

By email

17 November 2021

Dear Regulatory Director,

## **Ofwat's expectations for strategic planning frameworks at PR24**

By 2050 companies will need to deliver much more to meet government, customer and stakeholder expectations. This will include reducing abstraction from overstressed sources, reducing leakage and eliminating harm from storm overflows. This will be delivered by a sector that has transitioned to net zero, not just for operational emissions but for embedded too. Therefore, the sector needs to change the way it plans and delivers for customers and the environment. **We want to support the investment that is needed in the sector.** Companies will need to undertake **early engagement, strong planning, and effective collaboration with partners to ensure that the best outcomes can be delivered.**

To deliver the ambitions of the next price review, PR24, and the targets that need to be achieved by 2050, **companies need clear strategies for delivery into the long term.** We expect company business plans for 2025–30 to be set in this context.

Companies already have several long-term strategic planning frameworks. These frameworks include water resources management plans (WRMPs), drainage and wastewater management plans (DWMPs), the water industry national environment programme (WINEP) in England, and the national environment programme (NEP) in Wales. These frameworks set a long-term direction of travel for key areas of company activities and usually involve collaboration with other regulators and stakeholders. **The outputs from strategic planning frameworks will need to inform, and align with, each company's long-term strategy.**

We welcome the progress companies have made in the development of strategic planning frameworks and how they have looked to contribute positively to delivery for the long term. However, **companies will need to take the opportunity now to plan effectively so that the right investments can be identified to deliver the best long-term outcomes.**

This letter does not seek to replace existing or future regulatory guidance relating to current frameworks but reinforces key areas from an Ofwat perspective. We highlight how we want these frameworks to interact and inform business plans for PR24 and outline our approaches

to ongoing engagement during their development. We are writing now to set out our expectations for what companies need to do through these existing frameworks to ensure a clear and consistent long-term strategy is presented in PR24 submissions. This is not a goal in itself – this will ensure that companies deliver the best value outcomes for customers, environment and society. This is a good time to be setting our expectations as many of these plans are in development and soon to be approaching the consultation stages.

To develop the best long-term strategies and business plans, companies need to:

- **Engage effectively with regulators, customers and stakeholders throughout the development of plans under existing planning frameworks.** The proactive engagement and feedback we provided to companies during the consultation stages of WRMP19 as a statutory consultee resulted in better quality plans, more closely aligned to customer and environmental interests. This early engagement also meant that we had increased confidence in the company investments presented at PR19. We want to build on this to maximise the benefits that can be achieved through the range of current frameworks.
- **Show continuity of planning by linking with, and where necessary, explaining the evolution of, previous long-term plans** and setting out adaptive plans to reflect best value delivery into an uncertain future. The strategic planning frameworks should take appropriate account of past allowances and delivery, and we expect companies to integrate the development of them fully into mainstream business planning.
- **Identify the most efficient ways to deliver best value over the long term**, including partnership funding where appropriate. Customers should only fund the efficient costs to address the well justified needs identified in the strategic planning frameworks.
- **Support decisions by using common scenarios (and wider scenario planning as appropriate) using consistent data across all relevant frameworks.** The strategic planning frameworks should link long-term ambition to shorter term deliverables, be adaptive and identify low regret interventions to meet needs allowing for future flexibility. Decisions should be made based on robust costs and benefits valuation. Long-term strategies, scenarios and adaptive plans will be supported by a preparatory investment approach where necessary to support timely delivery.

We provide detail on our expectations and engagement approaches for two key frameworks, WRMPs and DWMPs, in the annex. Joint WINEP guidance is in progress but we expect it to be used in parallel with this letter. Further guidance is to be published shortly on our expectations for companies' long-term strategies, including detail on common scenarios.

We will continue to work closely with government and regulators in both England and Wales to ensure that best value outcomes are reflected through the price review. And we look forward to discussing strategic planning frameworks with companies as they develop to inform business plans for PR24.

