

To interested parties

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## **Decision on Interest During Construction (IDC) rates to be applied during 2025-26 to offshore transmission (OFTO) projects and electricity interconnectors granted the cap and floor regime**

### **Introduction**

This letter sets out our decision on the IDC rates for OFTO projects and Window 3 cap and floor electricity interconnectors to apply to projects taking Final Investment Decision (FID) in 2025-26.

Based on this updated methodology and a reference date of 31 January 2025,<sup>1</sup> we have decided the following:

- OFTO projects – to set the IDC rate capped at **9.46%**<sup>2</sup> (pre-tax, nominal) for projects reaching FID in 2025-26 (9.48% in 2024-25).
- Window 3 interconnectors – to set the IDC rate at **5.15%**<sup>3</sup> (vanilla, real-CPIH)<sup>4</sup> for projects reaching FID in 2025-26 (5.38% in 2024-25).<sup>5</sup> The IDC rate for any outstanding Window 1 project will be set after the project's FID date in accordance with our policy.<sup>6</sup> For any outstanding Window 2 projects, the IDC rate will be

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<sup>1</sup> This is the relevant date to which the spot figures and averages used to estimate the parameter values underpinning the IDC rates refer to; for example, a spot yield is the yield on 31 January 2025 and a 1-year average yield is the average yield in the 12-month period finishing on 31 January 2025.

<sup>2</sup> The 9.46% IDC rate for offshore transmission projects is the mid-point of the 7.89%-11.04% nominal pre-tax WACC range; please refer to Annex 1 for a detailed breakdown of the values used to estimate this range.

<sup>3</sup> The 5.15% IDC rate for interconnectors is the mid-point of the 4.02%-6.29% real-CPIH vanilla WACC range (excluding debt transaction costs); please refer to Annex 2 for a detailed breakdown of the values used to estimate this range.

<sup>4</sup> The rate for interconnectors is reported in vanilla, real-CPIH terms because the Cap and Floor Financial Models (CFFMs) run with real inputs and include a separate tax allowance. For a like-for-like comparison of the IDC rates; please refer to Annex 1 and 2.

<sup>5</sup> IDC rates for interconnectors do not include a debt transaction cost allowance, as transactions costs are accounted for separately in the CFFMs. If a transaction cost allowance was included in the IDC rates (in line with offshore transmission projects), the IDC rate in 2025-26 would be 5.29% (from 5.52% in 2024-25).

<sup>6</sup> [Cap and Floor Regime Handbook 2024](https://www.ofgem.gov.uk/publications/cap-and-floor-regime-handbook-2024): <https://www.ofgem.gov.uk/publications/cap-and-floor-regime-handbook-2024>

determined once the project has reached FID. This will follow the methodology detailed in the 2023-2024 IDC decision letter.<sup>7</sup>

- For OFTO projects, the IDC rate must be justified according to the cost assessment guidance and not exceed the cap rate of 9.46%.<sup>8</sup>

In November 2023, we published a consultation (the November 2023 Consultation) on moving from the Retail Price Index (RPI) to the Consumer Prices Index including owner occupiers' housing costs (CPIH) as the inflation measure for calculating the IDC.<sup>9</sup> The CPIH is our proposed inflation index for the IDC rates for offshore transmission owner (OFTO) projects and Window 3 cap and floor electricity interconnectors. We continue to use Consumer Price Index (CPI) as proxy until CPIH-based forecasts become reliably available.

This decision applies to projects under the OFTO regime and Window 3 cap and floor electricity interconnectors and it will apply to OFTO projects and Window 3 cap and floor projects from 31 March 2025 onwards. Our proposed approach aligns with the wider Ofgem regulatory regimes, such as RIIO-2 Final Determinations published on 3 February 2021 where we decided to implement a change from RPI to CPIH from 1 April 2021 for RIIO-2.<sup>10</sup>

Annexes 1 and 2 set out the IDC parameters for 2025-26 for OFTO projects and Window 3 cap and floor electricity interconnectors. For comparison, we have provided the IDC rates for 2024-25 and the relative percentage point change in the parameters' value between 31 January 2024 and 31 January 2025.

Our parameters within the IDC methodology were last reviewed in our 2018 consultation<sup>11</sup> and we plan to review them to ensure they accurately reflect current market dynamics.

