 | DPC            | 2,337                 | 2030                    |
| <a href="#">Severn Trent Water</a>                  | Severn Trent Sources (STS)                                                    | Treatment and Transfer       | In-House       | 124 (capex)           | 2034                    |
| <a href="#">Severn Trent Water</a>                  | West Midlands Raw Water Storage                                               | Reservoir                    | DPC            | 491                   | 2032-40                 |
| <a href="#">Southern Water</a>                      | Hampshire Water Transfer and Water Recycling (HWTWR)                          | Transfer and Water Recycling | DPC            | 3,031                 | 2029                    |
| <a href="#">Southern Water</a>                      | Aylesford re-use (Medway) and Ford re-use (Littlehampton) bundle <sup>8</sup> | Water Recycling              | DPC            | 1,295                 | 2029-30                 |
| <a href="#">Southern Water</a>                      | Thames to Southern Transfer (T2ST)                                            | Transfer                     | DPC            | 2,188                 | 2033                    |
| <a href="#">South East Water</a>                    | Broad Oak Reservoir                                                           | Reservoir                    | DPC            | 1,092                 | 2031-35                 |
| <a href="#">Thames Water</a>                        | Beckton Water Recycling <sup>9</sup>                                          | Water Recycling              | DPC            | 3,511                 | 2028-29                 |
| <a href="#">Thames Water</a>                        | South East Strategic Resource Option (SESRO)                                  | Reservoir                    | SIPR           | 7,523                 | 2029-30                 |
| <a href="#">Thames Water</a>                        | Teddington Direct River Abstraction (DRA)                                     | Water Recycling              | In-House       | 989                   | 2028-29                 |
| <a href="#">Thames Water</a>                        | Lower Thames West London Reservoir <sup>10</sup> (LTWLR)                      | Transfer                     | DPC            | 1,729                 | 2030/31                 |
| <a href="#">United Utilities</a>                    | North West Transfer <sup>11</sup>                                             | Transfer                     | DPC            | 353                   | 2027-30                 |
| <a href="#">Wessex Water / South West Water</a>     | Cheddar 2 Source and Transfer                                                 | Reservoir and Transfer       | DPC            | 839                   | 2029                    |
| <a href="#">Wessex Water / South West Water</a>     | Poole Water Recycling and Transfer                                            | Transfer and Water Recycling | DPC            | 306                   | 2030                    |

<sup>7</sup> Minworth has moved from DPC delivery to in-house delivery<sup>8</sup> This is not a RAPID Strategic Resource Option<sup>9</sup> Beckton water recycling is an alternative to Teddington DRA<sup>10</sup> Incorporates Surbiton to Queen Mary Transfer (was previously Teddington to Queen Mary at DD)<sup>11</sup> North West Transfer has moved from in-house delivery to DPC delivery

| Company(s)                                                                 | Project Name                                       | Project Type              | Delivery Model              | Whole life totex (£m) | Construction start date |
|----------------------------------------------------------------------------|----------------------------------------------------|---------------------------|-----------------------------|-----------------------|-------------------------|
| Wessex Water / South West Water                                            | Mendips Quarry                                     | Reservoir                 | DPC                         | 1,728                 | 2035                    |
| Yorkshire Water / Northumbrian Water/UU                                    | Kielder Transfer SRO                               | Transfer                  | In-House /DPC <sup>12</sup> | 1,146                 | 2032                    |
| Thames Water                                                               | Severn to Thames Transfer (STT)                    | Transfer                  | DPC                         | 4,310                 | 2030–35                 |
| <b>New major projects</b>                                                  |                                                    |                           |                             |                       |                         |
| Severn Trent, Yorkshire Water and the Coal Authority                       | Nottinghamshire Mine Water Treatment               | Water treatment/ Transfer | DPC                         | 755                   | 2038                    |
| Yorkshire Water                                                            | West Yorkshire Water Treatment Works <sup>13</sup> | Water Treatment works     | DPC                         | 310                   | 2029–30                 |
| Severn Trent and the Canal and River Trust                                 | Rudyard Reservoir Augmentation                     | Reservoir                 | DPC                         | 738                   | 2035                    |
| Severn Trent/ Yorkshire                                                    | South Yorkshire Sources <sup>14</sup>              | Source and Transfer       | DPC                         | 419                   | 2031                    |
| Anglian Water                                                              | Mablethorpe                                        | Desalination              | DPC                         | 2,205                 | 2030                    |
| Northumbrian Water                                                         | North Suffolk <sup>15</sup>                        | Reservoir                 | DPC                         | 812                   | 2030–31                 |
| South East Water                                                           | New Arlington                                      | Reservoir                 | DPC                         | 268                   | 2035–40                 |
| <b>Projects moving from major projects to PR24 enhancement expenditure</b> |                                                    |                           |                             |                       |                         |
| Severn Trent Water                                                         | Carsington to Tittesworth Main (large)             | Transfer                  | In-House                    | 363                   | 2025–26                 |

## 2.2.1 Criteria for the RAPID programme

We recognise that some new major projects entering the PR24 portfolio may have risks and complexities which warrant additional regulatory support and oversight from RAPID in the pre-construction phase. To understand which projects this should apply to, all projects have been assessed against the following criteria set out by RAPID for PR24:

<sup>12</sup> This project has some components which qualify for DPC and some which don't and will need in-house delivery

<sup>13</sup> This was in enhancement at DD, representations gave evidence to qualify it for DPC. This is not a RAPID Strategic Resource Option

<sup>14</sup> Now includes York Water Treatment Works which was included in draft determinations as a project in its own right

<sup>15</sup> North Suffolk reservoir is an alternative to Lowestoft water recycling

| Criteria | Description                                                                                                                                                                                                                                                                             |
|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1        | Are there potential environmental and water quality risks associated with the solution which are likely to have a significant impact on feasibility, cost, and timing of the project?                                                                                                   |
| 2        | Is the project likely to provide similar or better value to meet the supply-demand imbalance compared to existing options, or does it represent best value for meeting additional water resources needs because of further investigation and analysis to inform future planning rounds. |
| 3        | Is the project a pathfinder project for driving the strategic direction for key elements of the regulatory frameworks? For example, where solution timings interact with emerging water quality regulation.                                                                             |

Building on our draft determinations, we have identified that all new major projects set out in Table 1, with the exception of West Yorkshire Water Treatment Works and Aylesford and Ford, meet all aspects of the criteria above and we are therefore proposing to include them in the RAPID gated process from April 2025.

Alongside this, for PR24, RAPID has also identified a number of other projects which may benefit from additional 'light touch' regulatory oversight, whilst not necessarily being subject to the full requirements of the gated process. Within the major projects portfolio, this only includes Aylesford and Ford. Please see Annex A2 for further details on the new RAPID light touch oversight approach which will be applied to those projects.

## 2.3 Stakeholder representations

We had a number of representations from companies on the proposed portfolio of projects, putting forward new projects or providing further information on potential DPC projects in the draft determinations indicating that they may not meet the DPC criteria.

We also had some representations from others raising specific concerns about some projects including land use planning and environmental impacts. It is important to note that major projects will go through the Development Consent Order and/or Town and Country Planning process and need consents from the Planning Inspectorate, the Secretary of State and other regulatory bodies including the Environment Agency and Drinking Water Inspectorate before they can be constructed and operated. Those consenting processes will consider the land use planning and environmental impacts of the projects in detail. They will determine whether those impacts are acceptable and whether the projects should go ahead. Those decisions are not within Ofwat's remit.

### 2.3.1 New projects proposed at draft determinations

We have received proposals for seven new projects (as shown in table 1) to be delivered through DPC by companies since the draft determinations. We have engaged with relevant water companies proposing these new schemes and considered them

carefully, to ensure the discreteness test has been met (i.e. whether a project can be managed independently). We also conducted further assessment of their suitability to be undertaken via DPC or SIPR models.

The new projects are included in table 1 above. The only project which has moved from enhancement expenditure into major projects is West Yorkshire Water Treatment Works. At draft determinations, West Yorkshire Water Treatment Works was one of the schemes we provisionally determined not suitable for DPC. Yorkshire Water provided us with more detailed information in their draft determinations representations, confirming that West Yorkshire Water Treatment Works is likely to qualify as a DPC project as it will be sufficiently discrete. They also shared extra evidence about the solution they plan to use.

### **2.3.2 Projects moving from DPC to in-house delivery**

We have considered the representations made by relevant companies on their draft determinations. Having done further analysis, we have concluded that the following schemes previously proposed for DPC delivery are better suited to being delivered in-house:

- Minworth Advanced Water Treatment Plant and pipeline (part of the GUC project)
- Carsington to Tittesworth Main

There was also one scheme which was proposed as a potential new DPC project, Wanlip Water Treatment Works. We have reviewed this project and are satisfied it does not meet the DPC discreteness tests.

#### **Grand Union Canal/Minworth**

Following further analysis and market engagement, the Grand Union Canal (GUC)/Minworth project will adopt a delivery model in which the Minworth extension is delivered in-house by Severn Trent with the rest of the project delivered via DPC.

The project transfers highly treated recycled water from Severn Trent's Minworth Wastewater Recycling Centre to meet water demand in Affinity Water's Southeast region. Potential bidders found the new Advanced Water Treatment Plant (AWTP) too integrated with Severn Trent's existing Minworth facility for DPC delivery. Consequently, Severn Trent will procure the AWTP and pipeline to Atherstone in-house, while the remainder of the project will proceed under a DPC model.

#### **Carsington to Tittesworth main**

Severn Trent has provided further evidence detailing the discreteness of this project. The portion that remains discrete does not meet the size threshold of over £200 million whole life totex. This is therefore being funded as part of enhancement expenditure.

### 2.3.3 Projects moving from in-house delivery to DPC

In addition to the projects identified in PR24 business plans, water companies identified further major projects following the submissions of their business plans in October 2023. Some new schemes had been identified at a late stage and required further evidence and information before we could confirm that they would be included within the RAPID programme. In many cases, these projects were innovative and reflected the emerging opportunities of cross sector collaboration, particularly the Nottinghamshire Mine Water Treatment project (Severn Trent Water, Yorkshire Water and the Coal Authority) and the Rudyard reservoir augmentation project (Severn Trent and the Canal and Rivers Trust). In the draft determination, we said we would continue to engage with companies on these projects and, subject to further information, were minded to accept these as major projects within the RAPID programme.