Yours sincerely

**Aileen Armstrong**

Senior Director, Company Performance and Price Reviews

## **Annex: Water resources management plans 2024 (WRMP24), regional plans 2024 and drainage and wastewater management plans 2024 (DWMP24)**

In this annex we outline our specific expectations for the water resources management plans 2024 (WRMP24), regional planning 2024, and drainage and wastewater management plans (DWMP24), and our approach to early engagement. We recognise that WRMP24 is being developed in parallel with the regional planning process (where applicable), and we anticipate that most of the expectations outlined here are relevant to both company and regional plans. We also recognise the need for additional clarity on how long-term DWMP ambitions will be dealt with at price reviews, in particular for the first iteration (cycle one).

When developing the WRMP24 and DWMP24, companies should follow relevant legislation and make use of the current regulatory guidance and feedback. Future government and regulatory guidance should also be incorporated when available, including addressing priorities identified in the UK and Welsh Government's Strategic Policy Statements when finalised. This includes the joint Ofwat, Environment Agency and Natural Resources Wales water resources planning guideline<sup>1</sup> (and any future updates), Ofwat's consultation response letters on the draft WRMP19<sup>2</sup>, Ofwat's feedback on the regional planning 2024 method statements<sup>3</sup>, the DWMP technical framework<sup>4</sup> and the DWMP guiding principles<sup>5</sup>.

We have increasingly sophisticated water resource planning processes which are the result of many years of incremental improvements. However, at PR19 we had to intervene to allow additional enhancement funding for the investigation and development of strategic regional water resource solutions<sup>6</sup>. We felt this was necessary because companies did not sufficiently consider regionally sized or cross-boundary options in their WRMPs or business plans. Regional scale options, or those that allow synergies across company boundaries, have the potential to deliver resilient supplies more efficiently and provide wider benefits than smaller within-company options.

We also set up the Regulators' Alliance for Progressing Infrastructure Development (RAPID) – with the Environment Agency and Drinking Water Inspectorate – to help oversee the investigations into these regional scale and complex water resource options through a gated process and to address potential regulatory barriers. Therefore, we expect companies across all regions to learn from these interventions and the progress that has been made through them. We expect regionally sized options (those within the funded gated process and those

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<sup>1</sup> Environment Agency, Natural Resources Wales, Ofwat, [Water resources planning guideline](#), July 2021

<sup>2</sup> Ofwat, [Ofwat's engagement on WRMP19](#), June 2018

<sup>3</sup> Ofwat, [Ofwat's engagement on WRMP24](#), January 2021

<sup>4</sup> Water UK, [Drainage and Wastewater Management Plans](#), September 2018 (updated September 2021)

<sup>5</sup> The DWMP guiding principles document produced by the UK and Welsh Governments, Natural Resources Wales, Environment Agency and Ofwat is currently draft and due to be published late-2021

<sup>6</sup> Ofwat, [PR19 strategic regional water resource solutions appendix](#), December 2019

not) to be identified and transparently assessed by companies within both regional and company planning frameworks.

The new drainage and wastewater strategic planning process aims to bring increased focus and consistency in planning approaches across the industry to improve sewerage system performance and environmental water quality. We acknowledge that in preparing for DWMP cycle one the sector has already made good progress in identifying a range of future challenges and options to address them. A next step is to focus on maximising the opportunities for joining up with stakeholders and prioritising investment requirements across all DWMP framework objectives.

We understand that for DWMPs it can be challenging to engage and secure support from other risk management authorities (RMAs)<sup>7</sup> that need to be involved throughout the planning cycle. However, it is this support, particularly for co-developed, co-funded and co-delivered solutions, that will bring the most benefit to the environment, customers and communities. We ask that companies continue to engage proactively with stakeholders to push for best value solutions over the long term. We anticipate that for future iterations of DWMPs there will be continued improvements in collaborative working and, like WRMPs, DWMPs will develop into a mature planning process.

Companies must also align their strategic planning frameworks with other stakeholders' planning frameworks, such as river basin management plans, flood risk management plans, the flood and coastal erosion risk management strategy, and flood risk activity permits.

The key areas that we expect to be incorporated and addressed through regional planning 2024, WRMP24 and DWMP24 are as follows:

1. Identification of optimised long-term programmes using long-term targets;
2. Full consideration of a wide range of options to meet long-term challenges;
3. Development of a best value plan using efficient costs and robust valuation of benefits;
4. Presentation of an adaptive plan to address known issues and future uncertainties tested against a suitable range of scenarios; and
5. Demonstration that stakeholder and customer views have been taken into account, and that partnership opportunities have been identified to enable co-funding and co-delivery.

