August 2026

Notification of the PR24 cost change process draft determination for SES Water

Ofwat

Keith Haslett
Chief Executive Officer
Sutton and East Surrey Water plc
London Road
Redhill
Surrey
RH1 1LJ

Dear Keith

Cost change draft determination 2026

13 August 2026

I enclose in Appendix 1, the cost change draft determination by the Water Services Regulation Authority (Ofwat).

This draft determination is published on our website. We also publish the following documents, which support our cost change draft determination for SES Water:

- Cost change draft determinations 2026 - Sector Overview;
- Cost change draft determinations 2026 – Asset health cross cutting issues appendix;
- Cost change draft determinations 2026 – Price control deliverables (PCD) appendix;
- Cost change draft determinations 2026 – Asset health PCDs; and the
- Cost change draft determinations 2026 model and asset health model

In accordance with sub-paragraph 14ZA.1 of Condition B: Charges of Sutton and East Surrey Water plc's appointment as a water undertaker, Ofwat now gives notice of its intention to determine the questions set out in sub-paragraph 14ZA.3 of Condition B in relation to the following Eligible Item(s):

- 3. Asset health

I enclose the following additional information relevant to our decisions within the appendices of this document:

Appendix 2: Our draft determination on how SES Water's expenditure allowances are funded

Appendix 3: Our detailed assessment of, and decision on, SES Water's submitted claims.

SES Water should ensure that it reads all the information referred to above before responding to this consultation. The closing date for responding to this draft determination consultation is 24 September 2026. We have published SES Water's cost change submission on our website.

Yours sincerely,

Helen Campbell

Executive Director, Delivery

Contents

Cost change draft determination 2026 1

Appendix 1: Cost change draft determination 4

Appendix 2: Our draft determination on how SES Water's expenditure allowances are funded 6

A2.1 Delivery assessment 7

A2.2 Financeability assessment 8

A3.1 Asset health 9

3.1.1 Water network storage 9

Appendix 1: Cost change draft determination

In SES Water's 2026 cost change submission, we received one claim in the following cost area:

- Asset health water network storage

Table 1 below provides a summary of our draft determination total cost change expenditure allowance compared to the cost change expenditure you requested in your submission. We explain our decisions in Appendix 3 of this document.

Table 1: Breakdown of the difference between SES Water's view and Ofwat view of costs (£million, 2022-23 FYA CPIH prices)

	2025-30 period	2030-35 period
Company total cost change claim	11.6	0.0
Ofwat 'insufficient evidence of need' or 'out of scope of cost change process' assessment[1]	0.0	0.0
Company total 'in scope' cost change claim[2]	11.6	0.0
Ofwat 'best option' challenge[3]	0.0	0.0
Ofwat efficiency challenge[4]	-1.3	0.0
Ofwat draft determination cost change allowance	10.3	0.0
- Which includes conditional cost allowances of[5]	0.0	0.0

Our draft determinations include price control deliverables (PCDs) to hold SES Water to account for delivery. Our approach to PCDs is set out in Cost Change Draft Determinations 2026 – Price control deliverables appendix.

The impact of our draft determination on SES Water's price controls is set out in tables 2 and 3 below.

[1] There are no such costs for SES Water.
[2] The company's total eligible cost claim that demonstrates the need for the required step change in investment and is within the scope of the cost areas.
[3] Our review of the company's evidence of optioneering and associated cost benefit analysis and that the options put forward are the best option for customers.
[4] Our review of the company's evidence of efficient unit costs and associated methodology.
[5] Cost claims included within the 'in scope' total but are subject to the company providing additional information ahead of the final determination. There are no such allowances for SES Water.

Table 2: SES Water's draft determination revenue adjustments by price control and when they apply (£million, 2022-23 FYA CPIH prices)

	Water resources	Water network plus	Total
Total in-period revenue adjustment for 2027-28	0.000	0.000	0.000
Total in-period revenue adjustment for 2028-29	0.000	0.000	0.000
Total in-period revenue adjustment for 2029-30	0.000	0.000	0.000
Total end of period revenue adjustment at PR29	0.000	1.193	1.193

Table 3: SES Water's draft determination RCV adjustments by price control (£million, 2022-23 FYA CPIH prices)

	Water resources	Water network plus	Total
Total end of period RCV adjustment at PR29	0.000	9.861	9.861

Since our draft determination does not include any in-period revenue adjustments resulting from the cost change process, there are no changes to the company's last determined price controls or customer bills[6].

