

COMMERCIAL IN CONFIDENCE



Tideway updated revised Revenue Statement 2015

Allowed Revenue for Charging Years 2015/16 and 2016/17

COMMERCIAL IN CONFIDENCE

Updated revised Revenue Statement - 2016/17

Submitted to Ofwat on 17 December 2015

| <i>£, nominal</i> | Year preceding Prior Charging Year 2013/14 | Prior Charging Year 2014/15 | Current Charging Year 2015/16 | Forthcoming Charging Year 2016/17 |
|----------------------------|---|-----------------------------------|-------------------------------------|---|
| Allowed Revenue | | 0 | 0 | 33,603,285 |
| Amounts received from TWUL | 0 | 0 | | |

RPI Updated IP Charge Notification - 2016/17

Submitted to Thames Water on 17 December 2015

IP Charge for 2016/17 (£)

33,603,285 £

November RPI

259.8

Source: RPI (All Items) index, Consumer Price Inflation Reference Tables, Table 36, November 2015, Office for National Statistics.

Inputs 2015

| | Unit | Source/notes | 2012/13 | 2013/14 | 2014/15 | First Charging Year 2015/16 | Second charging year 2016/17 | Third Charging Year 2017/18 | Fourth Charging Year 2018/19 | Fifth Charging Year 2019/20 |
|--|---|--|---------|---------|---------|--------------------------------|---------------------------------|--------------------------------|---------------------------------|--------------------------------|
| Year starts | | | | | | 01/04/2015 | 01/04/2016 | 01/04/2017 | 01/04/2018 | 01/04/2019 |
| Year ends | | | | | | 31/03/2016 | 31/03/2017 | 31/03/2018 | 31/03/2019 | 31/03/2020 |
| Year t-2 | | | | | | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 |
| Year t-1 | | | | | | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
| Year t | | | | | | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 |
| Year t+1 | | | | | | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
| Year t+2 | | | | | | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
| 1.1 2014/15 RPI Adjustment Factor | | | | | | | | | | |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year commences | % | Source: Average independent new forecasts for RPI Table M3, "Forecasts for the UK economy: a comparison of independent forecasts", HM Treasury, August 2015 Required by Project Licence Appendix 1, 1.1 (i), (ii), (iii) | | | | 1.0% | 2.2% | 3.1% | 3.2% | 3.4% |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year ends | % | Source: Average independent new forecasts for RPI Table M3, "Forecasts for the UK economy: a comparison of independent forecasts", HM Treasury, August 2015 Required by Project Licence Appendix 1, 1.1 (i), (ii), (iii) | | | | 2.2% | 3.1% | 3.2% | 3.4% | N/A |
| RPI, September of Charging Year | | Source: RPI (All Items) index, Consumer Price Inflation Reference Tables, Table 36, September 2015, Office for National Statistics Required by Project Licence Appendix 1, 1.1 (ii) | | | 257.6 | 259.6 | | | | |
| RPI, March of Charging Year | | Source: RPI (All Items) index, Consumer Price Inflation Reference Tables, Table 36, September 2015, Office for National Statistics Required by Project Licence Appendix 1, 1.1 (ii) | | 254.8 | 257.1 | | | | | |
| Applicable Change in Revenue RPI | | | | | | | | | | |
| RPI (RPI for November in Charging Year Yt-1) | | Source: RPI (All Items) index, Consumer Price Inflation Reference Tables, Table 36, November 2015, Office for National Statistics. Required by Project Licence Appendix 1, Part A 3, 4 and 6 Note: for both First and Second Charging years, stated RPI is for November 2015, as Allowed Revenue for both these years is being calculated together | | 245.6 | 252.1 | 259.8 | 259.8 | | | |
| Year average RPI | | Source: RPI (All Items) index, Consumer Price Inflation Reference Tables, Table 36, July 2015, Office for National Statistics Required by Project Licence Appendix 1, Part A 3, 4 and 6 and Appendix 1, 1.1 (iv) | | | 256.7 | | | | | |
| A.3. Return on Capital and A.4 Liquidity | | | | | | | | | | |
| Water Services Regulation Authority Stated RCV (2014/15 Prices) at 31 March | 2014/15 prices, £ | Source: Ofwat published figure, zero prior to licence award Required by Project Licence Appendix 1, Part A 3 | | 0 | 0 | | | | | |
| Allowable Project Spend (actual and forecast) - as at October 2015 | | | | | | | | | | |
| Annual Actual Project Spend | Outturn prices, £ | Zero for 2015 Revenue Statement as no Allowable Project Spend has been verified by the ITA since Licence award | | | 0 | 0 | | | | |
| Estimated Allowable Project Spend | Outturn prices, £ | Source: internal accounting records for Estimated Allowable Project Spend to last day of September accounting period, provided by Head of Financial Control Required by Project Licence Appendix 1, Part A 3 | | | 0 | 50,235,541 | | | | |
| Forecast Allowable Project Spend | Outturn prices, £ | Source: Rev08 cost information, indexed to outturn prices as described in "Statement of calculation 2015" and adjusted to take account of Estimated Allowable Project Spend from licence award to the last day of the September accounting period Required by Project Licence Appendix 1, Part A 3, 4 | | | 0 | 191,883,745 | 406,672,380 | 558,277,949 | | |