These key areas of focus are further explored below.

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<sup>7</sup> Drainage and flooding responsibilities cut across many RMAs, including the Environment Agency, Natural Resources Wales, lead local flood authorities, councils, internal drainage boards, highways authorities and water and sewerage companies. As drainage systems interact with each other, there needs to be a collaborative, integrated approach to long-term planning to ensure shared risks are identified and the best value solutions are implemented.

## 1. Programme optimisation over the long term

### **WRMP24 and DWMP24 should be set clearly in the context of long-term plans and targets.**

Too often the sector seems to start afresh at each planning round. WRMP24 should build on WRMP19. Companies should explain clearly where and why (1) WRMP24 is a continuation of WRMP19 and (2) the plan has evolved. Companies should set out what has already been, and what is forecast to be, delivered in line with WRMP19, as well as explaining where alternatives have been delivered in place of funded WRMP19 options and why these have resulted in better outcomes for customers and the environment. The new DWMP planning framework enables companies to build on existing long-term planning approaches and delivery. The DWMP24, and any investment identified through it, should be framed in this context.

Given the sense of urgency to address the security of supplies, we are concerned that across the industry several WRMP19 schemes funded at PR19 have already been postponed. Of particular concern is companies wanting to re-appraise options that were included and funded as part of PR19 plans as an input to WRMP24. **The high frequency of option re-appraisal undermines the objectives of long-term planning** as it reduces clarity over preferred long-term solutions and raises concerns that proper option appraisal was not undertaken at the time of plan development. If options are re-appraised following the award of funding and subsequently not taken forward, it also **increases risks that customers are asked to pay twice across price control periods**. We will be seeking to reduce this risk by increasing the traceability of delivery during the current control period and at PR24.

**Companies should identify the drivers of investment and the optimum timing for delivering investment as part of the PR24 long-term strategy.** We recommend not setting artificial constraints or delivery deadlines in decision-making tools and optimisers as this can result in sub-optimal strategies and investment programmes within the frameworks. Setting a glidepath to meet long-term targets and outcomes should enable an efficient and deliverable long-term programme to be identified, allowing enough time for innovation and nature-based solutions. This will help ensure that plans reduce reliance on traditional solutions.

For WRMP24, near-term interventions to start delivering long-term targets such as a 50% leakage reduction<sup>8</sup>, 110l/h/d per capita consumption<sup>9</sup> and 1-in-500-year drought resilience<sup>10</sup> where these are applicable, should be set in the context of the optimum long-term strategy. These long-term delivery glidepaths should also account for the delivery of other outcomes such as net zero emissions.

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<sup>8</sup> In a [letter to the Secretary of State](#), Water UK on behalf of the water industry agreed to reduce leakage by 50% from 2017-18 levels

<sup>9</sup> Defra, [The government's strategic priorities for Ofwat – draft for consultation](#), July 2021. Note that the Welsh Government has not set 110l/h/d as a target but there is an expectation that companies' wholly or mainly in Wales plan to this by the 2050s

<sup>10</sup> HM Treasury, [National Infrastructure Strategy](#), November 2020

When considering long-term targets and ambitions in DWMP24, such as the common planning objective for addressing the risk of sewer flooding in a 1-in-50-year storm event, companies should identify the optimum timing to achieve these levels over the planning horizon. Companies must consider the type and pace of investment required to meet planning objectives and only include investment proposals in business plans that are justified, well evidenced and that deliver long-term best value.

The **interventions identified in strategic 25-year plans will need to be translated into deliverable solutions, which are then clearly identified in company business plans**. For DWMPs, we anticipate that companies will start from their long-term outcomes and work back to identify interventions needed in PR24. This should factor in long-term targets and ambition whilst also considering potentially competing priorities (eg addressing storm overflows and working towards net zero). Companies must be clear on what issues the proposed interventions are seeking to address, why some have been prioritised over others, how interventions may interact or complement each other, and why funding in addition to base allowances is needed.

Rather than considering investment in isolation, we expect companies to look across other business plan policy areas and planning frameworks to account for the impact that focused investment elsewhere can have on WRMP and DWMP needs. For example, plans to target sewer misuse in DWMP24 may mean that fewer blockages should be forecast in the future. There may also be implications on future wastewater planning from changes in water usage patterns across regions, influenced by growth and water efficiency programmes.

