

Update to the Cost of Debt for 2018/19

The Bank of England has resumed publication of IUDMRZC, leading Ofgem to revise the Cost of Debt figures for 2018/19

From	Andrew Ryan
To	Network Licensees & other interested parties
Cc	
Date	30 April 2018

- 1.1. Ofgem relies upon interest rate data published by the Bank of England (BoE) to derive the Cost of Debt (CoD), which helps to determine the revenue of network companies. In May 2017, the BoE suspended the publication of a key data series, and Ofgem, when calculating the 2018/19 CoD, based it on the limited data then available. The BoE has recently resumed publication, and the latest BoE data implies a lower CoD for 2018/19 to that previously applied by Ofgem. In November 2018, Ofgem will determine the 2019/20 revenue for networks, and we expect that in aggregate the revenue of all of the networks to be around £50m lower as a result of the update to the 2018/19 Cost of Debt.
- 1.2. The IUDMRZC series, published by The Bank of England (BoE), is the 10 Years Real Zero Coupon Yield from British Government Securities. In accordance with para 5.9 of the Financial Handbook, Ofgem uses IUDMRZC to derive the market view of inflation, which in turn is applied to derive the real cost of investment-grade debt used in the Price Control Financial Model (PCFM).
- 1.3. However, in May 2017 the BoE suspended the publication of IUDMRZC. In November 2017, Ofgem explained that, in compliance with para 5.10 of the Financial Handbook, as an interim solution, it was to continue using the IUDMRZC series until the latest available data for the Annual Iteration Process (AIP) 2017.¹ The CoD figure for 2018/19 was based upon data to 4 May 2017, rather than 30 October 2017 as would normally be the case.
- 1.4. In March 2018, the BoE resumed publication of IUDMRZC and provided a complete set of historical back data. As per the Financial Handbook, Ofgem intends to update the 2018/19 CoD figures to reflect the most up to date data available (i.e. to use data to 30 October 2017). The latest estimates of the 2018/19 CoD figures can be found in Table 1 below.
- 1.5. The first use of the updated CoD figure for 2018/19 will be in the next AIP, i.e. in November 2018, when Ofgem determines the 2019/20 revenue for the network companies. The 2019/20 network revenues will reflect the updated estimate of the 2018/19 CoD, and is currently expected to be around £50m lower than it would otherwise be, as a result of the updating of the BoE data.

¹

https://www.ofgem.gov.uk/system/files/docs/2017/11/amendments_to_cost_of_debt_indexation_model_memo_0.pdf

Table 1: Real cost of debt for 2018/19, percent

	Current estimate	As used in AIP 2017
GD/GT/ET (excluding SHETL)	1.91	2.03
SHETL	1.16	1.22
ED Fast Track	1.91	2.03
ED Slow Track	2.09	2.19