[6] For SES Water, the last determined priced controls are those updated for the 2025 blind year reconciliation.

Appendix 2: Our draft determination on how SES Water's expenditure allowances are funded

We must determine whether expenditure allowed in the cost change process requires a change to company price controls to allow in-period funding. The cost change guidance notes set out our approach to assessing whether to provide in-period or end of period funding for allowed expenditure. The factors we consider are set summarised in section 5 of PR24 Cost change draft determinations 2026 – Sector overview document. Where we provide in-period revenue adjustments, this consists of:

- any pay as you go expenditure reflecting operating expenditure (opex) allowances;
- allowed return on any committed additions to RCV, based on the allowed return in companies' PR24 determination;
- run-off on any committed additions to RCV based on the final determination RCV run-off rates for the relevant wholesale controls; and
- where applicable, we will also provide issuance costs for additional required equity identified within the financial model at the same rate as for the final determinations of 2.5% of new equity.

For SES Water we do not allow in-period funding for the allowed expenditure. Our decision reflects our consideration of the relevant factors in the round.

- We do not provide in-period funding for £10.3 million of allowed expenditure for SES Water's asset health claim. Funding for this asset health expenditure will be provided as an adjustment to RCV at 31 March 2030 and an adjustment to revenues over the 2030-35 price control period.

In our assessment we carefully considered the financial impact of the additional expenditure we allow and how a company is progressing against delivery of its existing investment programme. Our assessment shows that the company would remain financeable on the basis of the notional capital structure over the 2025-30 period. Any reduction in financial ratios as a result of the additional expenditure allowances would also be mitigated by the current underspend on its year 1 total expenditure (totex) allowances.

If SES Water wishes to make the case for in-period funding in its response to our draft determination, it should include consideration of the impact of both the cost change and ODI payment processes in its response to the draft determination[7]. This should take account of our draft determination (and the company's view of this) and any other factors or changes since it submitted its claims during the March to May 2026

[7] See cost change guidance, IN 26/01 Submission of cost change applications.

submission window. This should take account of the latest view on progress on delivering existing investment programmes.

If the company requests in-period funding as part of a future cost change process, we will reassess all of the factors relevant to in-period funding set out in the cost change draft determinations sector overview.

A2.1 Delivery assessment

2025-30 delivery

We reviewed the company's May 2026 delivery plan update. On balance, although we have concerns about the company's output forecasts, we consider that the company provides sufficient and convincing evidence to demonstrate that it remains on track to deliver its PR24 commitments by the end of 2025-30 period. We provide a summary of our assessment below.

In its May 2026 delivery plan update the company showed the following positive indicators in relation to 2025-30 delivery progress:

- The company reported meeting all its interim milestones in 2025-26.
- The company is forecasting to have released 85% of its capital schemes to the supply chain by the end of 2026-27.
- The company is forecasting to have 85% of its capital schemes in construction or delivered by the end of 2027-28. This should provide the company with headroom to respond to unforeseen events and manage any delivery risks.
- The company remains confident that it will deliver all of its PCD outputs by the end of 2025-30 period.

However, there are still some indicators that raise concerns in relation to the company's delivery forecasts for the 2025-30 period:

- The company has shown slow progress in relation to water PCD outputs, delivering below baseline target in 2025-26 (see section below on delivery in 2025-26).
- The company spent 25% less than PCD related allowances in 2025-26 for water and is forecasting to slightly underspend PCD allowances by the end of 2025-30. The company has explained that it is targeting cost efficiencies in its programme.

Delivery in 2025-26

In its May 2026 delivery plan update, the company reported delivering 35% less PCD outputs (in value terms) in 2025-26 compared to baseline target. The company has therefore failed to demonstrate that it is not behind on delivery in 2025-26.

A2.2 Financeability assessment

SES Water requested in-period funding within its cost change submission. In a joint submission with South West Water, the company argued that even the relatively modest investment case it proposed could have a material adverse effect on its notional credit metrics if recovery was deferred to the end of the period. It also argued that this would be compounded with further submissions in 2027.