| Excluded Project Spend | Outturn prices, £ | Source: internal accounting records, provided by Head of Financial Control Note: For information (not required for Allowed Revenue calculation), backward-looking only. | | | | 52,931,877 | | | | |
| Alliance Agreement receipts - expenditure funded by these receipts is treated as Excluded Project Spend and therefore is excluded from the Allowable spend metrics set out above | Outturn prices, £ | Source: Head of Financial Control Notes: Zero prior to Licence award. Required by Project Licence Appendix 2, 1.5 | | | 0 | 0 | 0 | | | |
| BWACC | % | Source: Project Licence, Appendix 1, 1.18 Required by Project Licence Appendix 1, Part A 3, 4, 6, 7, 8 | | | | 2.487% | | | | |
| A.5. Opex | | | | | | | | | | |
| Opex forecast as at October 2015 | Outturn prices, £ | Note: In line with the Project Licence, zero as all expenditure treated as capex. Required by Project Licence Appendix 1, Part A 5 | | | | 0 | 0 | | | |
| A.6. Financing Cost Adjustment | | | | | | | | | | |
| Financing Cost Adjustment Index Yield - 12 months trailing average at 31 March | % | Source: Indices for RBP v1.xlsx Calculated with reference to iBoxx BBB data from Bloomberg and spot implied inflation rates for 10 year maturity from Bank of England Required by Project Licence Appendix 1, Part A 6 | | | | 1.30% | | | | |
| Water Services Regulation Authority Adjusted RCV (Current Prices) at 31 March | Current prices at 31 March of Charging Year | Source: Ofwat published figure, zero prior to Licence award Required by Project Licence Appendix 1, Part A 6 | 0 | 0 | 0 | | | | | |
| Net Debt at 31 March | Current prices at 31 March of Charging Year | Source: IP regulatory accounts, zero prior to Licence award Required by Project Licence Appendix 1, Part A 6 | 0 | 0 | 0 | | | | | |
| Notional Debt to RCV ratio | % | Source: Project Licence Appendix 1, 1.42 Required by Project Licence Appendix 1, Part A 6 | | | | 62.50% | | | | |
| A 1.4. Tax | | | | | | | | | | |
| Tax as at October 2015 | Outturn prices, £ | In line with the Project Licence, zero as the IP is not required to pay corporation tax or any other income-based tax See Project Licence Appendix 1, Part A 1.4 | | | | 0 | 0 | | | |
| A.7. Under/Over Recovered Revenue Adjustment - as at October 2015 | | | | | | | | | | |
| Allowed Revenue | £ | See Project Licence, Appendix 1, Part A 7 | | | | | | | | |
| Amount recovered in respect of IP Charge as at end of [Charging Year T-3] | £ | Not applicable for 2015 and 2016 Revenue Statements as adjustment applies in respect of Charging Year T-2, and 2015 is the first year the Allowed Revenue calculation has been made. In future years, source will be previous Revenue Statements | | | | | | | | |
| Amount recovered in respect of IP Charge April - September accounting periods [Charging Year T-2] | £ | Not applicable for 2015 and 2016 Revenue Statements as adjustment applies in respect of Charging Year T-2, and 2015 is the first year the Allowed Revenue calculation has been made. In future years, source will be IP regulatory accounts | | | | | | | | |
| Amount recovered in respect of IP Charge as at end of [Charging Year T-2] | £ | Not applicable for 2015 and 2016 Revenue Statements as adjustment applies in respect of Charging Year T-2, and 2015 is the first year the Allowed Revenue calculation has been made. In future years, source will be IP regulatory accounts | | | | | | | | |
| Amount recovered in respect of IP Charge April - September accounting periods [Charging Year T-1] | £ | Not applicable for 2015 and 2016 Revenue Statements as adjustment applies in respect of Charging Year T-2, and 2015 is the first year the Allowed Revenue calculation has been made. In future years, source will be IP internal accounting records | | | | | | | | |
| A.8. Reconciliation adjustment | | | | | | | | | | |
| Time since first calculation | Years | See Project Licence, Appendix 1, Part A 8 | | | | | | | | |
| Reconcile this year? | | Not applicable for 2015 Revenue Statement as reconciliation adjustment applies in respect of Charging Year T-1 and 2015 is the first year the Allowed Revenue calculation has been made. This input will represent the number of years since revenue was first calculated to feed into the NPV adjustment of the reconciliation adjustment Not applicable for 2015 Revenue Statement as reconciliation adjustment applies in respect of Charging Year T-1 and 2015 is the first year the Allowed Revenue calculation has been made. In future, this input will be defined as follows: 1 = yes, 0 = no | | | | | | | | |
| A.11. Additional Return on Capital Building Block | | | | | | | | | | |
| Additional Allowable Project Spend | | Not applicable at present. Inputs to be added if this building block becomes relevant (i.e. if Tideway makes an IAR Overrun Application to increase Allowable Project Spend above the Threshold Outturn). See Project Licence, Appendix 1, Part A 11 | | | | | | | | |
| A 1.6.4. Net Present Value Adjustment | | | | | | | | | | |
| End of first charging year | | Last day of the First Charging Year | | | | 31/03/2016 | | | | |
| Licence Award | | Date of Licence award | | | | 24/08/2015 | | | | |