**Companies should prioritise and stagger schemes across multiple price review periods**, depending on the scale, complexity and required lead times for planning. This will facilitate improved working arrangements with partners, securing additional funding, and gathering more information. It will avoid inefficient early spend, as well as help to demonstrate which solutions should be delivered or started early to address risks and deliver the most benefit.

## 2. Consideration of a wide range of options

WRMP24 and DWMP24 should identify and evidence efficient, deliverable, and ambitious investment programmes in the interests of customers, environment and society. **Companies will need to have considered a wide range of potential options** to provide confidence that these are the appropriate programmes to meet these long-term outcomes.

**For WRMP24 a range of supply-side and demand-side options should be explored**. This will enable a twin track approach to meeting the supply-demand balance. The number of options considered should be proportional to the scale of the long-term need and be sufficient for real choices between options and different programmes. Options should include those involving other water companies (water trading as both a supplier and purchaser) and other sectors (third party options) and should include options to develop resources to facilitate trading. We welcome regions that are seeking to identify options that create resources for

cross-sector collaboration. These should be promoted where this is more cost effective and better value than equivalent single-sector schemes.

For DWMP24 **we expect companies to consider a wide range of options that mitigate the risks identified, including nature-based solutions, catchment-scale schemes and traditional grey infrastructure interventions.** Many wastewater system performance risks relate to network operational or maintenance approaches that can be improved. Therefore, before exploring enhancement options we expect companies to demonstrate that adjustments to operational and maintenance regimes have been considered. Options should demonstrate that wider environmental improvements and collaborative partnership working have been incorporated. Companies should explore options that seek to address multiple drivers, such as managing surface water that benefits both flooding and water quality performance. Companies should demonstrate how interdependencies with other stakeholders' strategic plans have been considered. Some options may need longer lead times to evolve and will need to be developed in collaboration with other stakeholders meaning they may not always be appropriate for near term needs. The options should fully consider partnership working opportunities, including co-funding and co-delivery.

For both WRMP24 and DWMP24, companies should embrace **innovative options including those making use of smart data and networks.** Companies' plans should make efficient use of current technology, investigate the use of emerging technology and future innovation, as well as explore nature-based solutions. We also expect a full consideration of operational interventions, where these are appropriate, for example during low probability events. This will help to avoid developing unnecessary infrastructure which may have very low utilisation or not be required if risks do not transpire.

**The options being assessed should represent deliverable solutions** with mitigation costs and benefits included within the option appraisal. Delivery challenges of options should be clearly identified early in the process. Large scale interventions being promoted through a final WRMP24 or DWMP24 should be identified as major projects and the potential for delivery via Direct Procurement for Customers fully explored.

**Companies should consider modular options or sub-options,** where appropriate, in order to facilitate the identification of low regret investment to meet short- and medium-term needs, but to also allow flexibility to deliver against a wider range of long-term uncertainties.

### **3. Best value planning using robust and efficient costs**

In developing best value plans, **we expect companies to provide robust evidence of efficient costs and account for a wide range of public value benefits** including wider resilience, environmental and societal factors.

WRMP24 and DWMP24 should be based on high quality evidence. **Companies should use robust and efficient costs when developing WRMP24 and DWMP24 to provide confidence in option selection and decision making.** Companies should prioritise using outturn data but recognise where historic costs may represent inefficiencies or older technologies.



We expect there to be consistency of costs and benefits valuation between companies' WRMP24 and DWMP24 and PR24 business plans. The calculation methods, datasets and process for ensuring consistency should be presented upfront in the planning frameworks. The justification for preferred options is open to challenge if cost and benefit data changes significantly between the strategic planning frameworks and business plans. For WRMP24, to help identify any changes and to understand what investment is being justified, we have ensured that the water resources planning data tables (which we expect to be published in parallel with the draft and final WRMP24) include business plan links.

DWMP24 evidenced investment will also need to be tracked in PR24 business plan data tables to provide a clear link between programme selection and funding needs. To help identify any changes between draft and final DWMPs and business plans, and to understand what investment is being justified for PR24, we are considering the use of simplified DWMP24 data tables, similar to those used for WRMP24. We will work with the sector to develop a format for presenting data on scheme types, costs and benefits in tables which should help bridge the gap between DWMPs and business plans. We will also consider data links with the WINEP.