Nottinghamshire Mine Water Treatment and Rudyard Reservoir augmentation projects are both now confirmed as major projects which it is envisaged will be delivered through DPC.

Yorkshire Water's West Yorkshire Water Treatment Works is the only water supply for a significant number of their customers in the Bradford area. Yorkshire Water has proposed a new West Yorkshire Water Treatment Works to improve resilience of its water supply operations. It will also allow repair and upgrade works to happen at the existing water treatment works which is currently difficult due to a lack of alternative supplies to customers. The project will involve the creation of a new 75 Ml/d water treatment works and 150 Ml of new storage. It was not included as a DPC project in our draft determinations as Yorkshire Water were still considering some options which would not qualify for DPC. Now they have confirmed this is their preferred option and we have reviewed it and are satisfied it means the DPC criteria.

### 2.3.4 Southern Water's alternative delivery proposal

In its business plan Southern Water proposed a lighter touch alternative to DPC for those projects which would not qualify for DPC. These were typically below the whole life totex threshold or were a high number of lower value, shorter life assets not distinct from the rest of the network. Southern Water called this proposal 'DPC lite'.

In draft determinations we said that we welcomed suggestions and proposals for innovation from companies where it could offer better value for customers. However, we believed the existing regulatory framework allowed Southern Water to go ahead with the proposed schemes without further regulatory adaptations. We will continue to discuss the approaches and whether alternative models are likely to deliver greater benefits for customers.

In our draft determinations, we assessed the DPC lite schemes put forward by Southern Water as part of our usual approach to cost assessment.

Southern Water provided additional information in its draft determinations representation, including value for money assessments, for its DPC lite proposal for delivery of smart meters (AMS), Sustainable Urban Drainage systems (SUDs) and bioresources.

After careful consideration, we decided to keep all the proposed schemes under the enhancement expenditure in this period (April 2025 to March 2030). We will continue discussing the potential benefits that alternative delivery mechanisms could bring to customers and we remain open to considering different approaches.

### **2.3.5 PR19 and other projects**

#### **Thames Tideway**

The Thames Tideway Tunnel ("TTT") project being delivered by Bazalgette Tunnel Limited ("Tideway") was the first competitively procured scheme under the Specified Infrastructure Projects Regulations (SIPR). Tideway was licenced in 2015 to design, construct, finance and maintain the TTT during its projected 120-year economic life. With major construction now complete, full testing and commissioning will commence in 2025 and the TTT is expected to be handed over to Thames Water to operate as part of its London wastewater network in 2027.

While Thames Water procured Tideway in 2015 to deliver the TTT, it is also required under SIPR to carry out certain activities connected with the TTT, including the integration of the TTT into Thames Water's wider wastewater network. We have provided in PR24 expenditure allowances for those costs which Thames Water will incur in carrying out those activities associated with the TTT to be undertaken during the 2025-2030 period.

To incentivise Thames Water in the delivery of the TTT related activities during the commissioning phase we have developed four bespoke performance commitments to incentivise Thames Water to deliver, alongside Tideway, acceptance of the TTT by 31 August 2027. Following representations from both Thames and Tideway, we have maintained these commitments with minor refinements in the final determination.

#### **Haweswater Aqueduct Resilience Programme (HARP)**

United Utilities originally proposed the Haweswater Aqueduct Resilience Programme (HARP) to be delivered by way of the Direct Procurement for Customers (DPC) model in PR19. The HARP project is designed to replace six tunnels originally constructed in the 1930s and 1950s as part of the 110km aqueduct which currently transfers drinking water from the Lake District to Manchester and other population centres in North-West England.

HARP will be delivered under DPC by a competitively appointed provider (CAP), which is to design, build, finance and maintain HARP. The term of the project agreement will be

25-years plus an estimated 8-year construction period. HARP will be operated by United Utilities once complete.

United Utilities has completed its evaluation of the bids received and expects shortly to announce the identity of the preferred bidder.

We have provided in PR24 expenditure allowances for those costs which United Utilities will incur in overseeing the delivery of HARP by the CAP. The cost of delivering HARP by the CAP has been determined through the competitive procurement process. The costs incurred by the CAP will be recovered over the term of the contract from United Utilities. The amounts payable by United Utilities will in turn be recovered from its water customers during the contract's term (via an Allowed Revenue Direction rather than price limits).

While the amount payable each year in the 2025–30 period to the CAP can only be ascertained at contract award, an estimate of the amount payable by United Utilities, and then recovered from its customers has been reflected in final determinations bill impacts.

Ofwat will consider and determine whether to provide its consent to United Utilities, pursuant to its licence, entering into an Agreement with the preferred bidder (the CAP Agreement) during January 2025.

As part of PR19, we included a pre-procurement incentive mechanism relating to HARP by which United Utilities could, depending on the assessed value for money benefit associated with the procurement, receive a reward of up to £14 million. The value of the reward, if any, will be calculated by Ofwat in early 2025.

## **Cwm Taf**

Dwr Cymru originally proposed Cwm Taf water treatment works in PR19. The company has substantially reworked its proposal, moving from one large water treatment works on a greenfield site to two separate water treatment works. As a result, it will need to repeat a substantial amount of the work that was funded at PR19. The company has requested a total of £24 million for development costs.

In draft determinations we said that we did not think the company had demonstrated that there was no overlap with those parts of the proposal which were previously funded at PR19 and so applied an adjustment to reduce the development costs.

In its representation the company provided sufficient and convincing evidence to demonstrate that the investment was not for previously funded work and met the need for enhancement criteria. Therefore, for the final determination, we do not apply an adjustment. Further details are available in the 'PR24 final determinations: Expenditure allowances.'

## **Havant Thicket Reservoir**

The Havant Thicket reservoir is being delivered by Portsmouth Water for the benefit of Southern Water's customers.

In addition to the Havant Thicket reservoir project, Southern Water is developing the Hampshire Water Transfer and Water Recycling (HWTWR) DPC project. This will enable direct raw water transfers from the Havant Thicket reservoir to Southern Water's Otterbourne water supply works. It will significantly increase the volume of water that can be supplied from the reservoir, in certain conditions, by up to 90 Ml/day (on top of the 21 Ml/day already planned).

To facilitate optimal delivery of the HWTWR DPC project and the Havant Thicket reservoir, changes to the initial reservoir design and substantive alignment works are needed, including adding a second pipeline (the original design required only one bidirectional pipeline). This will mean Southern Water does not need to construct a separate pipeline tunnel from the reservoir for its HWTWR DPC project. The alignment works are an increase in scope for the Havant Thicket reservoir project.

We made changes to Portsmouth Water's conditions of appointment prior to PR19, allowing us to determine a separate 10-year price control for the Havant Thicket reservoir. Portsmouth Water's conditions of appointment also allow us to amend the scope of the activities included in the separate Havant Thicket price control. Effective from 1 November 2024 we amended the scope of the 'Havant Thicket Activities' at Portsmouth Water's request (and with the agreement of Southern Water).<sup>16</sup> The changes made were to account for necessary interface works with Southern Water's HWTWR DPC project.

In addition, during early construction in late 2023, ground issues (shear planes and related sand formations) were discovered on site that could not have been reasonably foreseen by initial site investigations, as confirmed by our own technical advisors. The cost to rectify these will materially increase the overall project cost.

### **Allowing for the cost of alignment works and ground issues at Havant Thicket**

In PR19 we introduced a cost adjustment mechanism (CAM) linked to planning and procurement gateways.<sup>17</sup> Portsmouth Water submitted a CAM application and in January 2023 we issued our final decision, amending what we considered to be the efficient cost for delivering the Havant Thicket reservoir from £146 million to £366 million in 2022-23 prices.

We are now introducing a further cost adjustment mechanism to deal with the alignment works and the ground issues set out above. We accept that these costs were not available to Portsmouth Water for inclusion in this price review due to delays in receiving planning approvals as well as not being able to finalise the reservoir design (to accommodate the ground issues).

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<sup>16</sup> Ofwat, [Update to Havant Thicket Activities and statement of reasons for changes](#), 1 November 2024

<sup>17</sup> Ofwat, [Havant Thicket – Cost Adjustment: Final Decision](#), January 2023

Portsmouth Water may apply to Ofwat for a second cost adjustment mechanism (CAM2) to allow for the cost of the alignment works as well as the ground issues. Before submitting the CAM2 application, Portsmouth Water and Southern Water will ensure the associated costs are independently reviewed by their third-party assurers. When assessing the CAM2, we will additionally benchmark the costs using a specialist independent advisor to ensure value for money for Southern Water's customers.

Under the Bulk Supply Agreement between Southern Water and Portsmouth Water, following CAM2, Southern Water will be required to pay Portsmouth Water the increased costs decided at CAM2 but will only be able to claim these additional costs from its customers after the next price review. To deal with this, we have made provision for Southern Water to apply for an interim determination, which would allow it to collect the additional costs from its customers in-period, following the CAM2 decision. This is dealt with in Section 5 'Havant Thicket Uncertainty Mechanism.'

We acknowledge that uncertainties will remain after CAM2. Costs related to these uncertainties will be logged for reconciliation at PR29. The 'Havant Thicket appendix'<sup>18</sup> outlines the PR29 reconciliation process.

## **Thames Water Asset Improvement Gated Allowances**

### **1. London water network improvement (PR19 conditional gated allowance)**

Following a post-PR19 gated process in November 2022, we allowed Thames Water a £347 million allowance in 2022-23 prices (£294 million in 2017-18 prices) to enhance the performance of its London water network. The London water improvement conditional allowance (LWICA) was conditional on Thames Water delivering an agreed scope of work, and on a contribution of £400 million (in 2017-18 prices) from its shareholders to the cost of the improvement works.

Thames Water's progress on the LWICA is detailed in the document 'PR24 final determinations: Expenditure allowances – Thames Water asset improvement gated allowances appendix'.