Calculation 2015

Building Block

| Building Block | Unit | Notes/description | 2013/14 | 2014/15 | First Charging Year | Second Charging Year |
|---|--|---|---------|---------|---------------------|----------------------|
| Year starts | | | | | 2015/16 | 2016/17 |
| Year ends | | | | | 01/04/2015 | 01/04/2016 |
| Year t-2 | | | | | 31/03/2016 | 31/03/2017 |
| Year t-1 | | | | | 2013/14 | 2014/15 |
| Year t | | | | | 2014/15 | 2015/16 |
| Year t+1 | | | | | 2015/16 | 2016/17 |
| Year t+2 | | | | | 2016/17 | 2017/18 |
| | | | | | 2017/18 | 2018/19 |
| 1.1 2014/15 RPI Adjustment Factor | | A factor calculated for each Charging Year to express costs associated with that year in a 2014/15 price base. See Project Licence, Appendix 1, 1.1 | | | | |
| (a) for the purposes of calculating Forecast Allowable Project Spend for Charging Year Yt+1, estimated Allowable Project Spend for the said Charging Year shall be deflated from a price base in Charging Year Yt+1 to the Base RPI Index year (2014/15), using an adjustment factor derived from multiplying the factors set out in (i), (ii), (iii) and (iv) below; | | | | | | |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year Yt+1 commences | % | Forecast RPI - see input sheet for description of source | | | 3.1% | 3.2% |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year Yt+1 ends | % | Forecast RPI - see input sheet for description of source | | | 2.2% | 3.1% |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year Yt commences | % | Forecast RPI - see input sheet for description of source | | | | |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year Yt ends | % | Forecast RPI - see input sheet for description of source | | | | |
| Percentage movement in the RPI (All Items) index as published by Office for National Statistics for the period April to September in the calendar year in which Charging Year Yt-1 commenced | % | Calculated with reference to the index values for March and September to capture April to September inflation (see detailed modelling assumptions sheet) | | | 1.0% | |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year Yt-1 commenced | % | Forecast RPI - see input sheet for description of source | | | 1.0% | |
| Forecast RPI Adjustment Factor for the calendar year in which Charging Year Yt-1 ends | % | Forecast RPI - see input sheet for description of source | | | 2.2% | |
| Base RPI | | | | | 256.7 | 256.7 |
| Charging Year Yt-2, or where this is on or before Base RPI Index year, 2014/15 | | Year average RPI for 2014/15, used as base year RPI | | | | |
| | | Year average RPI for Charging year T-2 (or 2014/15 where this is later) | | | | |
| 1.1 (i) | | Factor used to adjust prices from Charging Year T+1 to Charging Year T | | | 1.03 | |
| 1.1 (ii) | | Factor used to adjust prices from Charging Year T to Charging Year T-1 | | | 1.02 | |
| 1.1 (iii) | | Factor used to adjust prices from Charging Year T-1 to Charging Year T-2 | | | 1.02 | |
| 1.1 (iv) | | Factor used to adjust prices from Charging Year T-2 to Charging Year T-3 | | | 1.00 | |
| RPI Adjustment Factor Charging Year T+1 | | Combines factors (i), (ii) and (iv) above to calculate factor used to adjust prices from Charging Year T+1 to 2014/15 price base. For First Charging Year, use calculations from Second Charging Year in relation to Charging Year T | | | 1.04 | 1.07 |
| RPI Adjustment Factor Charging Year T | | Combines factors (i), (ii) and (iv) above to calculate factor used to adjust prices from Charging Year T to 2014/15 price base. For First Charging Year, use calculations from Second Charging Year in relation to Charging Year T-1 | | | 1.02 | 1.04 |
| RPI Adjustment Factor Charging Year T-1 | | Combines factors (ii) and (iv) above to calculate factor used to adjust prices from Charging Year T-1 to 2014/15 price base. For First Charging Year, use calculations from Second Charging Year in relation to Charging Year T-2 | | | 1.00 | 1.02 |
| RPI Adjustment Factor Charging Year T-2 | | Equal to factor (iv) above - used to adjust prices from Charging Year T-2 to 2014/15 price base. Set equal to 1 for Second Charging Year as Year T-2 is equal to base year | | | | 1.00 |