## **2025-26 IDC rates for OFTO projects and Window 3 cap and floor electricity interconnectors**

### **Our decision**

We have decided to set the IDC rates for 2025-26 as follows:

- OFTO projects – to set the IDC rate capped at **9.46%** (pre-tax, nominal) for those OFTO projects reaching FID during 2025-26.

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<sup>7</sup> [Decision on 2023-24 Interest During Construction \(IDC\) rates for offshore transmission projects and cap and floor interconnectors](https://www.ofgem.gov.uk/decision/decision-2023-24-interest-during-construction-idc-rates-offshore-transmission-projects-and-cap-and-floor-interconnectors): <https://www.ofgem.gov.uk/decision/decision-2023-24-interest-during-construction-idc-rates-offshore-transmission-projects-and-cap-and-floor-interconnectors>

<sup>8</sup> [Offshore Transmission: Guidance for Cost Assessment \(2022\)](https://www.ofgem.gov.uk/sites/default/files/2022-03/Offshore%20Transmission%20Guidance%20for%20Cost%20Assessment%202022.pdf): <https://www.ofgem.gov.uk/sites/default/files/2022-03/Offshore%20Transmission%20Guidance%20for%20Cost%20Assessment%202022.pdf>

<sup>9</sup> [Consultation on moving from RPI to CPIH as the inflation index for the Interest During Construction rate for projects under the Offshore Transmission Owner regime and Window 3 electricity interconnectors](https://www.ofgem.gov.uk/publications/consultation-moving-rpi-cpih-inflation-index-interest-during-construction-projects-under-offshore-transmission-owner-regime-and-window-3-electricity-interconnectors): <https://www.ofgem.gov.uk/publications/consultation-moving-rpi-cpih-inflation-index-interest-during-construction-projects-under-offshore-transmission-owner-regime-and-window-3-electricity-interconnectors>

<sup>10</sup> [RIIO-2 Final Determinations – Finance Annex \(REVISED\)](https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_finance_annex_revised_002.pdf): [https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final\\_determinations\\_-\\_finance\\_annex\\_revised\\_002.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_finance_annex_revised_002.pdf)

<sup>11</sup> [Review of the methodology for the calculation of the Interest During Construction for offshore transmission and future interconnectors granted the cap and floor regime | Ofgem](#)

- Window 3 interconnectors – to set the IDC rate at **5.15%** (vanilla, real-CPIH) for projects reaching FID during 2025-26.

Annex 1 and Annex 2 present the low and high parameter values for IDC rates' parameters for OFTO projects and Window 3 cap and floor electricity interconnectors, respectively. These values pertain to the years 2025-26 and 2024-25, highlighting the year-on-year percentage point changes. The values are based on specific reference dates.

For a detailed overview of our IDC methodology, please refer to Annex 3 of our decision letter. This annex outlines the calculation methods for IDC rates applicable to OFTO projects and Window 3 cap and floor electricity interconnectors. If you have any questions or require further information regarding this decision, please contact the Cap and Floor team at ([regfinance@ofgem.gov.uk](mailto:regfinance@ofgem.gov.uk)).

**Yours sincerely,**

**Azeez Siddiqui**  
**Head of Corporate Finance**

## **Annex 1: Value of input parameters of IDC rates for offshore transmission projects**

The table below sets out the values at the low and high end of the ranges that we have set for each parameter of the IDC rates for OFTO projects for year 2025-26 and 2024-25, as well as the relative percentage point change in the parameters' values year on year.

### **OFTO Projects**

<b>Parameter</b>	<b>IDC 2025- 26 Low</b>	<b>IDC 2025-26 High</b>	<b>IDC 2024- 25 Low</b>	<b>IDC 2024-25 High</b>	<b>Change (Year on Year) Low</b>	<b>Change (Year on Year) High</b>
Debt Yield	4.75%	5.20%	4.90%	5.55%	-0.15%	-0.35%
Transaction costs	0.25%	0.50%	0.25%	0.50%	0.00%	0.00%
Cost of debt	5.00%	5.70%	5.15%	6.05%	-0.15%	-0.35%
Risk-free rate	3.95%	4.30%	3.60%	4.00%	0.35%	0.30%
Total market return	8.80%	9.31%	8.59%	9.10%	0.21%	0.21%
Asset beta	0.45	0.85	0.45	0.80	0.00	0.05
Gearing	37.5%	37.5%	37.5%	37.5%	0.00%	0.00%
Equity beta	0.72	1.36	0.72	1.28	0.00	0.08
Cost of equity	7.21%	10.68%	7.19%	10.53%	0.02%	0.15%
Vanilla WACC	6.38%	8.81%	6.43%	8.85%	-0.05%	-0.04%
RPI	3.70%	3.70%	3.45%	3.45%	0.25%	0.25%
CPI	2.40%	2.40%	2.20%	2.20%	0.20%	0.20%
RPI-real WACC vanilla	2.59%	4.93%	2.88%	5.22%	-0.29%	-0.29%
CPI-real WACC vanilla	3.89%	6.26%	4.13%	6.50%	-0.24%	-0.24%
Tax rate	25.0%	25.0%	25.0%	25.0%	0.00%	0.00%
Pre-tax cost of equity	9.62%	14.24%	9.59%	14.03%	0.03%	0.21%
<b>Pre-tax WACC*</b>	7.89%	11.04%	7.92%	11.04%	-0.03%	0.00%
RPI-real pre-tax WACC	4.04%	7.08%	4.32%	7.34%	-0.28%	-0.26%
CPI-real pre-tax WACC	5.36%	8.44%	5.60%	8.65%	-0.24%	-0.21%