We expect companies to demonstrate that the preferred solutions for PR24 offer quantifiable best value for money for customers, the environment and society when compared with a range of other options, and the do-nothing scenario. **We expect to see a clear line of sight between long-term DWMPs and WRMPs and the requested investment at PR24.** This should include how the cost to deliver a scheme compares with the monetised benefits it will bring in the short and long term. For both WRMP24 and DWMP24, the least cost programme should be clearly presented to allow the additional costs and benefits delivered through best value planning to be clearly identified and communicated effectively to all stakeholders.

**We expect benefits to be consistently calculated and assessed across WRMP24, DWMP24 and WINEP.** Where there are higher levels of benefit uncertainty this should be made clear and appropriately accounted for in the decision-making process. Companies should separately identify where they expect to deliver additional benefits (such as biodiversity net gain) through their final WRMP24 and DWMP24 programmes. These benefits should be subject to measurable commitments at PR24 such as changes in the levels of performance commitments, price control deliverables or other mechanisms where the benefits are less certain. Companies should consistently report and track benefits so that customers can see the added value from these investments. This should include identifying and reporting on the impacts on operational and embedded greenhouse gas emissions for the programmes identified through these frameworks.

#### **4. Adaptive planning to address uncertainties**

We expect WRMP24 and DWMP24 to be **flexible and, based on the uncertainties identified, follow an adaptive pathways approach.** This will allow investment to be scheduled and to respond to new information over time. A good understanding of future uncertainties along with effective adaptive planning, will ensure that the most optimum solutions are proposed

for PR24. This reduces the risk of over or under investment. Adaptive plans provide visibility and accountability around how companies' long-term strategies will change in the future.

We recognise that some enhancement investment may be necessary where preparatory work is required in advance of an adaptive pathway being triggered. This water or wastewater investment, such as enabling works, would be over and above normal option investigation and development funding included within base expenditure. We expect requests in this area to align with key principles for uncertain preparatory funding as outlined in guidance on companies' long-term strategies we will publish shortly.

Companies should **use a range of scenarios and stress testing to optimise investment needs against a range of likely futures to identify risks, uncertainties and mitigations**. For WRMP24 and DWMP24 we expect scenarios-based testing to include the small number of common reference scenarios we have developed collaboratively with the sector which will support the identification and justification of low regret investments.

As well as the common reference scenarios, it would also be beneficial for WRMP24 and DWMP24 to be using the same common assumptions, costs, valuation of benefits, appraisal approaches and decision-making tools (with any significant divergence clearly explained). It is expected that this level of consistency would be common across all areas of company business and not just the key strategic planning frameworks. Further detail on our expectations for adaptive planning and common reference scenarios will be set out in our forthcoming long-term delivery strategy document.

## 5. Taking account of stakeholder views and partnership working

Aligned with our public value principles<sup>11</sup> **we expect that where options generate value for multiple beneficiaries, the funding request should reflect that water company customers pay their fair share. Funding should also reflect the relative benefits to water companies and third parties**. Customers can only be expected to fund activities consistent with a water company's statutory functions. Solutions delivered in partnership should allow companies to leverage input from third parties.

Due to the nature of drainage and flooding responsibilities, DWMPs will provide significant opportunities to explore wider stakeholder input including co-funding and co-delivery arrangements. We encourage companies to put forward partnership schemes in PR24 plans where co-funding opportunities have been identified and are well developed.

Where a solution is dependent on delivery of another scheme, either by the company itself or a third party, we expect any risks to delivery or funding to be identified along with any opportunities for added value. We expect to be able to clearly understand a company's contribution to a partnership scheme, the on-going financial commitment and/or

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<sup>11</sup> Ofwat, [Public value in the water sector: a supporting set of principles](#), July 2021, pp 13-14

responsibilities for the scheme, and the customer protection measures put in place for non-delivery or a change in the solution or timescales.