| Applicable Change in Revenue RPI | | RPI in November of previous Charging Year relative to 2014/15 base year | 0.96 | 0.98 | 1.01 | 1.01 |
| RPI | | RPI in November of Charging Year T-1 | 245.6 | 252.1 | 259.8 | 259.8 |
| RPIbase (Base RPI Index) | | Average RPI for 2014/15 | 256.7 | 256.7 | 256.7 | 256.7 |
| A.1. Allowed Revenue | £ | Total Allowed Revenue calculated as the total of the building blocks below, in accordance with Project Licence, Appendix 1, 1.4. See Statement of calculation 2015 for further detail. Second Charging Year Allowed Revenue incorporates Allowed Revenue for First Charging Year. | | | 10,945,662 | 33,603,285 |
| A.3. Return on Capital | £ | The Return on Capital building block allows the IP to earn a return on capital in relation to the forecast average RCV in the Charging Year in question. See Project Licence, Appendix 1, Part A 3 | | | 3,007,717 | 10,945,662 |
| Ofwat Stated RCV for Yt-2 | £, 2014/15 prices | RCV at the end of Charging Year T-2 as published by Ofwat by 1 September following the end of the Charging Year | | | - | - |
| OPRCV Yt-1 | £, 2014/15 prices | Opening RCV for Charging Year T-1. Zero for both the First and Second Charging Years | | | - | - |
| 2014/15 RPI Adjustment Factor Yt-1 | | Scalar to adjust forecast costs for Charging Year T-1 to 2014/15 price base | | | 1.00 | 1.02 |
| Annual Actual Project Spend Yt-1 | £, 2014/15 prices | Allowable Project Spend (verified by the ITA) incurred in Charging Year T-1 | | | - | 49,360,680 |
| Estimated Allowable Project Spend Yt-1 | £, 2014/15 prices | Allowable Project Spend (not verified by the ITA) incurred in Charging Year T-1 | | | 0 | 188,640,314 |
| OPRCV Yt | £, 2014/15 prices | Opening RCV for Charging Year T - the sum of opening RCV for Charging year T-1 and all Allowable Project Spend in that year | | | 0 | 238,000,994 |
| 2014/15 RPI Adjustment Factor Yt | | Scalar to adjust forecast costs for Charging Year T to 2014/15 price base | | | 1.02 | 1.04 |
| Annual Actual Project Spend Yt | £, 2014/15 prices | Allowable Project Spend (verified by the ITA) incurred in Charging Year T | | | 0 | 0 |
| Estimated Allowable Project Spend Yt | £, 2014/15 prices | Allowable Project Spend (not verified by the ITA) incurred in Charging Year T | | | 49,360,680 | 0 |
| Forecast Allowable Project Spend Yt | £, 2014/15 prices | Allowable Project Spend forecast to be incurred in Charging Year T | | | 188,640,314 | 390,129,468 |
| CPRCV Yt | £, 2014/15 prices | Closing RCV for Charging Year T - the sum of opening RCV for Charging Year T and all Allowable Project Spend in that year | | | 238,000,994 | 628,130,462 |
| YARCV Yt | £, 2014/15 prices | Year average RCV for Charging Year T | | | 119,000,497 | 433,065,728 |
| A.4. Liquidity | £ | The Liquidity building block allows the IP a liquidity allowance (return on capital) in relation to the incremental average RCV in the year following the Charging Year in question. See Project Licence, Appendix 1, Part A 4 | | | 7,937,945 | 11,493,325 |
| OPRCV Yt+1 | £, 2014/15 prices | Opening RCV for Charging Year T+1 | | | 238,000,994 | 628,130,462 |
| 2014/15 RPI Adjustment Factor Yt+1 | | Scalar to adjust forecast costs for Charging Year T+1 to 2014/15 price base | | | 1.04 | 1.07 |
| Forecast Allowable Project Spend for year t+1 | £, 2014/15 prices | Allowable Project Spend forecast to be incurred in Charging Year T+1 | | | 390,129,468 | 519,338,586 |
| CPRCV Yt+1 | £, 2014/15 prices | Closing RCV for Charging Year T+1 | | | 628,130,462 | 1,147,469,048 |
| FYARCV Yt+1 | £, 2014/15 prices | Average RCV for Charging Year T+1 | | | 433,065,728 | 887,799,755 |
| A.5. Opex | | In line with the Project Licence, the Opex building block is zero as all costs are accounted for as capital expenditure. See Project Licence, Appendix 1, Part A 5 | | | 0 | 0 |
| A.6. Financing Cost Adjustment building block | | The Financing Cost Adjustment building block is intended to protect against movements in the market cost of debt, by comparing a measure of financing costs at an annual reference point to a base reference point of March 2015. See Project Licence, Appendix 1, Part A 6 | | | 0 | 0 |