\*The IDC rate for OFTO projects presented on page 1 of this letter (9.46%) is the mid-point of the 7.89%-11.04% nominal pre-tax WACC range.

## **Annex 2: Value of input parameters of IDC rates for Window 3 cap and floor electricity interconnectors subject to the cap and floor regime**

The table below sets out the values at the low and high end of the ranges that we have set for each parameter of the IDC rates for Window 3 cap and floor electricity interconnectors subject to the cap and floor regime for year 2025-26 and 2024-25, as well as the relative percentage point change in the parameters' values year on year.

### **Interconnectors**

<b>Parameter</b>	<b>IDC 2025-26 Low</b>	<b>IDC 2025-26 High</b>	<b>IDC 2024-25 Low</b>	<b>IDC 2024-25 High</b>	<b>Change (Year on Year) Low</b>	<b>Change (Year on Year) High</b>
Debt Yield	4.75%	5.15%	4.75%	5.45%	0.00%	-0.30%
Transaction costs	n/a	n/a	n/a	n/a	n/a	n/a
Cost of debt	4.75%	5.15%	4.75%	5.45%	0.00%	-0.30%
Risk-free rate	3.95%	4.30%	3.60%	4.00%	0.35%	0.30%
Total market return	8.80%	9.31%	8.59%	9.10%	0.21%	0.21%
Asset beta	0.50	0.90	0.50	0.85	0.00	0.05
Gearing	37.5%	37.5%	37.5%	37.5%	0.00%	0.00%
Equity beta	0.80	1.44	0.80	1.36	0.00	0.08
Cost of equity	7.57%	11.06%	7.59%	10.93%	-0.02%	0.13%
Vanilla WACC	6.52%	8.84%	6.52%	8.88%	0.00%	-0.04%
RPI	3.70%	3.70%	3.45%	3.45%	0.25%	0.25%
CPI	2.40%	2.40%	2.20%	2.20%	0.20%	0.20%
RPI-real WACC vanilla*	2.72%	4.96%	2.97%	5.25%	-0.25%	-0.29%
<b>CPI-real WACC vanilla</b>	4.02%	6.29%	4.23%	6.53%	-0.21%	-0.24%
Tax rate	25.0%	25.0%	25.0%	25.0%	0.00%	0.00%
Pre-tax cost of equity	10.10%	14.74%	10.12%	14.58%	-0.02%	0.16%
Pre-tax WACC	8.09%	11.14%	8.11%	11.15%	-0.02%	-0.01%
RPI-real pre-tax WACC	4.24%	7.18%	4.50%	7.45%	-0.26%	-0.27%
CPI-real pre-tax WACC	5.56%	8.54%	5.78%	8.76%	-0.22%	-0.22%

\*The IDC rate for Window 3 cap and floor electricity interconnectors presented on page 1 of this letter (5.15%) is the mid-point of the 4.02%-6.29% real-CPIH vanilla WACC range (excluding debt transaction costs, as these are accounted for separately under the cap and floor regime; if transaction costs were included, the range would be 4.11%-6.47% and the mid-point 5.29%).

### ***Annex 3: Overview of our IDC methodology***

The methodology used to set the values of the parameters of the 2025-26 IDC rates has remained unchanged relative to the methodology used for the 2024-25 IDC rates.

