SPT Additional Cost of Borrowing for the RIIO-3 Price Control

25 November 2024

For our earlier Feb 2024 ENA industry study, we estimated additional cost of borrowing of 57bps p.a. for RIIO-3, with a range of 54 to 59 bps, compared to Ofgem's RIIO-2 allowance of 25 bps. We estimated an infrequent issuer premia of 14 bps p.a. Compared to Ofgem at RIIO-2, our estimate higher: i) RCF cost, in part because of higher SONIA; ii) CPIH premium, as we include CPI-CPIH basis risk; and iii) NIP – which Ofgem did not recognise at RIIO-2

Units: bps p.a.	Ofgem RIIO GD/T2 & ED2	NERA ENA Study (Feb 2024)	Comment
Transaction Costs	6	6	• Based on updated companies' data
Liquidity/RCF Costs	4	13	• Both Ofgem and NERA draw on companies' assumptions on RCF size and cost, but we assume 15% of RCF drawn to fund working capital/ operational needs incurring a margin cost • Increased liquidity cost also reflects higher SONIA at RIIO-3
Cost of Carry	10	12	• Two approaches: i) companies' cash and debt in latest RFPRs (12 bps), consistent with Ofgem's approach at RIIO-2, and ii) assume 12–24-month pre-financing, half met by RCF (range 8-16 bps)
CPIH Premium	5	18-23 (21)	• Ofgem recognised CPI switching costs of 5 bps p.a. (30 bps for new CPI debt, and 15bps for switching RPI-CPI, weighted by ILD%) • We estimate 30-50 bps p.a. for new CPI issuance using latest nominal-CPI swap costs, and 15 bps p.a. for manging RPI-CPI basis risk. Ofgem does not recognise CPI-CPIH basis risk cost, which we estimate to be 40-50 bps p.a. based on 1 st. dev. • We estimate the total cost for CPIH basis risk mitigation to be 18-23 bps p.a., by weighting the above estimate with 30% ILD, and new/embedded debt respectively
New Issue Premium (NIP)	0	5	• Latest market evidence supports a 15bps NIP, consistent with CAA for HAL. Multiplying 15bps with 35% assumed new debt% results in ca 5 bps p.a. of NIP
Additional Cost of Borrowing	25	54-59 (57)	
Infrequent Issuer Premia	6	10-18 (14)	• Lower bound based on the CMS-implied premium, since CMS does not provide risk hedging for credit risk (Ofgem approach) • Upper bound based on illiquidity premium estimated using the bid-ask spread differential between sub-benchmark issues and issues at and above £250m
Total	31	64-77 (71)	

For SPT, we estimate an additional cost of borrowing of 60bps p.a. We rely on industry evidence from our Feb 2024 ENA study for t-cost, liquidity cost and cost-of-carry, but we adjust NIP estimate for SPT expected debt issuance over RIIO-3. We find that SPT no longer qualifies for infrequent issuer premium in RIIO-3 based on its business plan submission

Units: bps p.a.	NERA ENA Study (Feb 2024)	NERA estimate for SPT (Nov 2024)	Comment
Transaction Costs	6	6	• Based on industry data, as per ENA Study (Feb 2024)
Liquidity/RCF Costs	13	13	• SPT estimate as per ENA study: based on companies' assumptions on RCF size and cost, and we assume 15% of RCF drawn to fund working capital/ operational needs. Updated to reflect latest SONIA rate relative to Feb 24, but no change to estimate.
Cost of Carry	12	11	• SPT estimates as per ENA study: based on i) industry median realised/forecast RIIO-2 cash requirement of around 5% cash/debt ratio, and the latest 5-year average spread of iBoxx Utilities 10yr+ index and SONIA of ca 2%, and ii) assume 12–24-month pre-financing, half met by RCF (range 7-15 bps, with an average of 11bps). Slight change reflects use of updated SONIA
CPIH Premium	18-23 (21)	18-23 (21)	• SPT estimate as per ENA study. We estimate 30-50 bps p.a. for new CPI issuance using latest nominal-CPI swap costs, and 15 bps p.a. for manging RPI-CPI basis risk. Ofgem does not recognise CPI-CPIH basis risk cost, which we estimate to be 40-50 bps p.a. based on 1 st. dev. We estimate the total cost for CPIH basis risk mitigation to be 18-23 bps p.a., by weighting the above estimate with 30% ILD, and new/embedded debt respectively.
New Issue Premium (NIP)	5	8.5	• In our ENA study we estimate a 15bps NIP, consistent with CAA for HAL. Multiplying 15bps with 35% assumed new debt% results in ca 5 bps p.a. of NIP. For SPT, we use the same 15bps NIP estimate from the ENA Study, but adjusted for SPT expected debt issuance over RIIO-3. We multiply 15bps with SPT's ca. 60% new debt% in RIIO-3, which results in c.8.5 bps p.a. of NIP.
Additional Cost of Borrowing	54-59 (57)	57-62 (60)	
Infrequent Issuer Premia	10-18 (14)	-	• We find that SPT does not qualify for infrequent issuer in RIIO-3 based on both actual debt issuance p.a., and Ofgem's notional approach, i.e. SPT's expected nominal RAV is c.£11 billion on average over RIIO-3, higher than RAV implied by the minimum new debt issuance of £250m, i.e. £250m*14/55%=£6.4 billion, assuming that 1/14th of debt RAV is refinanced each year, and that annual RAV growth is funded 55% by debt.
Total	64-77 (71)	57-62 (60)	

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