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The Utility Regulator
Financing Infrastructure Conference

Summary of a discussion paper by First Economics

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Introduction

- Our report considers:

  1. The different roles played by regulated networks and how they are financed

  2. How major expansion projects might be split out and delivered and financed separately

  3. How companies' regulatory asset bases (RABs) might be split out and financed

- These issues are relevant for Great Britain's regulated sectors as well as for Northern Ireland

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Different roles of regulated networks (1)

- Generally a single company is responsible for:
  - operating and maintaining the network, i.e. providing customers with ‘today’s outputs’
  - delivering major investments, to support the provision of ‘tomorrow’s outputs’
  - the collection of payment due from customers for past investments
- These activities are currently delivered and financed within one company
- But the characteristics of these businesses are quite different (see next slide)

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Different roles of regulated networks (2)

	Cash outflows	**Level of risk**	**Financing requirement**
'Operating business'	Ongoing expenditure on opex and capex	Medium	Low – some risk taking capital on ongoing basis
'Projects business'	Lumpy project capex	High	Medium to high – considerable risk taking capital during construction
'Capital recovery business'	Capital servicing and repayment	Low	High – considerable low risk capital on ongoing basis

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Reasons for concern with this model

- Is best value being achieved in financing the ‘low risk’ RAB?
- Should operating companies have to manage big balance sheets?
- Are major projects currently unduly difficult to finance?
- Do we suffer from a lack of contestability in their delivery?

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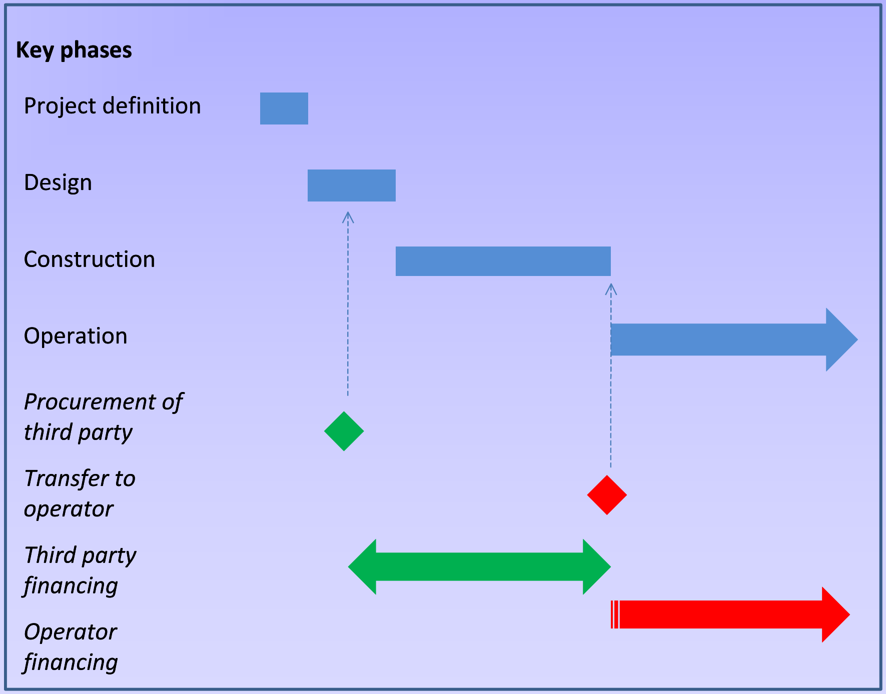
A third party role in major projects

- Could third parties play a fuller role than at present?
- Would a Design Build Finance Transfer Model (DBFT) be applicable?
- Could third parties also maintain new infrastructure (DBFM)?

Possible phases in a DBFT model



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Benefits and dis-benefits

- Finance: probably greater availability – and a lesser ‘financeability’ burden on regulated companies – but not necessarily a better price
- Cost: fuller competition in procurement *should* drive down scheme costs but would also increase transaction costs
- Risk transfer: could be improved *if* third parties are better placed to take project risks

- **Key issue: how separable are major projects from existing networks?** (A case study from GB rail)

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Financing historical investment

- Regulated companies have borrowed sizeable amounts of money in carrying out investment for customers, e.g.:
  - NIE T&D: £500m since privatisation
  - E&W water: £35 billion since privatisation

- Borrowing costs are not trivial and a typical company currently pays a ‘risk premium’ of ~150 basis points

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RABco

- Could borrowing costs be reduced if accumulated debts were taken from regulated companies and put in a separate company (RABco)?

- Financing efficiencies would probably be dependent on explicit regulatory, customer and/or government commitment to repayment