SES Water also set out that in-period funding would be in the long-term interests of customers, as it would minimise the whole life costs to the customer and maintain the smoothest bill profile for customers between price control periods. It also sets out that this would most closely replicate the natural profile for customers had the totex been allowed at PR24. The company supported this with customer research which found that 78% of participants preferred bill increases to begin earlier and argued that stakeholder engagement has consistently found that customers value a smooth bill profile that avoids step-changes in revenue between regulatory periods. We have responded to these points in the Cost Change Draft Determinations 2026 – Sector overview.

We have set out our approach to assessing financeability in annex A2.2 of the PR24 cost claim draft determinations 2026 sector overview report. We have assessed SES Water's financeability on the basis of the notional capital structure within a copy of the final determinations financial model by adding in the additional cost allowances in our draft determinations. We have maintained other assumptions, including the allowed return on capital, in line with the final determinations. Our financeability assessment assumes the company spends its totex allowances according to the profile set out in the final determinations and has no under- or out-performance.

Adjusted interest cover and funds from operations to net debt are lower than the financial ratios set out in our final determinations, particularly in 2029-30. However, the ratios for all years are above our guidance for the target credit rating of Baa1/BBB+ and the average across 2025-30 provides material headroom to that guidance. As such, we assess that SES Water remains financeable over the 2025-30 price control period without in-period funding.

Appendix 3: Our assessment of and decision on SES Water's submitted claims

This appendix sets out our detailed assessment of, and decision on each of the company's 2026 cost change claims. It should be read alongside the documents specified in the first page of this draft determination.

In its response to the draft determination, the company should confirm, to the extent that it has not already done so, which proposed schemes could impact sites of special scientific interest (SSSIs) or land in National Parks, or areas of outstanding natural beauty.

A3.1 Asset health

3.1.1 Water network storage

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
Summary of request	The company has requested £11.6 million for improvements at one water treatment works, where the proposed interventions are to replace the existing contact tank and treated water tanks. The need for investment is supported by portfolio level scenario modelling and asset level data.		
Need for a step change in investment	**Decision summary - Pass** The company provides sufficient and convincing evidence to demonstrate that the proposed investment meets the 'Need for step change in investment' criteria. The estimate for 'what base buys' is low for this work.[8] In order to protect customers from paying twice, our general approach is to recover cost change allowances where existing base allowances	**Pass**	**0%**

[8] Our assessment and further detail can be found in the 'Cost Change Draft Determinations 2026 – Asset health cross cutting issues appendix'

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	turn out to be sufficient. If we were to amend this approach, we would look to implement a targeted customer protection for this allowance in light of the concern regarding 'what base buys'. **Company evidence** - The company states that investment in water storage assets is needed where ageing tanks, reservoirs or contact structures are materially deteriorating and can no longer be relied on to maintain water quality, operational resilience and continuity of supply through routine maintenance alone. This is evidenced to be the case at the treatment works selected for intervention under the asset health reopener, with site specific evidence detailing, storage assets at or beyond design life (more than 110 years old), with reported cracking and potential ingress risk.[9] The company shows historic investment in contact tanks and final water tanks at £2.5 million in each investment period over the last 10 years (2015-20 and 2020-25).[10] The requested investment of this asset health reopener at the water treatment works selected for intervention by SES Water, is more than four times this estimate at £11.6 million. The Pennon Group state in their report that service reservoir deterioration and performance modelling for the PR24 submission, showed that deterioration and service risks over a 40 year horizon could be managed within typical base allowances during the asset investment period 2025-30, but that "this would involve sub-optimal maintenance decisions of isolated		

[9] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, p.3
[10] Pennon, 'Cost Change Submission - asset health', May 2026, Table 5