| Financing Cost Adjustment Yt | | | | | 0 | 0 |
| Financing Cost Adjustment Index Yield | % | See Project Licence Appendix 1, Part A 6.3 | | | 1.30% | |
| Base Reference Point (BRP) | % | The historic 12 months' trailing average of the Financing Cost Adjustment Index Yield as at 31 March 2015 | | | 1.30% | 1.30% |
| Annual Reference Point (ARP) | % | The historic 12 months' trailing average of the Financing Cost Adjustment Index Yield as at 31 March of Charging Year Yt-2 | | | 1.30% | 1.30% |
| BRP-ARP | % | Difference between BRP and ARP | | | 0.0% | 0.0% |
| Market Cost of Debt Adjustment Factor | % | See Project Licence Appendix 1 Part A 6.7 | | | 0.0% | 0.0% |
| Net Debt in Charging Year Yt-2 | £, current prices (March of Charging Year T-2) | Net Debt at the end of Charging Year T-2 as defined in Project Licence Appendix 1, 1.41 | | | 0 | 0 |
| Water Services Regulation Authority Adjusted RCV (Current Prices) in Charging Year Yt-2 | £, current prices (March of Charging Year T-2) | RCV at the end of Charging Year T-2 in then current prices | | | 0 | 0 |
| Notional Debt to RCV Ratio | % | As defined in Project Licence Appendix 1, 1.42 | | | 62.5% | 62.5% |
| Notional Net Debt in Charging Year Yt-2 | £, current prices (March of Charging Year T-2) | RCV multiplied by Notional Debt to RCV ratio. See Project Licence Appendix 1 Part A 6.9 | | | 0 | 0 |
| Net Debt in Charging Year Yt-3 | £, current prices (March of Charging Year T-3) | Net Debt at the end of Charging Year T-3 as defined in Project Licence Appendix 1, 1.41 | | | 0 | 0 |
| Water Services Regulation Authority Adjusted RCV (Current Prices) in Charging Year Yt-3 | £, current prices (March of Charging Year T-3) | RCV at the end of Charging Year T-3 in then current prices | | | 0 | 0 |
| Notional Debt to RCV Ratio | % | As defined in Project Licence Appendix 1, 1.42 | | | 62.5% | 62.5% |
| Notional Net Debt in Charging Year Yt-3 | £, current prices (March of Charging Year T-3) | RCV multiplied by Notional Debt to RCV ratio. See Project Licence Appendix 1 Part A 6.9 | | | 0 | 0 |
| Applicable Change in Revenue RPI for Charging Year Yt | | | | | 1.01 | 1.07 |
| Applicable Change in Revenue RPI for Charging Year Yt-2 | | | | | 0.96 | 0.98 |
| A.1.4. Tax | £ | In line with the Project Licence, zero as the IP is not required to pay corporation tax or any other income-based tax. See Project Licence Appendix 1, Part A 1.4 | | | 0 | 0 |
| A.7. Under/Over Recovered Revenue Adjustment | £ | The revenue adjustment building block is to reconcile for under/over recovered Allowed Revenue in previous Charging Years. Not applicable for 2015 and 2016 Revenue Statements as adjustment applies in respect of Charging Year T-2, and 2015 is the first year the Allowed Revenue calculation has been made. See Project Licence, Appendix 1, Part A.7 | | | 0 | 0 |
| A.8. Reconciliation adjustment | £ | Not applicable for 2015 Revenue Statement as reconciliation adjustment applies in respect of Charging Year T-1 and 2015 is the first year the Allowed Revenue calculation has been made. See Project Licence, Appendix 1, Part A 8 | | | 0 | 0 |
| A.11. Additional Return on Capital Building Block | £ | Not applicable. To be added to calculation if building block becomes relevant (i.e. if Tideway makes an IAR Overrun Application to increase Allowable Project Spend above the Threshold Outturn). See Project Licence, Appendix 1, Part A 11 | | | | |
| A.11. Additional Liquidity Building Block | £ | Not applicable. To be added to calculation if building block becomes relevant (i.e. if Tideway makes an IAR Overrun Application to increase Allowable Project Spend above the Threshold Outturn). See Project Licence, Appendix 1, Part A 11 | | | | |
| A.1.6.4. Net Present Value Adjustment | £ | Value adjustment using the BWACC to take account of the fact that Allowed Revenue for the First Charging Year (2015/16) is being calculated and billed one year late. | | | | 11,164,299 |
| PD | | Calculation of the proportion of a year between Licence award and the end of the First Charging Year | | | | 0.60 |
| End of first charging year Licence Award | | | | | | 31/03/2016 |
| | | | | | | 24/08/2015 |