### **2. London water supply system resilience (PR19 conditional gated allowance)**

Following a post-PR19 gated process in December 2023, we allowed Thames Water a £492 million allowance in 2022-23 prices (£417 million in 2017-18 prices) to improve the resilience of water supplies in parts of its London water network. The allowance was conditional on Thames Water delivering an agreed scope of work.

The delivery commitments extend across multiple price control periods, covering 2022 to 2031, aligned with the investment profile for the proposed schemes. We approved

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<sup>18</sup> Ofwat, [PR19 final determination – Havant Thicket appendix](#), December 2019

eight schemes, incorporating related price control deliverables through adjustments to PR19 commitments and continuing through PR24 and with two of the eight schemes having final delivery dates that fall in the PR29 period (2030–35). Most of the price control deliverables are concentrated in the 2025–30 period, as shown in table 2 below:

**Table 2: London water supply system resilience conditional allowances**

|                                            | £million 2017–18 prices | £million 2022–23 prices |
|--------------------------------------------|-------------------------|-------------------------|
| <b>Allowance falling in PR19 (2020–25)</b> | 26.2                    | 30.9                    |
| <b>Allowance falling in PR24 (2025–30)</b> | 370.2                   | 437.1                   |
| <b>Allowance falling in PR29 (2030–35)</b> | 20.2                    | 23.9                    |
| <b>Total allowance</b>                     | 416.6                   | 491.9                   |

As part of our approval, we obtained commitments from Thames Water to return money to customers if it does not deliver the proposed investments, which we will implement through price reviews.

## 3. Setting development cost allowances for major projects

### 3.1 What we said in our draft determinations

In our draft determinations, we set out our overall approach to determining allowances to fund the efficient development costs for projects falling within the 2025-30 period. For all major projects we set allowances for the pre-construction development which comprises:

- **Project development costs** – which includes design costs, costs to obtain the necessary planning consents to deliver the project. We also included allowances for acquiring land rights necessary for the project to be delivered, delivering any site enabling works (where relevant) and delivering any interface works to be completed in the 2025-30 period; and
- **Cost of developing the project for competitive delivery** – DPC-related costs, where appropriate, including costs of developing the project for delivery via DPC, running the procurement process for DPC and managing the CAP Agreement. Where projects are likely to be delivered via SIPR we have allowed for the costs of developing the project via SIPR.

We noted that pre-construction development plays a vital role in shaping the level and profile of project delivery risk. Insufficient or poor-quality project development and planning is a major contributor to cost overruns and project delays that impact customers and wider society. It is therefore important that companies commit the appropriate time and resources to the development of these significant infrastructure projects to minimise the risks to customers and the environment.

We challenged companies to identify mitigating actions and enabling works that would increase confidence that the project will be delivered in an efficient and timely manner, as we did not believe that companies were doing enough.

#### 3.1.1 Cost allowances

At draft determinations, we allowed £1.2 billion of expenditure to fund major projects (that is, RAPID projects and other major projects that were subject to delivery via DPC and SIPR) out of a total request of £1.3 billion. We conducted a direct cost comparison across the portfolio of major projects in the water sector, using comparative benchmarks based on major infrastructure projects in other sectors as a sense check.

We applied cost challenges to individual projects where companies did not adequately evidence their cost estimates. Overall, we set allowances for each project at or above the levels requested in the PR24 business plans.

We split our proposed cost allowances between 'baseline' and 'contingent' funding. Baseline allowances were included within the overall cost allowance for the purposes of setting revenue allowances for each company. This equalled to £0.7 million out of the £1.2 billion allowed. Contingent allowances were conditional on hitting specific consent triggers with costs logged up and then funded through revenue allowances set as part of the 2029 Price Review (PR29). This equalled £0.5 million out of the £1.2 billion allowed. This approach distinguished between the pre-consent and the post-consent phases, to take account of where a project currently sits within the development timeline.

For the 2025–30 period, we proposed to apply a 40:40 cost sharing rate for baseline expenditure, whereby companies bear 40% of any overspend but retain 40% of any underspend. We also proposed a 25:25 cost sharing rate for expenditure in the post-consent phase of development.

## 3.2 Stakeholder representations

The expenditure request has almost doubled as a result of the representations from water companies. The increase, of more than £1.1 billion, is the result of greater maturity of the scope, design, and programme of projects since the PR24 business plan submissions in October 2023. Key factors include proposals to develop new projects, improvements in cost estimation, and bringing forward expenditure to reduce risks of programme delays in response to our challenge at draft determinations. As a result of the representations, planned development expenditure, as a proportion of capital expenditure, aligns closely with levels observed in other sectors<sup>19</sup> and the Thames Tideway Tunnel (TTT).

Companies responded to our cost challenges at draft determinations by providing further evidence to support their development cost requests. We received challenge from companies regarding our proposed framework. They argued that it could create perverse outcomes that would increase the costs and risks borne by customers. Several companies commented that the cost sharing arrangements would penalise them for taking steps to bring forward expenditure to de-risk delivery of the projects, despite acting efficiently. As a result, they were unlikely to take steps to 'do the right thing' which would have increased costs and risks borne by customers.

Some companies argued that funding contingent costs through an end of period adjustment would create challenges in terms of cashflows and the ability to raise finance to fund potentially significant levels of expenditure. They proposed upfront funding with a clawback of unused allowances (similar to the PR19 framework), or an uncertainty mechanism to adjust revenue allowances in-period.

Several companies also noted that there were significant risks around project scope and requirements, particularly in relation to aspects of emerging water quality regulation that cannot be predicted and planned for, and which could drive material

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<sup>19</sup> Other sectors include energy, nuclear, roads and other transport.

increases in costs due to changes outside of their control. These companies favoured the use of a specific uncertainty mechanism to allow for the efficient costs of meeting such changes in scope.

### 3.3 Our assessments and reasons

Our final determinations provide allowances of £2.15 billion to fund pre-construction development, commercial and procurement strategies, land acquisition and enabling works. The allowances will be reflected in the wholesale revenue limits set for the 2025–30 period.

In table 3 below, we summarise our final determination for allowances that we are providing to each company to fund the development of their major projects in 2025–30.

**Table 3: development cost allowances by company for major projects in the 2025–30 period (£million, 2022–23 prices)**

| Company                    | Total (£million, 2022–23 prices) |
|----------------------------|----------------------------------|
| Anglian Water              | 810.50                           |
| Northumbrian Water         | 48.66                            |
| United Utilities           | 32.43                            |
| Southern Water             | 286.90                           |
| Severn Trent               | 103.41                           |
| South West Water           | 86.82                            |
| Thames Water <sup>20</sup> | 473.95                           |
| Wessex Water               | 68.15                            |
| Yorkshire Water            | 97.16                            |
| Affinity Water             | 66.20                            |
| South East Water           | 72.31                            |
| <b>Total</b>               | <b>2,146.49</b>                  |

Figure 1 below sets out the approach we have adopted in setting allowances for the development of major projects. Our final allowances have been derived by considering three components based on the information provided on costs:

- **Core development activities** – This includes project and programme management; engineering, design, and site investigations; environmental and/or water quality

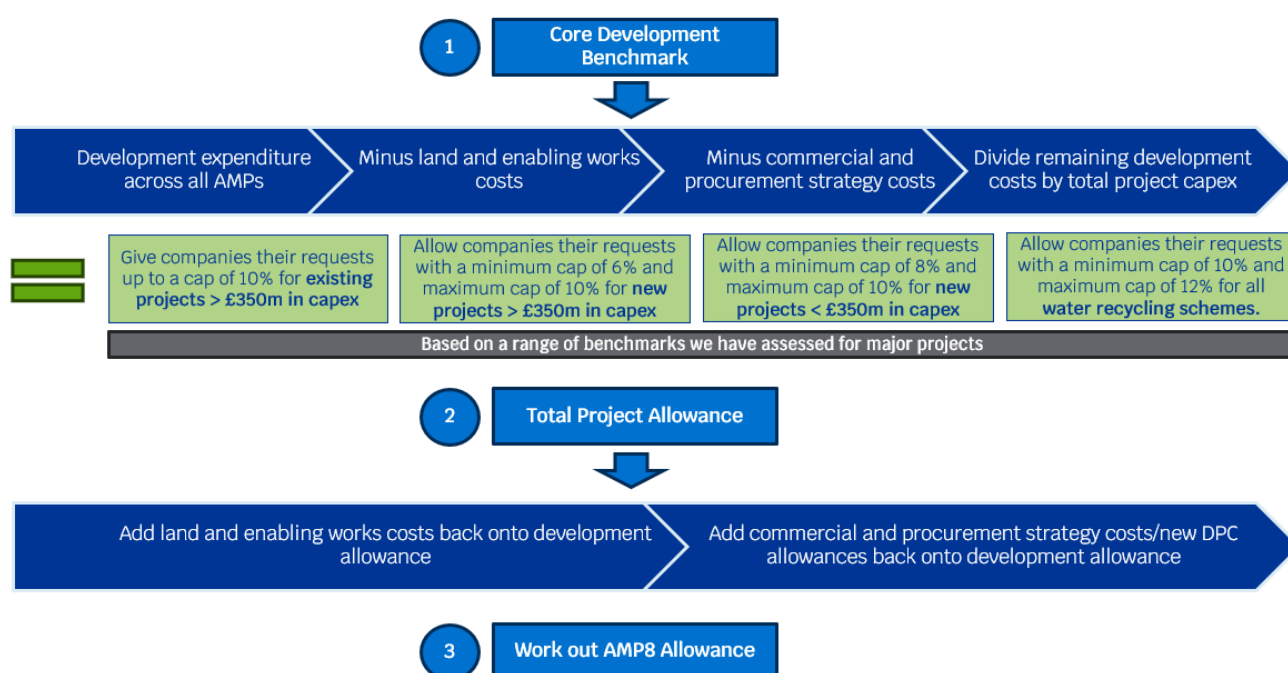
<sup>20</sup> Thames Water have asked for an uncertainty mechanism to fund a further £363.97 million of land a delivery costs across their portfolio.

investigations; and stakeholder engagement and planning;

- **Commercial and procurement strategy** – including developing the commercial arrangements to deliver the project through DPC or SIPR; and
- **Early construction activities** – This includes acquiring land rights necessary for the project to be delivered and delivering any enabling works to be completed in the 2025–30 period (where relevant).