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	repairs/remedials compared to investment options selected when maximum net benefit is considered over the long-term".[11] The company has outlined its contact and storage tank strategy, stating that the approach is focused on having a programme of investment that reduces risk and delivers high quality drinking water[12]. The company has graded the current condition of the contact tank at the water treatment works identified for intervention, as condition grade 5 and the treated water storage tanks as condition grades 3 and 4[13]. The company proposes that the tanks are approaching three times their expected design lives, are in poor condition, are operating in a harsh environment, and thus, represent a high likelihood of failure risk, where significant refurbishment may only minimally extend the asset life or replacement need.[14] Though there exists a wider programme of replacement at the works to address deteriorating asset condition, increasing water quality and supply risk and resilience shortfalls, the company confirmed there to be no planned improvements to the storage tanks as part of the 2025-30 enhancement works, and no other planned based maintenance work on site. [15] **Our assessment** - Our current analysis indicates that there is a sector-wide health issue for network storage assets.[16] The company provides sufficient and convincing evidence that there is a need for a step change in investment to address asset health issues. The company provides		

[11] Pennon, 'Cost Change Submission - asset health', May 2026, p.18
[12] Pennon, 'Cost Change Submission - asset health', May 2026, p.15
[13] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, p.10
[14] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, p.9
[15] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, pp.3,10
[16] Further detail can be found in the 'Cost Change Draft Determinations 2026 – Asset health cross cutting issues appendix'

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	evidence of poor network storage asset condition at the treatment works selected for intervention and demonstrates a need for investment to restore the asset and reduce "risk to water quality and supply resilience in the near term".[17] The company does not clearly evidence how asset condition has deteriorated over time, but it does reference previous portfolio level deterioration and scenario modelling conducted by the Pennon Group, demonstrating management of the asset class by isolated repairs/remedials to be sub-optimal in the longer term. A query response[18] outlines that the company are using the reopener process to replace two high risk storage points alongside other scheduled enhancement activity. Evidence is further provided that treated water storage tanks, and the contact tank are not included within the existing PR24 enhancement case. The evidence and narrative surrounding the site-specific risk analysis, support the need for the step change in investment requested. The company's view of 'what base buys' (implicit allowance) across its asset proposals is lower than a view of what base buys based on historical sector expenditure rates. [19] We consider that the company has submitted sufficient and convincing evidence that a step change in investment is needed. No letter of support from the Drinking Water Inspectorate (DWI) was however provided with the submission. Our expectation is that the company will provide this with in its draft determination response.		

[17] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, p.10
[18] Response to Ofwat query 'OFW-SES-CCP-003'
[19] Our assessment and further detail can be found in the 'Cost Change Draft Determinations 2026 – Asset health cross cutting issues appendix'

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
Best option for customers	**Decision summary - Pass** The company provides sufficient and convincing evidence to demonstrate that the proposed investment meets the 'Best option for customers' criteria. **Company evidence** - The company outlines the optioneering processes within the submission, highlighting that a wide range of options have been considered under each asset case.[20] The company has included the different options that were considered, and why they were taken forward or rejected. Furthermore, the company has explained the preferred option and has addressed some of the challenges of the option; such as space restraints.[21] The company has provided a list of proposed solutions including benefits to customers. A cost benefit analysis has been included within the submission which shows the difference between increased maintenance and asset replacement, using a 'do nothing' scenario as a baseline. The analysis shows asset replacement is more favourable for both private and social benefit. The cost benefit analysis shows that increased maintenance has a higher benefit: cost ratio than asset replacement, the company explains this is due to low upfront costs.[22] **Our assessment** - The company has provided sufficient and convincing evidence to demonstrate that optioneering has been undertaken and provides explanation of the preferred option selection. The company demonstrates qualitative site-level optioneering and identifies some potential benefits of the proposed interventions. Whilst the cost and Benefit-Cost Ratio (BCR) analysis	**Pass**	**0%**

[20] Pennon, 'Cost Change Submission - asset health', May 2026, p.19
[21] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, p.12
[22] Pennon, 'Cost Change Submission – asset health – technical annex – [redacted], May 2026, p.16-17; Pennon, Query response 'OFW-SES-CCP-003', June 2026