Statement of calculation

Introduction

The following section sets out how Tideway's Allowed Revenue calculation for the charging years 2015/16 and 2016/17 has been made.

A number of detailed modelling assumptions have been made in interpreting Appendix 1 of the Project Licence.

The Licence has been written to provide the basis of a revenue submission in a typical year. The 2015 submission is atypical as it covers two years. As such, a number of assumptions were required to ensure the calculation was in line with the spirit and intent of the Licence. These have been agreed with Ofwat prior to submission (email received from Andy Chesworth dated 09/10/15)

| Sheet | Issue | Suggested resolution |
|-------------------|--|---|
| Revenue Statement | How to present First and Second Charging Year Allowed Revenue on the Revenue Statement. | Both First and Second Year Allowed Revenue are added and shown as a single figure for the "Forthcoming Charging Year" on the Revenue Statement. Both years of Allowed Revenue will be billed by Thames Water in 2016/17, and will need to be treated as a single year of Allowed Revenue for the purposes of revenue reconciliation in 2018/19 and overpayment provisions in licence and Revenue Agreement. |
| Inputs 2015 | Applying the definition of Applicable Change in Revenue RPI for the First Charging Year seems to suggest referring to November 2014 RPI. However, this revenue will not be billed until 2016/17. | Consistent with the financial model used as part of the IP procurement process, apply November 2015 RPI for the Applicable Change in Revenue RPI for the First Charging Year. |
| Inputs 2015 | The 2014/15 RPI Adjustment Factor refers to "the percentage movement in the RPI (All Items) index as published by ONS for the period April to September in the calendar year..." However, if the index values for April and September are taken, this only picks up 5 months of inflation. Together with the other elements of the formula, this results in an underestimate of inflation for the Charging Year. | Interpret the movement for the period April to September as the movement between the March and September index values, which ensures April inflation is also picked up. |
| Calculation 2015 | The definition of the 2014/15 RPI Adjustment Factor does not take account of the fact that the Allowed Revenue for the First Charging Year is being calculated within the year rather than in advance. This results in the latest data not being taken into account and would generate an inconsistency with the 2014/15 RPI Adjustment Factor calculated for the Second Charging Year. | Use the 2014/15 RPI Adjustment Factor as calculated for the Second Charging Year for the First Charging Year as well for consistency and accuracy - this means that the latest actual RPI data will be taken into account. |
| Calculation 2015 | The Return on Capital building block (A 3) states that return on capital for the First Charging Year should be calculated based on forecast allowable project spend. However, this will exclude actual costs incurred since licence award. | Apply same approach as for Second and later Charging Years, using Annual Actual Project Spend and Estimated Allowable Project Spend up to the end of the September accounting period, and Forecast Allowable Project Spend after this. |
| Calculation 2015 | The Annual Reference Point for the Financing Cost Adjustment for the First Charging Year would be prior to the Base Reference Point if interpreted literally. | Assume Annual Reference Point for First Charging Year = Base Reference Point = 31 March 2015 |
| Calculation 2015 | Additional Return on Capital and Additional Liquidity Building Blocks may never become relevant. | Exclude calculations for Additional Return on Capital and Additional Liquidity until there is a non-negligible probability that these will be required. |
| Calculation 2015 | Reconciliation Adjustment (A 8) states that Financing Cost Adjustment should be subject to reconciliation, but none of the elements of this calculation are forecast. | Leave a placeholder for reconciliation of the Financing Cost Adjustment should this, for any reason, become relevant in future, but exclude from calculation at present. |