From this we have derived a development allowance for each project. We have then aggregated the project specific allowances for the purposes of determining the overall company level allowances set out in table 3 above. Our final methodology set out that we expect companies to adopt a portfolio approach to the development of major projects. This will allow for reprioritisation of the allowances across projects, where appropriate, in conversation with Ofwat.

**Figure 1: Our approach to calculating development cost allowances for each major project**



Based on these identified benchmark ranges, we applied a cap on core development expenditure of 10 per cent of capex for existing RAPID projects, except for water recycling ones which we capped at 12 per cent of capex. We have allowed companies their projected costs up to the cap.

We have derived core development expenditure allowances differently for new major projects. We have applied the following methodology:

- For new projects with a capital value of less than £350 million, we have set a minimum allowance of 8 per cent of project capex and a cap of 10 per cent of capex;

- For a new project with a capital value of at least £350 million we have set a minimum allowance of 6 per cent of project capex and a similar cap of 10 per cent of capex.

**Table 4: Allowances for core development expenditure across all asset management periods, AMPs (£million, 2022-23 prices)**

| Solution                             | Capex   | Total Core Devex <sup>21</sup> | % of Capex | Ofwat % Allowance | Ofwat Core Devex Calc. |
|--------------------------------------|---------|--------------------------------|------------|-------------------|------------------------|
| Aylesford and Ford                   | 313.67  | N/A                            | N/A        | 10.00%            | 31.37                  |
| Bacton                               | 727.00  | 38.95                          | 5.36%      | 6.00%             | 43.62                  |
| Beckton                              | 993.55  | 48.13                          | 4.84%      | 4.84%             | 48.13                  |
| Broad Oak Reservoir                  | 304.78  | 25.74                          | 8.45%      | 8.45%             | 25.74                  |
| Cheddar 2                            | 680.36  | 22.12                          | 3.25%      | 3.25%             | 22.12                  |
| West Yorkshire Water Treatment Works | 220.04  | N/A                            | N/A        | 8.00%             | 17.60                  |
| Fens Reservoir                       | 3271.42 | 248.26                         | 7.59%      | 7.59%             | 248.26                 |
| GUC                                  | 466.77  | 34.59                          | 7.41%      | 7.41%             | 34.59                  |
| HWTWRP                               | 1236.31 | 154.89                         | 12.53%     | 12.00%            | 148.36                 |
| Kielder Transfer SRO                 | 384.47  | 30.75                          | 8.00%      | 8.00%             | 30.75                  |
| Lincolnshire Reservoir               | 3765.95 | 215.23                         | 5.72%      | 5.72%             | 215.23                 |
| LTWLR                                | 634.95  | 44.18                          | 6.96%      | 6.96%             | 44.18                  |
| Mablethorpe                          | 686.00  | 40.09                          | 5.84%      | 6.00%             | 41.16                  |
| Mendip                               | 1218.25 | 34.59                          | 2.84%      | 2.84%             | 34.59                  |
| Minworth                             | 176.00  | 22.92                          | 13.02%     | 12.00%            | 21.12                  |
| New Arlington                        | 225.00  | N/A                            | N/A        | 8.00%             | 18.00                  |
| North Suffolk                        | 662.00  | N/A                            | N/A        | 6.00%             | 39.72                  |
| North West Transfer                  | 323.09  | 42.39                          | 13.12%     | 10.00%            | 32.31                  |
| Notts Mine SRO                       | 341.00  | 14.50                          | 4.25%      | 8.00%             | 27.28                  |
| P2G                                  | 174.00  | 6.67                           | 3.83%      | 3.83%             | 6.67                   |
| Poole                                | 163.16  | 16.95                          | 10.39%     | 10.39%            | 16.95                  |
| Rudyard                              | 290.00  | 12.33                          | 4.25%      | 8.00%             | 23.20                  |
| SESRO                                | 2662.38 | 213.39                         | 8.01%      | 8.01%             | 213.39                 |
| Severn Trent Sources                 | 145.74  | 18.08                          | 12.41%     | 12.00%            | 17.49                  |
| South Yorkshire Sources              | 308.77  | 32.82                          | 10.63%     | 10.00%            | 30.88                  |
| STT                                  | 1536.75 | 54.67                          | 3.56%      | 3.56%             | 54.67                  |
| T2AT                                 | 401.72  | 12.92                          | 3.22%      | 3.22%             | 12.92                  |
| T2ST                                 | 1006.00 | 108.56                         | 10.79%     | 10.00%            | 100.60                 |

<sup>21</sup> Core devex is the sum of total project development costs over all asset management periods (AMPs) minus costs associated with land, enabling works and commercial and procurement strategy.

| Solution              | Capex            | Total Core Devex <sup>21</sup> | % of Capex | Ofwat % Allowance | Ofwat Core Devex Calc. |
|-----------------------|------------------|--------------------------------|------------|-------------------|------------------------|
| Teddington DRA        | 301.21           | 49.08                          | 16.29%     | 12.00%            | 36.15                  |
| W. Midlands Raw Water | 315.98           | N/A                            | N/A        | 8.00%             | 25.28                  |
| <b>Totals</b>         | <b>23,936.31</b> | <b>1,542.81</b>                | <b>-</b>   | <b>-</b>          | <b>1,662.32</b>        |

### 3.3.2 Use of benchmarks

We considered external benchmarks of infrastructure development expenditure from other sectors (largely the energy and transport sectors) as a sense check to our draft determinations. We found that development expenditure typically accounted for 8–12 per cent of scheme costs, although this varied depending on the size and complexity of the scheme. In most cases, our benchmarks exclude land and enabling works. However, it is unclear whether commercial and procurement expenditure was recorded as development expenditure or elsewhere.

Development expenditure for TTT is around 9 per cent of capital expenditure to date (excluding costs of land acquisition and enabling works but including the costs of setting up the shadow IP<sup>22</sup>)<sup>23</sup>. In comparison, development costs for HARP are expected to outturn at a significantly smaller percentage of expected project costs.

For RAPID projects specifically, development costs were estimated to be 4.8% of capital expenditure at the initial business plans. In response to our draft determinations companies have uplifted their estimates of development costs. Some projects have identified significant additional expenditure to bring forward early construction spend (mostly land and enabling works) to reduce risk and enhance deliverability. As a result, development costs are better aligned to the levels observed for major projects in other sectors.

Some representations to our draft determinations provided cost benchmarks<sup>24</sup> of projects in other sectors as supporting evidence to their updated cost request. In some cases, the range of estimates provided for their selected sample of projects was wider than our analysis. However, the typical development costs of the samples were, on average, less than 10 per cent of project costs. Moreover, a limited number of projects were identified as having development costs of more than 12 per cent of project costs. This evidence informed our decisions on the minimum and maximum limits for core development expenditure for the purposes of setting our allowance.

<sup>22</sup> IP stands for Infrastructure Provider.

<sup>23</sup> In 2015, development expenditure was less than 10 percent of the expected costs of TTT.

<sup>24</sup> Submitted confidentially.

### 3.3.3 DPC/SIPR development allowances

#### DPC

For final determinations, we have calculated an appropriate allowance for DPC-related costs based on the experience of the DPC pathfinder projects HARP and Cwm Taf. Having considered companies' representations, we have changed our approach to the setting the DPC development allowance to better align with the new major projects incentive.

We do not propose to amend the minimum allowance of £9 million for DPC-related activities independent of size, however, to keep a consistent definition of totex, we are proposing to cap whole life totex calculation to 25 years. Therefore, total allowances have been calculated as £9 million plus 0.55% of whole life totex capped at 25 years.

For DPC-related activities, where the procurement is expected to extend beyond the 2025–30 period, we have adjusted the allowance proportionally to reflect the share of DPC-related costs within the 2025–30 scope, based on the expected stage of each project.

We have amended the profiling of the total DPC allowance based on the following methodology:

- **Stage 1:** Meeting stage 1 in the 2025–30 period accounts for 0% of DPC-related allowance. This is because projects are expected to have met stage 1 by April 2025.
- **Stage 2:** Meeting stage 2 in the 2025–30 period accounts for 40% of total DPC-related allowance.
- **Stage 3:** Meeting stage 3 in the 2025–30 period accounts for 40% of total DPC-related allowance.
- **Stage 4:** Meeting stage 4 in the 2025–30 period accounts for 20% of total DPC-related allowance.

For example, if Solution A is only forecast to meet Stage 2 and Stage 3 in the 2025–30 period, the solution will be funded for 80% of the whole DPC allowance. Stage 4 related activities will therefore be funded in the 2030–35 period, in this scenario.

We recognise that a small number of companies put forward cost requests in relation to CAP management activities post DPC Stage 4. These costs can only be determined once there is clarity on the commercial structure of the relationship that needs to be managed. We will allow a reconciliation of costs at PR29 with companies able to log-up expenditure for any costs that might be incurred in the 2025–30 period and will set ongoing allowances as part of future determinations of revenue limits.