Companies should ensure that **the development of WRMP24 and DWMP24 is collaborative, and the consultation process is truly consultative, easy to access and transparent for all.**

Companies should also ensure that customers and stakeholders are able to understand how the decisions on option selection have been made including the basis on which options have been selected as least-cost and/or best-value.

Companies need to ensure plans are delivered on time and to a good quality so that the interacting processes of regional plans, WRMP24, DWMP24 and business plans, together with other planning frameworks and any consultations, can inform each other in a timely way.

For DWMP24 it should be clear that RMAs have been fully involved in the process. We expect being involved in proactive engagement throughout the process as DWMPs develop.

For WRMP24 we will continue to engage with companies throughout the process up to finalisation and publication of the plans. This includes following the statement of response and revised draft plan stage. This will help ensure that concerns are addressed prior to publication and presentation in business plans. Any outstanding issues that we consider have not been adequately address during the WRMP24 process may be open to challenge at PR24.

### **WRMP24 pre-consultation meetings**

As well as outlining our general expectations in advance of PR24 we are writing to set out our approach to pre-consultation engagement for WRMP24. We are pleased to see several companies have already started pre-consultation engagement with stakeholders. Early engagement by companies with stakeholders and regulators reduces the likelihood of issues coming to light at a later stage of the planning process. We note that in our role as a statutory consultee, as set out in the planning guidelines, companies are required to have pre consultation discussions with Ofwat on their WRMPs. It is important that the pre-consultation engagement with Ofwat is proportionate and targeted. For these reasons, we expect that:

- we would have at least one pre-consultation discussion meeting with each company (the first being before the end of January 2022), focusing on the key issues for the WRMP24; and
- we would share our feedback with government and other regulators where we feel that this is appropriate.

Engagement meetings will take the place of formal responses to companies at the pre-consultation stage and will allow us to provide early feedback, challenge and identify areas where more justification may be required to inform the WRMP and business plan. Based on the challenges facing companies and any risks identified with the company approaches during these initial discussions further engagement may be necessary. It is important to note that comments regarding a company's WRMP, at any stage of the WRMP24 process, are made

without prejudice to Ofwat's decision regarding business plans at PR24 and any subsequent price review.

Within the context of PR24, we expect the pre-consultation engagement to focus on the approach that companies are following to develop their WRMP24 (as informed by regional plans) and the integration into their business plans. We want to discuss the development stages of companies' plans including understanding progress on WRMP19 delivery to date and how long-term plans developed for WRMP19 are informing WRMP24, the size of the challenge and what is driving this, options that are being considered, and how companies will select an optimised best value plan in the interests of customers, society and the environment.

To arrange a meeting please email [wrmp@ofwat.gov.uk](mailto:wrmp@ofwat.gov.uk). Please also copy this e-mail address in on all correspondence to Ofwat on WRMPs.

### **DWMP24 pre-draft meetings**

Consistent with the engagement approach we have adopted with WRMPs, we consider that proactive engagement and feedback ahead of the draft and final DWMP stages will help deliver better outcomes for the long term that closely align to customer, stakeholder, and environmental needs.

We are pleased to have been invited to some company DWMP strategic forums where progress and the development of options are discussed openly with key stakeholders. We welcome being able to continue to attend such forums and to participate in DWMP steering group meetings to support the development of plans. It is important to note that comments regarding a company's DWMP, at any stage of the process, are made without prejudice to Ofwat's decision regarding business plans at PR24 and any subsequent price review.

We intend to hold pre-draft meetings with companies in February 2022 to discuss progress with the development of DWMPs<sup>12</sup> and to start to understand the likely investment needs for PR24. These meetings will be an opportunity for companies to present how they have been progressing with their DWMPs against the technical framework and the DWMP guiding principles. It will also allow Ofwat to start to understand the scale and scope of companies' long-term risks and investment requirements in advance of PR24 business plans. We aim to be able to provide informal feedback following these early meetings setting out our initial thoughts on companies' DWMPs which should be considered when developing draft and final plans, and also PR24 business plans.

For any DWMP correspondence with Ofwat, or to arrange the meeting with us in February 2022, please email [dwmp@ofwat.gov.uk](mailto:dwmp@ofwat.gov.uk).

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<sup>12</sup> Company discussions will help us progress our strategic priorities set by Defra and Welsh Government, and our actions under the flood and coastal erosion risk management strategy action plan.