The NPV adjustment for the Revenue Adjustment building block will be discussed and agreed with Ofwat in advance of this building block becoming active in the calculation of Allowed Revenue for the 2018/19 Charging Year

Summary

The inputs to this calculation, and the sources of these inputs, are set out on the "Inputs 2015" sheet of this workbook.

| | | | | | | | | | | | | | | |
|---|---|------|--------|---|---|---|---|-----|---|---|---|---|-----|--|
| IP Allowed Revenue (t) = | Return on capital + Liquidity + Operating expenditure + Financing cost adjustment + Tax +/- Revenue adjustment +/- Building block for reconciliation adjustment + Additional return on capital + Additional liquidity | | | | | | | | | | | | | |
| IP Allowed Revenue (First Charging Year) | = | 3.0 | + 7.9 | + | 0 | + | 0 | + 0 | + | 0 | + | 0 | + 0 | |
| | = | 10.9 | | | | | | | | | | | | |
| IP Allowed Revenue (Second Charging Year) | = | 10.9 | + 11.5 | + | 0 | + | 0 | + 0 | + | 0 | + | 0 | + 0 | |
| | = | 22.4 | | | | | | | | | | | | |

The Allowed Revenue for the First Charging Year is subject to an NPV adjustment as follows:

$$\text{Adjusted Allowed Revenue (First Charging Year)} = \text{Allowed Revenue (First Charging Year)} * (1 + \text{BWACC})^{(0.5 + \text{PD}/2)}$$

where PD is the proportion of the First Charging Year between Licence Award and the end of the First Year

$$= 10.9 * (1 + 0.02497)^{(0.5 + (221/366)/2)}$$

$$= 11.2$$

$$\text{Total Allowed Revenue for the First Charging Year and Second Charging Year} = 33.603 \text{ £m}$$

The calculation of each of these elements is described below.

Inputs

The inputs for the Allowed Revenue calculation are set out in "Inputs 2015", along with source information and accompanying notes.

As agreed with Ofwat, the Allowable Project Spend inputs are consistent with Rev08, expressed in outturn prices.

The price base adjustment has been made using actual and forecast data for the Applicable Change in Cost Indices (the basket of indices defined in the Project Licence, Appendix 1, 1.12)

*actual values for all the relevant indices have been used up to August 2015 on a monthly basis

*after August 2015, forecast RPI is used as a proxy forecast for the basket (using the same forecast RPI rates as set out in the inputs sheet), as agreed with Ofwat

An average index for each Charging Year has been constructed consistent with the approach as set out in the definition of the 2014/15 RPI adjustment factor (Project Licence, Appendix 1, 1.1)

This index has been applied to the Rev08 costs in 2014/15 prices to generate Rev08 costs in outturn prices.

Return on Capital

The Return on Capital building block allows the IP to earn a return on capital in relation to the forecast average RCV in the Charging Year in question. Average RCV is calculated using actual, estimated and forecast allowable project spend, as shown in the table below.

| | Y1 | Y2 | Y3 |
|-------------------------|-------|-------|---------|
| Opening RCV | 0.00 | 238.0 | 628.1 |
| Allowable Project Spend | 238.0 | 390.1 | 519.3 |
| Closing RCV | 238.0 | 628.1 | 1,147.5 |
| Average RCV | 119.0 | 433.1 | 887.8 |

For the First Charging Year, this building block is calculated as follows:

$$\begin{aligned} \text{Return on Capital} &= \text{Average RCV in Y1} * \text{Bid WACC} * \text{Applicable Change in Revenue RPI for the First Charging Year} \\ &= 119.0 * 2.497\% * \frac{259.8}{256.7} \\ &= 3.0 \text{ (£m)} \end{aligned}$$

For the Second Charging Year, this building block is calculated as follows:

$$\begin{aligned} \text{Return on Capital} &= \text{Average RCV in Y2} * \text{Bid WACC} * \text{Applicable Change in Revenue RPI for the Second Charging Year} \\ &= 433.1 * 2.497\% * \frac{259.8}{256.7} \\ &= 10.9 \text{ (£m)} \end{aligned}$$

Liquidity

The Liquidity building block allows the IP a liquidity allowance (return on capital) in relation to the incremental average RCV in the year following the Charging Year in question