**Table 5: Allowances for DPC development expenditure for 2025-30 (£million, 2022/23 prices)**

| Solution                             | Capex            | Opex          | WLC<br>25 years  | DPC<br>Allowance | 2025-30<br>Allowance | Adjustments   | Final<br>2025-30<br>Allowance |
|--------------------------------------|------------------|---------------|------------------|------------------|----------------------|---------------|-------------------------------|
| Aylesford and Ford                   | 313.67           | 10.55         | 577.50           | 12.18            | 12.18                | 0.00          | 12.18                         |
| Bacton                               | 727.00           | 26.80         | 1397.00          | 16.68            | 16.68                | 0.00          | 16.68                         |
| Beckton                              | 993.55           | 15.11         | 1371.35          | 16.54            | 6.62                 | 0.00          | 6.62                          |
| Broad Oak Reservoir                  | 304.78           | 2.37          | 364.03           | 11.00            | 11.00                | 0.00          | 11.00                         |
| Cheddar 2                            | 680.36           | 5.85          | 826.61           | 13.55            | 13.55                | -1.50         | 12.05                         |
| West Yorkshire Water Treatment Works | 220.04           | 2.78          | 289.56           | 10.59            | 10.59                | 0.00          | 10.59                         |
| GUC                                  | 466.77           | 9.03          | 692.55           | 12.81            | 12.81                | -1.50         | 11.31                         |
| HWTWRP                               | 1236.31          | 26.26         | 1892.86          | 19.41            | 19.41                | -4.00         | 15.41                         |
| Kielder Transfer SRO                 | 384.47           | 6.30          | 542.09           | 11.98            | 4.79                 | 0.00          | 4.79                          |
| LTWLR                                | 634.95           | 7.53          | 823.28           | 13.53            | 5.41                 | 0.00          | 5.41                          |
| Mablethorpe                          | 686.00           | 25.33         | 1319.23          | 16.26            | 16.26                | 0.00          | 16.26                         |
| Mendip                               | 1218.25          | 17.53         | 1656.50          | 18.11            | 7.24                 | 0.00          | 7.24                          |
| New Arlington                        | 225.00           | 1.07          | 251.75           | 10.38            | 4.15                 | 0.00          | 4.15                          |
| North Suffolk                        | 662.00           | 1.50          | 699.50           | 12.85            | 5.14                 | 0.00          | 5.14                          |
| North West Transfer                  | 323.09           | 0.97          | 347.34           | 10.91            | 10.91                | 0.00          | 10.91                         |
| Notts Mine SRO                       | 341.00           | 5.20          | 471.00           | 11.59            | 4.64                 | 0.00          | 4.64                          |
| P2G                                  | 174.00           | 2.43          | 234.75           | 10.29            | 0.00                 | 0.00          | 0.00                          |
| Poole                                | 163.16           | 5.07          | 289.91           | 10.59            | 10.59                | -1.50         | 9.09                          |
| Rudyard                              | 290.00           | 6.10          | 442.50           | 11.43            | 4.57                 | 0.00          | 4.57                          |
| South Yorkshire Sources              | 308.77           | 4.80          | 428.77           | 11.36            | 9.09                 | 0.00          | 9.09                          |
| STT                                  | 1536.75          | 16.65         | 1952.90          | 19.74            | 7.90                 | 0.00          | 7.90                          |
| T2AT                                 | 401.72           | 1.82          | 447.17           | 11.46            | 0.00                 | 0.00          | 0.00                          |
| T2ST                                 | 1006.00          | 19.06         | 1482.43          | 17.15            | 13.72                | 1.50          | 12.22                         |
| W. Midlands Raw Water                | 315.98           | 2.33          | 374.23           | 11.06            | 4.42                 | 0.00          | 4.42                          |
| <b>Totals</b>                        | <b>13,299.95</b> | <b>211.89</b> | <b>18,597.31</b> | <b>309.29</b>    | <b>199.50</b>        | <b>-10.00</b> | <b>189.50</b>                 |

## SIPR

For the three large reservoir projects which are being proposed for delivery via SIPR, we continue to follow our approach of accepting the companies' estimates for costs that relate to these activities. We remain satisfied that the overall costs proposed by the companies are sufficient to carry out core activities for commercial development when comparing to TTT. We have identified a number of issues regarding how costs have been allocated to specific development activities.

For SESRO and the Fens reservoir projects, we noted that the revised commercial and procurement costs of the projects was significantly lower than the initial business plan submission, despite the representations evidencing significant cost increases related to the establishment of the shadow IP and procurement of contracts.

For Fens, we identified costs relating to the Shadow IP and SIPR legal costs had been included in the 'Other' costs category. These costs were included in the commercial and procurement cost lines previously. We have therefore reallocated these to the total commercial and procurement line for the purposes of calculating the allowances on a consistent basis.

For SESRO, we identified a proportion of costs relating to the IP had not been included within the development expenditure template but was identified in the overall scheme costs. We have therefore allocated these costs to the commercial and procurement line to ensure that the costs are captured appropriately. We note that for Lincs reservoir, all SIPR-related costs have been moved to the 2030-35 period.

Below is a summary of the final numbers we are allowing for SIPR development:

**Table 6: Allowances for SIPR development for 2025-30 (£million, 2022-23 prices)**

| Solution               | Original Allocation in Cost Template (Representation) | Ofwat Reallocation |
|------------------------|-------------------------------------------------------|--------------------|
| Fens Reservoir         | 37.71                                                 | 116.47             |
| Lincolnshire Reservoir | 0.00                                                  | 0.00               |
| SESRO                  | 62.12                                                 | 77.81              |

### 3.3.4 Early construction expenditure

Companies have proposed to bring forward early construction spend, which we treated as contingent funding as part of our draft determinations approach and suggested this should be allowed up front. This includes activities such as acquiring land rights necessary for delivery; any enabling works and any interface works that are to be completed in the 2025-30 period. The purpose of this is to de-risk projects early in the development phase with the rationale to limit delays and material risks which could arise otherwise.

For the final determination, we have therefore removed the split between baseline and contingent funding in most cases. We have accepted the cost estimates provided by companies as sufficiently evidenced and will fund this early construction expenditure in advance as part of the revenue allowances, with the exception of some costs proposed by Thames Water.

Thames Water have identified potential costs that were highly uncertain and therefore considered them to be contingent. We agree that the additional costs of acquiring all land rights in full for SESRO, the potential costs of switching from a DPC approach to an in-house delivery model for the Lower Thames to West London Reservoir project are highly uncertain in terms of timing and likelihood that the costs would be incurred in full. As a result, we treat these costs as contingent, but we have allowed up to 15 per cent of the cost estimate, where appropriate, where we concluded that there is sufficient evidence that some costs are likely to be incurred (for example, to enable Thames Water to fund full acquisition of some parcels of land). The triggering of the contingent allowance for Thames Water if required will be managed through the uncertainty mechanism which is being introduced for PR24 (section 5).

We are confident this is the right approach, despite differing from what we had set out in draft determinations, because we can ensure customer protection with the end of period reconciliation as seen through PR19 and the uncertainty mechanism.

### 3.3.5 Summary of allowances by project

Table 7 below summarises our final determinations allowances for each major project. This is a combination of core development expenditure, our DPC allowances and early construction expenditure. It is important to note that table 7 does not include the proposed allowances for in-house projects expecting to commence construction during the 2025–30 period. These have been assessed under PR24 enhancement expenditure.

**Table 7: Final allowances for major projects for 2025–30 (£million, 2022–23 prices)**

| Solution                             | Total Core Devex | 2025–30 Core Devex | Land and EW | DPC/SIPR /C and P | Adjustments | 2025–30 Allowance | % of Capex |
|--------------------------------------|------------------|--------------------|-------------|-------------------|-------------|-------------------|------------|
| Aylesford and Ford                   | 31.37            | 31.37              | 0.00        | 12.18             | 0.00        | 43.54             | 13.88%     |
| Bacton                               | 43.62            | 43.62              | 16.79       | 16.68             | 0.00        | 77.09             | 10.60%     |
| Beckton                              | 48.13            | 30.71              | 0.00        | 6.62              | 0.00        | 37.33             | 3.76%      |
| Broad Oak Reservoir                  | 25.74            | 21.09              | 18.06       | 11.00             | 0.00        | 50.16             | 16.46%     |
| Cheddar 2                            | 17.60            | 16.98              | 54.50       | 12.05             | 0.00        | 83.52             | 12.28%     |
| West Yorkshire Water Treatment Works | 22.12            | 17.60              | 0.00        | 10.59             | 0.00        | 28.20             | 12.82%     |
| Fens Reservoir                       | 248.26           | 224.09             | 119.56      | 116.47            | 0.00        | 460.11            | 14.06%     |
| GUC                                  | 34.59            | 21.02              | 6.18        | 11.31             | 0.00        | 38.51             | 8.25%      |
| HWTWRP                               | 148.36           | 71.00              | 7.23        | 15.41             | 0.00        | 93.64             | 7.57%      |
| Kielder Transfer SRO                 | 30.75            | 18.65              | 2.31        | 4.79              | 0.00        | 25.75             | 6.70%      |
| Lincolnshire Reservoir               | 215.23           | 173.20             | 20.02       | 0.00              | 0.00        | 193.22            | 5.13%      |

| Solution                     | Total Core Devex | 2025-30 Core Devex | Land and EW   | DPC/SIPR /C and P | Adjustments   | 2025-30 Allowance | % of Capex |
|------------------------------|------------------|--------------------|---------------|-------------------|---------------|-------------------|------------|
| LTWLR**                      | 44.18            | 40.59              | 0.00          | 5.41              | +17.56        | 63.56             | 10.01%     |
| Mablethorpe                  | 41.16            | 41.16              | 14.96         | 16.26             | 0.00          | 72.37             | 10.55%     |
| Mendip                       | 34.59            | 29.37              | 5.90          | 7.24              | -3.80         | 38.71             | 3.18%      |
| Minworth <sup>25</sup>       | 21.12            | 11.15              | 0.47          | 4.03              | 0.00          | 15.65             | 8.89%      |
| New Arlington                | 18.00            | 18.00              | 0.00          | 4.15              | 0.00          | 22.15             | 9.84%      |
| North Suffolk                | 39.72            | 39.72              | 0.00          | 5.14              | 0.00          | 44.86             | 6.78%      |
| North West Transfer          | 32.31            | 15.40              | 0.46          | 10.91             | 0.00          | 26.78             | 8.29%      |
| Notts Mine SRO               | 27.28            | 22.45              | 1.09          | 4.64              | 0.00          | 28.18             | 8.26%      |
| P2G                          | 6.67             | 4.88               | 2.61          | 0.22              | 0.00          | 7.71              | 4.43%      |
| Poole                        | 16.95            | 10.93              | 11.52         | 9.09              | 0.00          | 31.55             | 19.34%     |
| Rudyard                      | 23.20            | 19.63              | 1.04          | 4.57              | 0.00          | 25.25             | 8.71%      |
| SESRO**                      | 213.39           | 159.40             | 144.28        | 77.81             | +41.57        | 423.06            | 15.89%     |
| Severn Trent Sources         | 17.49            | 0.88               | 0.00          | 0.00              | +0.59         | 1.47              | 1.01%      |
| South Yorkshire Sources      | 30.88            | 24.43              | 1.84          | 9.09              | 0.00          | 35.36             | 11.45%     |
| STT**                        | 54.67            | 24.22              | 0.00          | 7.90              | 0.00          | 32.12             | 2.09%      |
| T2AT                         | 12.92            | 4.87               | 0.35          | 0.93              | 0.00          | 6.15              | 1.53%      |
| T2ST                         | 100.60           | 61.04              | 5.29          | 12.22             | 0.00          | 78.55             | 7.81%      |
| Teddington DRA <sup>26</sup> | 36.15            | 18.18              | 8.07          | 4.80              | 0.00          | 31.05             | 10.31%     |
| W.Midlands Raw Water         | 25.28            | 25.28              | 0.00          | 4.42              | 0.00          | 29.70             | 9.40%      |
| <b>Totals</b>                | <b>1,662.32</b>  | <b>1,240.90</b>    | <b>442.54</b> | <b>405.92</b>     | <b>+55.92</b> | <b>2,145.29*</b>  | <b>-</b>   |

\* This total excludes SRO modelling costs for South West Water and Wessex Water.