Relative to 2024-25, the values of five of these parameters (debt yield, risk-free rate, equity beta, inflation and total market return) have changed, while the values of all other parameters (debt transaction costs and gearing) have remained the same.

The remainder of this section provides an overview of our approach to setting the value of each of the five parameters of the IDC rates:

#### Corporation tax

On 1 April 2023, the corporation tax increased from 19% to 25%.<sup>12</sup>

#### Cost of debt – Yield

The yield component of the cost of debt allowance is set based on the spot and 1-year average yields on three iBoxx GBP bond indices:

- A-rated Non-Financial Corporate (primary benchmark).
- BBB-rated Non-Financial Corporate (primary benchmark).
- Infrastructure (secondary benchmark used as a cross-check).

The tenor of the indices is selected to match the approximate average length of the construction period of the different assets:

- Offshore transmission: tenor of 1-3 years, reflecting average construction period of 2 years; and
- Interconnectors: tenor of 3-5 years, reflecting average construction period of 4 years.

We set the bottom end of the ranges as a weighted average of the spot and 1-year average yields on the A-rated Non-Financial Corporate index, with weights of two thirds and one third respectively.

Similarly, we set the top end of the ranges as a weighted average of the spot and 1-year average yields on the BBB-rated Non-Financial Corporate index, with weights of two thirds and one third respectively.

#### Inflation

To convert the ranges from nominal to real, we use the CPI inflation assumption, as a proxy for CPIH.

The CPI assumption is set based on the average of CPI forecasts from OBR, BoE, and HM Treasury's comparison of independent forecasters. Based on the updated analysis using a reference date of 31 January 2025, we have updated the CPI assumption for the 2025-26 IDC rates to 2.40%. This is an overall increase relative to the CPI of 2.20% we used for setting the 2024-25 IDC rates. Although the IDC rates for OFTO projects and Window 3 cap and floor electricity interconnectors are set, respectively, in nominal and CPIH-real terms, RPI-real ranges are also provided in Annex 1 and 2 to allow for comparison. The RPI inflation assumption was set based on the 1-year average 5-year breakeven inflation (which is the inflation assumption implied in the difference between nominal and real 5-year UK Gilt yields).

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<sup>12</sup> [Corporation Tax rates and allowances - GOV.UK](https://www.gov.uk/government/statistics/corporation-tax-rates-and-allowances)

### Cost of equity

#### Risk-free rate

The risk-free rate is set based on spot, 20-day average and 1-year average yields on the 5-year UK Gilt.

#### Asset Beta

The baseline asset beta range is derived using two sets of comparators:

- at the lower end, applying a small uplift from 0.42 to 0.45 to the asset beta estimates used for construction-intensive regulated networks, such as the Scottish transmission companies in the RIIO-T1 price controls;
- at the upper end, estimates of the asset beta pertaining to comparator firms in the construction and engineering sector<sup>13</sup>.

Based on the updated analysis using a reference date of 31 January 2025, we have updated the upper end of the baseline asset beta for 2025-26 IDC rates to 0.85. This is an increase relative to the upper end of the baseline asset beta of 0.80 we used for setting the 2024-25 IDC rates.

The lower end of the baseline asset beta remained unchanged relative to the methodology used for the 2024-25 IDC rates. Uplifts are then applied to the baseline range to reflect additional riskiness relative to the baseline scenario, for example due to additional exposure to the marine environment:

- Offshore transmission: no uplift at the low end, 0.05 uplift at the high end.
- Interconnector: 0.05 uplift at the low end and 0.10 uplift at the high end.

The asset betas are then re-gearred into equity betas using the notional gearing level.

#### Total Market Return (TMR)

The TMR range remains aligned with the range estimated for the RIIO-2 price controls for transmission and gas distribution networks, as confirmed at Final Determinations published on 3 February 2021.<sup>14</sup>

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<sup>13</sup> Our methodology for estimating the upper end of asset beta uses ten comparator firms in the construction and engineering sector that are publicly listed on the London Stock Exchange.

<sup>14</sup> In the Finance Annex to the Final Determinations, the TMR range (6.25% to 6.75%) is presented in real terms relative to CPIH inflation, with CPIH forecast to be equal to CPI. Applying the Fisher formula and the CPI inflation assumption used to set IDC rates (2.40%) to this range returns a nominal TMR range of 8.80% to 9.31%, as  $(1+6.25\%) * (1+2.40\%) - 1 = 8.80\%$  and  $(1+6.75\%) * (1+2.40\%) - 1 = 9.31\%$ .