For the First Charging Year, this building block is calculated as follows:

$$\begin{aligned} \text{Liquidity} &= (\text{Forecast average RCV in year 2} - \text{Average RCV in year 1}) * \text{Bid WACC} * \text{Applicable Change in Revenue RPI for the First Charging Year} \\ &= 314.1 * 2.497\% * \frac{259.8}{256.7} \\ &= 7.9 \text{ (£m)} \end{aligned}$$

For the Second Charging Year, this building block is calculated as follows:

$$\begin{aligned} \text{Liquidity} &= (\text{Forecast average RCV in year 3} - \text{Average RCV in year 2}) * \text{Bid WACC} * \text{Applicable Change in Revenue RPI for the Second Charging Year} \\ &= 454.7 * 2.497\% * \frac{259.8}{256.7} \\ &= 11.5 \text{ (£m)} \end{aligned}$$

Operating Expenditure (opex)

In line with the Project Licence, the Opex building block is zero as all costs are accounted for as capital expenditure.

Financing Cost Adjustment

The Financing Cost Adjustment building block is intended to protect against movements in the market cost of debt, recognising that the IP's Bid WACC will apply for a much longer period than the standard five year control period for a WaSC or WoC.

The Financing Cost Adjustment for a given year is calculated as follows:

$$\text{Financing Cost Adjustment (t)} = \frac{(\text{Net Debt (t-2)} - \text{Net Debt (t-3)}) * \text{Market Cost of Debt Adjustment Factor (t)} * (1 + \text{BWACC})^2 * \text{Applicable Change in Revenue RPI (t)}}{\text{Applicable Change in Revenue RPI (t-2)}}$$

where Market Cost of Debt Adjustment Factor (t) =

- i) if the difference between the BRP and the ARP on any ARP Calculation Date is +/- 50 bps, the market cost of debt adjustment will be 0
- ii) if the difference between the BRP and the ARP is between (+/-) 51 bps and 100 bps, the market cost of debt adjustment factor will be equal to 50% of the amount by which such difference exceeds 50bps
- iii) if the difference between the BRP and the ARP is greater than +/- 100 bps, the market cost of debt adjustment factor will be equal to the amount by which such difference exceeds 75 bps

BRP = the 12 months' trailing average of the Financing Cost Adjustment Index Yield as at 31 March 2015

ARP = the 12 months' trailing average of the Financing Cost Adjustment Index Yield as at 31 March of Charging Year t-2

where the Financing Cost Adjustment Index Yield =

$$\frac{(1 + \text{iBoxx BBB UK non-financials with 10+ year maturity})}{(1 + \text{spot implied inflation rates for 10 year maturity published by the Bank of England})}$$

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Note that where the ratio between Net Debt and Ofwat-stated RCV (current prices) is higher than the notional debt to RCV ratio, Net Debt will be deemed to equal the notional debt to RCV ratio multiplied by the Ofwat-stated RCV in current prices.

The Financing Cost Adjustment Building Block for each Charging Year is the sum of the Financing Cost Adjustment for that Charging Year and all previous Charging Years, to reflect the build-up of the market cost of debt protection over time.

There will be no Financing Cost Adjustment in respect of the Allowed Revenue for the First or Second Charging Years, as in both cases, the IP did not exist in Charging Year t-2 and t-3, and so did not hold any Net Debt at this time.

Tax

In line with the Project Licence, the tax building block is zero as the IP is not required to pay corporation tax or any other income-based tax.

Revenue Adjustment

The revenue adjustment building block is to reconcile for under/over recovered Allowed Revenue in previous Charging Years.

There is no revenue adjustment for the Allowed Revenue in the First and Second Charging Years, as Thames Water has not yet been asked to collect any revenue of behalf of the IP.

This building block will apply from the 2018/19 Charging Year onwards.

Building Block Reconciliation Adjustment

A reconciliation adjustment will apply for the Return on Capital, Liquidity, Opex, Financing Cost Adjustment, Tax, Additional Return on Capital and Additional Liquidity building blocks.

As no previous calculations of Allowed Revenue have been made, this building block is zero for the purpose of this calculation.

This building block will apply from the 2017/18 Charging Year onwards.

Additional Return on Capital

The Additional Return on Capital building block will only apply if spend exceeds the Threshold Outturn and the IP has made an IAR Overrun Application.

Therefore this building block is zero for the purposes of this calculation.

Additional Liquidity

The Additional Return on Capital building block will only apply if spend exceeds the Threshold Outturn and the IP has made an IAR Overrun Application.

Therefore this building block is zero for the purposes of this calculation.