\*\* Thames Water has identified up to a further £363.97 million of contingent spend across these SROs for the 2025-30 period, which may be funded through our uncertainty mechanism.

### 3.3.6 Wider issues

For final determinations, we have made the decision to allow water companies to keep their RAPID gates one and two underspend for any projects that existed as part of PR19 as set out in the PR19 Past Delivery Appendix<sup>27</sup>. This is because we recognise water companies have carried this expenditure over to use on RAPID gate three activities. We have therefore not allowed any funding requests for the 2025-30 period which relate to the carryover of gate underspend. The return of underspends through the PR19 strategic water resources end of period reconciliation should be treated as an addition to the ring-fenced allowances for the 2025-30 period.

With lessons learnt from this, we are also providing flexibility for companies to take a portfolio approach to their major projects, specifically allowing them to reallocate funding according to programme need. For example, we have provided allowances for a company to progress their preferred project, but we are also partially funding the

<sup>25</sup> A further £65.55 million has been allowed for construction under the enhancement expenditure model.

<sup>26</sup> A further £107.62 million has been allowed for construction under the enhancement model.

<sup>27</sup> PR24 final determinations: Accounting for Past Delivery

parallel development of an alternate project as part of adaptive planning pathways. Our approach allows the company to reallocate funding from preferred project to the alternate project if the appropriate trigger has been reached.

We expect that the pipeline of projects will be reprioritised over time in response to economic and political factors. Some projects are under significant pressure to accelerate delivery, while others are being pushed back. This will drive a reprofiling of expenditure. We have already seen Anglian Water increase its forecast expenditure for the Fens reservoir to prioritise delivery of the scheme over the Lincolnshire Reservoir in response to external factors. Compared to the initial business plans, expenditure has been rebalanced away from the Lincs Reservoir project to the Fens Reservoir development. We expect to see similar situations to arise for other projects during the 2025–30 period and therefore need to allow flexibility to allow for such rebalancing. Any reallocations will be subject to Ofwat's consent.

### **3.3.7 Accounting for DPC projects**

The DPC framework is an important model for water companies to deliver major projects in a cost effective and capital efficient manner. It offers the potential for significant innovation in identifying and implementing solutions and broadening the opportunities for a wider range of participants in large infrastructure projects. We consider that the approach also offers a range of benefits to water company investors themselves by, for example, facilitating an efficient allocation of risks to those parties best placed to manage them and supporting companies in being able to demonstrate that they are delivering projects in the most advantageous way for bill payers.

DPC is a relatively new approach in the sector, with the first DPC projects moving beyond procurement and into delivery during 2025 – 30. Ofwat has provided guidance and definitions in the Annual Performance Report on how it considers such projects should be accounted for and treated in financial statements, reflecting what we consider to be the underlying economic benefits and obligations that accrue to the respective parties subject to the contract (See definitions relating to Table 1.E in the Regulatory Accounting Guidelines).

We note that credit ratings agencies have indicated a variety of differing approaches in relation to how they expect to treat DPC projects under their ratings assessments. To date, because no DPC project has commenced, no agency has assessed a company's rating based on the inclusion of a DPC contract and so it would not be appropriate for us to consider action at this time. During 2025 –30 and beyond we will continue to review what impact, if any, a DPC contract might have on companies' credit ratings and what adjustments, if any, may be justified to our future financial assessments. Our assessment will take a holistic approach recognising the full range of factors and consequences that arise from the use of a DPC approach as well as the consequential impacts for company ratings and financeability.

## 4. Major projects delivery incentives

### 4.1 What we said in our draft determinations

At PR19 we had a limited number of projects and therefore we included at PR19 bespoke incentives for Thames Water's Thames Tideway Tunnel control<sup>28</sup>, and for United Utilities HARP project. RAPID also set its own PR19 penalties for RAPID projects.

At draft determinations, due to the increasing number of projects in the pipeline we proposed a standardised DPC incentive regime and RAPID proposed its own separate incentives as well.

We set out our proposed approach to incentivising high quality and timely DPC submissions through Ofwat stages 2-4 for non-RAPID DPC projects and Ofwat stages 3-4 for RAPID DPC projects. We proposed a weighted incentive process to ensure companies were focusing on rigorous project development from the outset, moving to timelier delivery as they move through the stages. To support the efficient and timely delivery of projects, we proposed:

- development allowances and cost sharing arrangements;
- penalties based on quality and timeliness of submissions at DPC stages. This was defined as an increasing percentage of the cost allowances for DPC development to ensure the companies deliver good quality submissions which progress the delivery of the projects;
- a reward of up to 4 per cent of whole life totex on successful delivery of the DPC project to incentivise companies to engage constructively and find value-adding approaches in designing and procuring the scheme, to achieve the best outcomes for customers.

We stated that we would implement the DPC incentives through the major projects end of period reconciliation mechanism.

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<sup>28</sup> which are independent of the incentives mechanisms which operate with regards to Bazalgette Tunnel Limited (Tideway

## 4.2 Stakeholder representations

Company responses generally welcomed the DPC incentives. There were various points raised:

- Draft determinations did not mention whether the incentives applied to SIPR projects;
- Concern about double jeopardy with the RAPID penalties;
- Concern regarding a lack of a clear, measurable framework for assessing performance at each stage, and how both timeliness and quality will be evaluated;
- Questioning whether rewards and penalties would apply to the lead party or be split across all companies involved;
- Concern that the rewards should not be offset against future penalty exposure in ensuring a reasonable risk-return balance.

## 4.3 Our assessment and reasons

We recognise that the proposals in draft determinations were framed at a relatively high level and needed more development. We have considered the responses received from stakeholders and have focussed on how we achieve the objectives of the incentives, addressing the issues raised and considering further possible unintended consequences.

The purpose of the penalty is to ensure that the companies deliver good quality submissions which progress delivery of the projects. The purpose of the reward is to encourage companies to engage constructively with the DPC process, engaging constructively and find value-add approaches in designing schemes and tendering them, to achieve the best outcomes for customers

Alongside the representations, we have thought carefully about the design of the incentives framework. We have identified several issues that we need to address:

- The whole life totex figures from companies on which we based the reward were calculated on a range of different bases (for example, variation in the years of operating costs included);
- The development costs assigned to DPC stages, on which the penalties were based, were calculated on different bases between RAPID and non-RAPID projects;
- The complexity of parallel penalty regimes (relating to DPC stages and RAPID gates respectively) for the same project;
- Concern that cost estimates for projects could increase over time and that this could lead to higher rewards;
- Lack of explicit linkage of the reward to successful delivery of the project and a risk that the reward could be paid out to shareholders before it is known whether successful delivery had been achieved;
- A risk of companies being incentivised to continue with projects to get the reward even if the project is no longer needed.

In the light of all the representations and our own further analysis, we have improved the consistency of the incentive package across projects, by introducing a single penalty regime covering both DPC stages and RAPID gates. This will more clearly link the reward to successful delivery, to clarify the application of the incentives to SIPR and who will receive the rewards and incur penalties. This single penalty regime will now be referred to as the Major Projects Incentive.

We recognise that we have not yet defined a detailed framework for evaluating quality and timeliness of submissions, but we will engage further with companies and ensure a framework, and guidelines are in place before Spring 2025 wherever possible.

## 4.4 Conclusion

To address the issues raised through the draft determination representations, we have made several changes to the Major Projects Incentive mechanism:

- we have used the same definition of totex for all projects<sup>29</sup>;
- all development costs will be considered for penalties, excluding costs of land and early works but including costs of setting up DPC or SIPR arrangements;
- a single penalty regime, phased across stages/gates but capped at 30% of development costs will be used;
- a reward will be partially earned on completion of a successful tender process, with part of this based on evidence of engagement and adding value in project development and tender design, and the remainder of the reward paid for subsequent successful delivery;
- for multi-party projects, penalties will apply in proportion to development cost allocation, subject to responsibility for delay or poor quality.