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	indicates that the maintenance option represents the more cost-effective solution, with a stronger cost-benefit case than asset replacement, clarification is given in the technical annex which explains that the preferred option represents the most economic whole life solution.		
Robust and efficient costs	**Decision summary – Pass** The company provides sufficient and convincing evidence to demonstrate that the proposed costs are robust and efficient. However, the submission does not provide sufficient and convincing evidence to support the application of the 13% regional uplift applied to derive SES costs from the SWB baseline costs. A 11.5% cost challenge is applied, removing the regional uplift.[23] **Company evidence** - The company has provided a structured cost build-up for each scheme, with clear separation of direct costs; indirect/on costs; and; optimism bias. The costing methodology is based on historical delivery data and supported by cost models and on cost models developed by a third party. The company has used historical outturn-based cost models (IUCMs) to develop cost proposals. The submission includes internal benchmarking, and benchmarking undertaken using a third-party benchmarking study and Water Research Council (WRc) TR61 data as comparator sources. Costs are derived from South West Water baseline costs and a 13% regional uplift is applied to reflect regional differences in tender prices. The uplift is based on BCIS regional tender price studies and was developed by a third party. The submission also includes evidence of technical and commercial assurance undertaken by a third party. **Our assessment** - The company provides sufficient and convincing evidence to demonstrate that the underlying costs are robust and efficient. The company demonstrates that costs are informed	**Pass**	**11.5%**

[23] Removing the 13% uplift is equivalent to a 11.5% reduction, as 1/1.13 -1 = - 11.50%

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	by historical delivery data and supported by internal and external benchmarking. The use of historical delivery data established cost models and benchmarking is consistent with Ofwat's expectation that costs should be informed by historical delivery experience and tested against comparator evidence. The company also provided additional evidence with their submission which explains the benchmarking methodology and provides further assurance regarding the appropriateness of comparator selection. While benchmarking is presented at a relatively high level and does not fully demonstrate that all comparisons have been undertaken on a like-for-like basis, the evidence collectively demonstrates that costs are broadly aligned with comparator schemes. The results of the benchmarking indicate that costs are generally efficient relative to comparator data sets The evidence provided demonstrates that 85% of network storage scheme costs have been benchmarked, rather than the full cost base, however we consider the evidence provided to be proportionate to the scale of the investment proposal. Taken together with the supporting methodology, historical delivery data and supplementary benchmarking evidence, this provides sufficient and convincing evidence that costs are broadly efficient. However, the company does not provide sufficient and convincing evidence to support the application of the 13% regional uplift. While the company references BCIS regional tender price studies and explains how the uplift has been calculated, it does not provide evidence demonstrating that comparable schemes delivered within the SES region are materially more expensive than equivalent schemes delivered elsewhere. The company also does not demonstrate that regional tender price differences result in equivalent increases in the costs of the specific interventions proposed.		

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	We do not consider the application of a regional price index alone to be sufficient justification for an uplift, and the company has not demonstrated that regional market differences are reflected in the actual delivery costs. In the absence of evidence to demonstrate this, we conclude that the company provides sufficient and convincing evidence to demonstrate that underlying costs are robust and efficient, however the company does not provide sufficient and convincing evidence to justify the application of the 13% regional uplift. On this basis, an 11.5% cost challenge is applied at draft determination.		
Customer protection	**Decision summary - Some gaps**. The company provides sufficient and convincing evidence to demonstrate that customers will be protected if the company under-delivers against the requested additional investment, however, does not provide any protection for the PR24 implicit allowance. We have therefore applied a PCD to the 'what base buys' estimate. **Company evidence** - The company proposes a Price Control Deliverable (PCD) that covers the proposed additional investment. The PCD is tied to the [redacted] Water Treatment Works site, proposing a new contact tank and water tank funded through the requested additional investment. A unit rate is provided, aligned to the cost of scheme delivery. The PCD is an end-of-period adjustment, with no time incentives proposed for early delivery. **Our assessment** - The company's proposed non-delivery PCD for the requested additional investment is in line with our expectations set out in the Asset Health guidance document and aligns to the approach set out in PR24 Final Determinations. If the company under-delivers in this area, the funding will be returned to customers. To ensure activities associated with base allowances are delivered, a Base PCD will be applied to the 'what base buys' estimate provided by	**Some gaps**	

Assessment criteria	Assessment	Decision	
		Criteria	Adjustment (applied and/ or conditional)
	the company in the 'Need for Investment' gate of the submission. Further detail on this PCD can be found in the Cost Change draft determinations 2026 – Price control deliverables appendix.		

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

© Crown copyright 2026

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to mailbox@ofwat.gov.uk.