We recognise that at draft determinations we did not set out whether the incentive mechanism would also apply to SIPR projects. The objectives of introducing the Major Project Incentive, both for rewards and penalties, are also relevant for SIPR projects. The Major Projects Incentive, with some modification, therefore will apply to SIPR projects. To avoid over-rewarding SIPR projects, we will apply the same 25-year totex definition as for DPC, with slightly lower rewards applying as explained below. The penalty regime will be similar to DPC equivalent stages. The reward composition will be as follows:

**Table 8: Major project incentive reward composition**

| Element                                                                            | DPC                              | SIPR                             | When paid                                  |
|------------------------------------------------------------------------------------|----------------------------------|----------------------------------|--------------------------------------------|
| <b>Totex definition</b>                                                            | Capex + 25-year opex fixed at FD | Capex + 25-year opex fixed at FD |                                            |
| <b>On financial close of the contract between the water company and the CAP or</b> | 1% automatic                     | 0.5%                             | Price control period after financial close |

<sup>29</sup> Capex plus 25-year Opex to match the expected CAP period

|                                    |                                                         |                                            |                                            |
|------------------------------------|---------------------------------------------------------|--------------------------------------------|--------------------------------------------|
| <b>infrastructure provider</b>     |                                                         |                                            |                                            |
| <b>Engagement and adding value</b> | 0 or 1% depending on evidence of value add              | 0 or 1% depending on evidence of value-add | Price control period after financial close |
| <b>Delivery</b>                    | 2% if operating successfully 2 years post commissioning | 1.5%                                       | Added to RCV                               |
| <b>Total</b>                       | 3-4% of defined totex                                   | 2-3% of defined totex                      | As above                                   |

We define successful operation as performing broadly in line with design parameters. We do not expect continuous operation, and do not consider planned maintenance or temporary outages as an issue, provided the scheme is capable of delivering what was intended. We do not expect to remove eligibility for rewards if either the signature of the DPC or SIPR contracts or commissioning of the scheme are delayed, provided the scheme still meets the need it was designed for, although rewards will not be paid until the specified milestones are achieved. Where multiple schemes work in combination, rewards for reaching financial close and engagement will be based on the milestone being achieved for each scheme, whereas the delivery reward will be based on all components necessary for delivery to each ultimate beneficiary.

**Table 9: Capex, opex, new whole life cost (WLC) and success fee for all major projects and RAPID projects (£million, 2022-23 prices)**

| <b>Solution</b>                           | <b>Capex</b> | <b>Annual Opex</b> | <b>New WLC</b> | <b>Maximum Success Fee*</b> |
|-------------------------------------------|--------------|--------------------|----------------|-----------------------------|
| <b>Aylesford and Ford</b>                 | 314          | 10.6               | 578            | 23                          |
| <b>Bacton Desalination</b>                | 727          | 26.8               | 1,397          | 56                          |
| <b>Beckton</b>                            | 994          | 15.1               | 1,371          | 55                          |
| <b>Broad Oak Reservoir</b>                | 305          | 2.4                | 364            | 15                          |
| <b>Cheddar 2 Source and Transfer</b>      | 680          | 5.9                | 827            | 33                          |
| <b>Fens Reservoir</b>                     | 3,271        | 4.9                | 3,394          | 102                         |
| <b>GUC</b>                                | 467          | 9.0                | 693            | 28                          |
| <b>HWTWRP</b>                             | 1,236        | 26.3               | 1,893          | 76                          |
| <b>Kielder Transfer SRO</b>               | 384          | 6.3                | 542            | 22                          |
| <b>Lincs Reservoir</b>                    | 3,766        | 10.0               | 4,016          | 120                         |
| <b>Mendip Quarries</b>                    | 1,218        | 17.5               | 1,656          | 66                          |
| <b>North West Transfer</b>                | 323          | 1.0                | 347            | 14                          |
| <b>P2G Transfer</b>                       | 174          | 2.4                | 235            | 9                           |
| <b>Poole Water Recycling and Transfer</b> | 163          | 5.1                | 290            | 12                          |
| <b>SESRO</b>                              | 2,662        | 4.7                | 2781           | 83                          |
| <b>STT</b>                                | 1,537        | 16.6               | 1,953          | 78                          |
| <b>T2AT</b>                               | 402          | 1.8                | 447            | 18                          |
| <b>T2ST</b>                               | 1,006        | 19.1               | 1,482          | 59                          |
| <b>LTWLR</b>                              | 635          | 7.5                | 823            | 33                          |
| <b>W. Midlands Raw Water Storage</b>      | 316          | 2.3                | 374            | 15                          |

|                                             |     |      |       |    |
|---------------------------------------------|-----|------|-------|----|
| <b>West Yorkshire Water Treatment Works</b> | 220 | 2.8  | 290   | 12 |
| <b>Mablethorpe</b>                          | 686 | 25.3 | 1,319 | 53 |
| <b>Notts Mine</b>                           | 341 | 5.2  | 471   | 19 |
| <b>Rudyard</b>                              | 290 | 6.1  | 443   | 18 |
| <b>North Suffolk Reservoir</b>              | 662 | 1.5  | 700   | 28 |
| <b>New Arlington</b>                        | 225 | 1.1  | 252   | 10 |
| <b>South Yorkshire Sources</b>              | 309 | 4.8  | 429   | 17 |

\* The success fee is a maximum of 4% for DPC projects and 3% for SIPR projects.

The rewards are intended as incentives for successful delivery. In developing further aspects of the regulatory regime applying to bulk supply projects, such as trading incentives and compensation for failure to deliver, we will include all aspects of the rewards in considering whether the regime provides a reasonable risk-reward balance. In particular, any profits made from the Major Projects incentive will be considered in our approach to compensation. We expect to consult further on trading incentives in relation to these projects, including on a proposal to remove the importer incentive which we no longer consider to be necessary or good value in relation to these projects.

**Table 10: Penalties for RAPID DPC projects**

|                                     | <b>Gate 2 /<br/>Stage 1</b> | <b>Gate 3 /<br/>Stage 2</b> | <b>Gate 4 /<br/>Stage 3</b> | <b>Stage 4</b> |
|-------------------------------------|-----------------------------|-----------------------------|-----------------------------|----------------|
| <b>DPC Weighting</b>                | 0%                          | 40%                         | 70%                         | 100%           |
| <b>RAPID Weighting</b>              | 100%                        | 60%                         | 30%                         | 0%             |
| <b>Total % of Development Costs</b> | 2%                          | 8%                          | 15%                         | 5%             |

The RAPID and DPC penalties are combined to create a single penalty. The total sum of this penalty is 30% of development costs which is equivalent to the previous RAPID penalty.

For non-RAPID DPC projects there is no RAPID weighting, and similarly for in-house RAPID projects there is no DPC weighting. However, projects that fulfil these characteristics will still have to do design development for planning and commercial preparedness to deliver the scheme. Therefore, non-RAPID projects will need a method for evaluating the development work on the scheme to ensure that it is progressing effectively. Similarly, we will need a method to ensure that the commercial and procurement approach for an in-house solution is progressing effectively. To address this, Ofwat and RAPID will be developing its approach and criteria following the final determinations. We will be adopting similar principles and approaches for assessing progress and readiness.

Where a project is terminated prior to completing the DPC or SIPR tender, we will consider whether any adjustments to penalties incurred earlier are necessary, to mitigate the risk that a company is incentivised to continue even where this is not justified.

In line with our PR19 approach, penalties will still be applicable for in-house RAPID projects to ensure efficient progression of projects. The reward component of the Major Projects Incentive will not apply for in-house projects.

As with the RAPID projects to date, we recognise that the development of these major projects will be challenging and may need to be reconsidered as they proceed. In considering the application of potential penalties, we will be guided by our overall objective to encourage the right behaviours. Companies should act in the best interests of customers and the environment and will not be penalised if they can demonstrate that any such behaviour which requires replanning has been necessary. This should be communicated to us in advance of any such event and we encourage companies to work collaboratively on any replanning.

We have discussed with the companies whether the rewards and penalties should be focussed on the Lead Party in each scheme or should be allocated proportionally based on the share of development costs each involved water company bears. Companies generally suggested that the initial reward on financial close and the penalties should be allocated proportionately, while the later rewards (for engagement and delivery) should focus on the Lead Party. We accept this position. In deciding on penalties, we will consider the extent to which each company contributed to the shortfall and may exempt companies from penalties if we consider that they have done everything possible to avoid the shortcoming. If alternative commercial models are adopted (other than the Lead Party model) we will consider what changes to the DPC incentives are needed.

We expect the rewards to be paid by the ultimate beneficiaries of each scheme, so they should be reflected in the charges under each bulk supply agreement where relevant. As noted above, we will engage further with the water companies to develop more detailed requirements for quality and timeliness and for demonstration of additional value.

Overall, the Major projects Incentive is there to support investment and to align companies to delivering successful outcomes. We expect most projects to achieve the rewards as set out and to deliver high quality assets and, as far as practicable, to develop the project on time, avoiding the need for penalties.

## 5. Uncertainty mechanisms

Costs for developing major projects can be uncertain, unexpected issues may arise that need to be resolved to keep the project on track. In addition, it can be hard to estimate costs such as the costs of land acquisition and enabling works (which are key to de-risking the delivery of the project) at an early stage. Failure to manage this uncertainty could result in material delays to delivering of projects which are needed to support resilient services to customers

We propose managing this uncertainty through funding upfront contingency funds for projects on top of 'base' development allowance and an end of period reconciliation at PR29 where any underspend or overspend compared to allowances is passed on to customers.

We recognise that while this is likely to be sufficient for the majority of projects, particularly given that companies have a range of large projects that can be managed as a portfolio, there is a risk that there could be material increases in costs during the 2025–30 period that could create financial constraints for the company. This could act as a barrier to a project continuing in the 2025–30 period even if it were in customers' best interests.

There are several broad scenarios that could trigger a material cost change, examples include:

- **Projects developing greater levels of maturity in scope/design/costs:** It is important to note that most projects are still in very early stages, as these projects develop, costs may rise due to increased certainty in various areas e.g. as a result of greater design maturity, certainty around land requirements, and better understanding of what enabling works are required.
- **High impact/low probability risks** such as if the DCO/planning application is unsuccessful; procurement fails etc – requiring significant rework.
- **Macroeconomic factors** such as market disruption/supply chain constraints causing material increases in construction, inflation above the Consumer Prices Index including owner occupiers' housing costs (CPIH).
- **New opportunities** could arise to derisk the delivery/construction of projects which could provide better value for customers.

We therefore consider it is important to provide an option for an in-period reopener or uncertainty mechanism to provide a 'safety valve' for projects and companies if there are issues related to cost increases in 2025–30.

We are proposing this will take the form of a bespoke interim determination process (IDoK). In relation to major projects, we are proposing that this would be applied to:

- All RAPID Strategic Resource Options (SROs);
- DPC/SIPR projects (if not SROs);
- Havant Thicket.

Where companies are funded in final determinations for more than one major project, we expect companies to manage major project development costs as a portfolio. As such, we propose the bespoke interim determination process for a company will be applied at the project portfolio level.

We intend to consult on the changes that would be required to Condition B early in 2025. This consultation will set out the criteria for the bespoke interim determination process uncertainty mechanism. Currently, we expect the key features of the bespoke interim determination process would include:

- **A lower materiality threshold.** Our current working assumptions is that the materiality threshold (as defined in condition B) would be 2% of appointed business turnover which is similar to the DPC bespoke interim determination process that some companies already have in their licences.
- **Clearly defined triggers.** In the case of major projects, we propose that the interim determination process can only be triggered once decisions are made under relevant gated processes (e.g. the RAPID gated process) and the company can demonstrate that it is unable to wait until the end of period reconciliation at PR29 to recover any additional money allowed from customers.
- **On timing,** our intention is to develop a timeline which is both consistent with the binding deadline of 15 December for our final determinations and also meets our aims of early engagement with companies.

We consider this approach will align the bespoke interim determination process mechanism with existing, well understood regulatory gated processes and allow companies to manage uncertainty.

Additional information on uncertainty mechanisms including our current view of the key features of the proposed bespoke interim determination process are set out in 'PR24 Final Determinations – In-period adjustments'.

## 5.1 Havant Thicket uncertainty mechanism for Southern Water

Section 2.3.7 sets out the background to the Havant Thicket reservoir. It is being delivered by Portsmouth Water for the benefit of Southern Water's customers and it is being funded by Southern Water's customers.

We have decided that Portsmouth Water may bring an in-period application for a cost adjustment mechanism. Under the Bulk Supply Agreement between Portsmouth Water and Southern Water, Southern Water will be required to pay Portsmouth Water the additional amounts determined in the cost adjustment mechanism.

In order to enable Southern Water to recover those additional amounts from its customers in period, it is necessary to enable Southern Water to apply for an interim determination.

We have therefore included a Notified Item (set out in Box 1 below) in our final determination for Southern Water so that the costs could be included in a standard interim determination process if it meets the relevant threshold requirements. We also propose amending Southern Water's conditions of appointment in 2025 to introduce the bespoke interim determination process referred to above that would have a lower materiality threshold. Price controls would only be changed following a final decision on CAM2 and, in relation to Havant Thicket, will be limited to issues considered in CAM2.

### Box 1: Havant Thicket related Notified Item for Southern Water

Ofwat gives notice that, to the extent specified, the following item has not been allowed for at all when making the final determination of Price Controls:

#### *Changes in charges payable under the Havant Thicket Agreement*

Any change in the charges payable by the Appointee to Portsmouth Water Limited ("Portsmouth Water") under the Havant Thicket Agreement:

- (a) in relation to Charging Years beginning on or after 1 April 2025; and
- (b) as a result of Ofwat's decision as to what changes should be made to the total expenditure allowance in relation to Portsmouth Water's Price Control for Havant Thicket Activities due to (i) ground conditions, and (ii) the 2024 changes to the designation of Havant Thicket Activities.

### Definitions

1. Words and expressions used in this Notified Item have the same meaning as in the Conditions of the Appointments of Southern Water Services Limited as a water and sewerage undertaker for the purposes of Chapter I of Part II of the Water Industry Act 1991, unless the contrary intention appears.
2. For the purposes of this Notified Item:

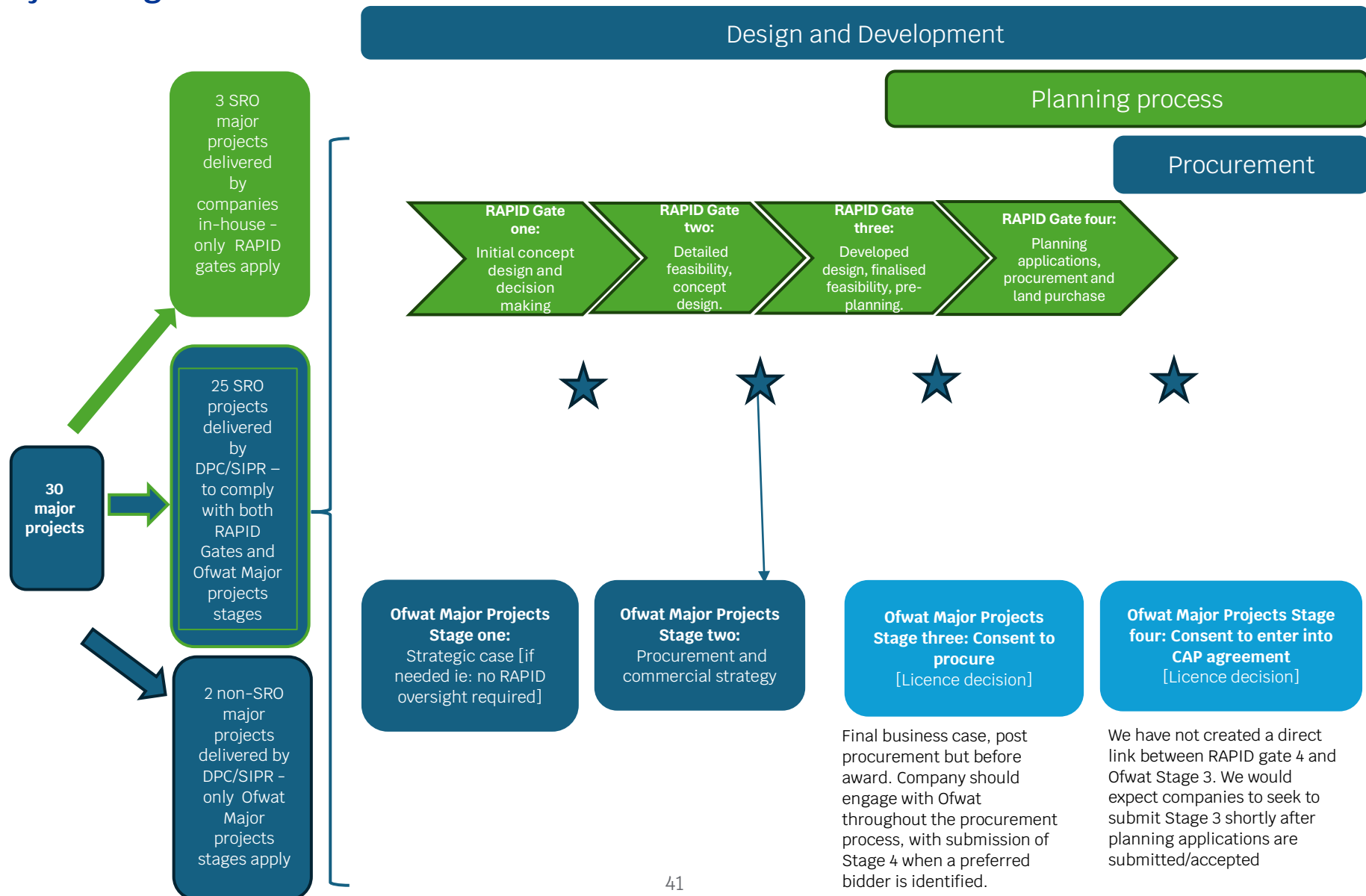
**"Havant Thicket Agreement"** includes any new or additional agreement between the Appointee and Portsmouth Water in respect of the Havant Thicket Activities.

### Additional notes:

1. In the event of an Interim Determination, no account will be taken of any costs to the extent that they would have been, or would be, avoided by prudent management action (and for this purpose what constitutes "prudent management action" shall be assessed by reference to the circumstances which were known or which ought reasonably to have been known to the Appointee at the relevant time).

2. Ofwat's decision as to what changes should be made to the total expenditure allowance in relation to Portsmouth Water's Price Control for Havant Thicket Activities due to (i) ground conditions, and (ii) the 2024 changes to the designation of Havant Thicket Activities will be made as part of the second Havant Thicket cost adjustment mechanism (CAM2).

## A1: Major projects by proposed delivery model and illustration of RAPID Gates and Major Project stages



## A2 Further details on the RAPID light touch approach

RAPID would like to extend its oversight to a number of projects which may benefit from additional regulatory support, whilst not necessarily being subject to the full requirements of the gated process. These projects have been identified as having the characteristics listed in the table below. As a result of this, successful delivery is likely to depend on how cross-cutting strategic risks and barriers are resolved.

**Table A1: Characteristics of projects suitable for RAPID light touch oversight**

| Characteristic | Description                                                                                                                                                                                |
|----------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1              | Involve potential environmental and water quality risks associated with the solution which are likely to have a significant impact on feasibility, cost, and timing of the project; and/or |
| 2              | Have been identified as a project that will be influenced by the development of new regulatory frameworks.                                                                                 |
| 3              | Typically much smaller than projects which benefit from oversight under the formal RAPID gated process.                                                                                    |

For final determinations, five projects have been identified as suitable for this approach:

- Aylesford (Medway) and Ford (Littlehampton) Water Recycling
- Colchester Water Recycling
- Lowestoft Water Recycling
- Sandown Water Recycling
- Sittingbourne Water Recycling

These projects will receive enhancement funding as part of PR24 final determinations allowances to be developed in-house. We recognise a number of these will also interact with the large schemes gated process. This information can be found in PR24 final determinations: Expenditure allowances.

For the RAPID light touch approach, formal gated submissions are not required. Instead, RAPID expect the projects above to have regular high-level check in meetings to understand the progress of the project, and ensure risks are being identified and addressed. At a minimum, updates should include project plans including key milestones and progress against these, a consenting strategy and progress against this, and an overview of technical work, including environmental and drinking water quality investigations. Further guidance will be published in 2025.

Projects are also expected to continue their engagement with the different partner regulators, including the Environment Agency, Natural Resources Wales, Drinking Water Inspectorate, the National Appraisals Unit and Natural England, on technical matters as they work towards the necessary environmental consents and planning permissions.

**Ofwat (The Water Services Regulation Authority)  
is a non-ministerial government department.  
We regulate the water sector in England and Wales.**

Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA  
Phone: 0121 644 7500

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