



15. How our plan should be financed

What this chapter is about

An appropriately balanced financial framework is key to current and future consumers being fairly charged for the networks they use and the services they receive. This chapter explains the principles we adopt to ensure a balance is struck between consumers benefitting from sustainably low bills and incentivising continued investment in long term assets which provide benefits over many years.

What you have told us so far

You have told us that the balancing charges between current and future customers is important. You have also told us that it is important that adequate funding is available in T2 for the potential investment required. Investors have told us they consider the risk of investing in UK regulated utilities has increased compared to earlier in the T1 period. Investors have also told us that Ofgem's working assumption for the level of return in the T2 period does not reflect our underlying business risks.

What we will deliver

We work hard to deliver sustainable financing, reducing long term costs for stakeholders.

This requires a return which reflects the risks involved in running an electricity transmission business and allocates risks to the parties best placed to manage them.

With the move towards net zero by 2050 and the related investment required we need to ensure we have adequate financial capacity and resilience. We show that Ofgem's package is not financeable at the same investment grade used in the T1 period without making artificial adjustments which break the regulatory principles underpinning our approach.

What you can find in this chapter

1. Our sustainable approach to financing
2. Regulatory principles underpinning our approach for RIIO-2
3. Financeability assessment of Ofgem and National Grid packages
4. Bill impacts

The financial package we propose enables us to raise the finance we need to deliver consumers'

and our stakeholders' key priorities on a sustainable basis. The right level of return is positive for consumers and customers as it enables the investment and incentivisation needed to facilitate the transition to a low carbon economy.

Our plan with both Ofgem's and our financial package will reduce customer and consumer bills when compared to T1 averages.



Introduction

We have worked with our stakeholders to build a business plan that reflects their expectations and delivers the services they want. This involves infrastructure investment which will be funded through a combination of debt and equity. In line with the RIIO-2 business plan guidance, we provide detailed analysis and evidence around the financial package in NGET_A15.01 Finance Annex. In this chapter, we focus on:

- our sustainable approach to financing;
- the strong regulatory principles which guide our approach;
- setting out our definition of financeability to assess the proposed financial package.

1. Sustainable approach to financing

We have a demonstrable and consistent track record in efficiently financing our activities

National Grid Electricity Transmission (NGET) forms part of the National Grid plc group, a publicly owned FTSE 100 utility company. The company is owned by our equity investors, a diverse range of largely long-term investors which reflects the broader UK market, including pension funds and individual retail investors, some of whom have held shareholdings for over 20 years.

Management operate the business on behalf of our equity investors in line with the NGET licence and supported by the regulatory model, investing in assets which will provide benefits to energy consumers over many years. We have a long track record of funding investment in regulated energy infrastructure. Our scale and the strength of our balance sheet enables us to access a diverse range of financial markets, ensuring that investment can be funded on behalf of consumers, even in periods of macro-economic distress.

Being part of a listed group requires a very high level of transparency of ownership, governance and financial disclosures. We continue to adopt best practice in our disclosures, for example, we have included additional transparency on our economic performance throughout the T1 period in our statutory accounts and are a member of the accounting for sustainability network which aims to integrate financial and environmental decision making.

NGET financing strategy is cost efficient for consumers

Based on our business plan submission, around 20% of our annual totex will be funded by customers via in-year revenues and 80% is funded by the company, to be recovered from future customers. This transfers risk from customers to the company, spreading the cost of the long-term investments we make over multiple generations, fairly matching the cost with those that use the network over time.

To optimise the efficiency of raising debt finance, the company funds around 40% of its share of totex from equity investors and 60% from debt investors. This is consistent with management's view of the optimal capital structure to minimise the weighted average cost of capital. It is also consistent with Ofgem's RIIO-2 working assumptions.

Funding sources include:

- reinvestment of profits attributable to equity investors;
- reinvestment of scrip dividends; last year just under 40% of NG plc's shareholders elected to reinvest dividends totalling around £600m;
- issuance of new equity, e.g. our £3.2bn rights issue in May 2010; and
- raising financing efficiently from debt investors.

Both debt and equity investors provide funding in anticipation of earning a return that is commensurate with the risk they are taking. Risk arises due to the uncertainty as to whether the future cash flows generated by the company will fully refund the investment and return expected by investors. Whilst our regulatory agreements reduce this risk, its five-year timeframe is much shorter than the current holding period of many of our investors and the regulatory asset life of 45 years. Therefore, investors' assessment of the attractiveness of investing in UK regulated energy networks will include a judgement about the long-term quality and stability of the UK regulatory regime and the certainty of recovery of the RAV which represents money due to investors. If investors perceive the risk is too high compared to the return, they will move their money elsewhere, making raising new equity and debt more costly, increasing costs to consumers.

We add value to consumers by accessing efficient sources of debt financing to fund large scale investment over the long term

Our business plan assumes that NGET expects to issue ~£3bn of long-term debt over the T2 period, both to fund capital expenditure and to refinance maturing debt.

Our scale enables access to the debt capital markets which tend to provide the most efficient source of debt financing. The vast majority of our debt is raised in this way and we work hard to ensure debt is issued as efficiently as possible in line with the incentives under the RIIO-1 framework. For example, we can issue debt in any one of multiple currencies, using derivatives to manage the ultimate liability into sterling ensuring we have access to the best value funding available. We have also used a variety of debt products to find new and innovative ways to issue debt including Retail Price Index (RPI) retail bonds.

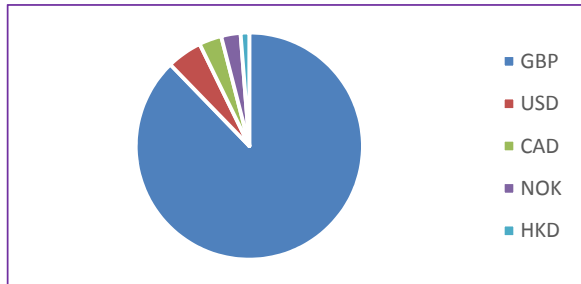
We are a well-known issuer with a clear and distinctive debt investor proposition, reflecting our world-class safety and reliability performance as well as our strong credit rating and financial ratios. Efficient debt funding is incentivised by the regulatory framework and the



resulting lower interest rates feed into future revenue allowances for all networks.

We seek to minimise the total interest rate charges to NGET, whilst managing liquidity risk and maintaining a balanced maturity profile of debt issued that appropriately manages refinancing risk.

Figure 15.1 £7.2bn of debt (pre derivatives) at 31 March 2019, by currency



A strong credit rating minimises our borrowing costs and ensures financial resilience to enable investment to deliver net zero

From a debt funding perspective, we aim to retain an A3/A- credit rating for NGET (for the actual company) as this ensures access to a wide range of debt instruments and capital markets at an efficient interest rate. This rating is supported through targeting a Baa1/BBB+ credit rating for the notional company.

We currently support the higher actual company rating through working hard across the capital markets to raise debt at lower interest rates than the regulatory benchmark and through delivering stakeholder outputs at lower totex levels to allowances. These outcomes are incentivised by the regulatory framework because the resulting lower interest rates and totex levels feed into future revenue allowances. With interest rates predicted to increase and lower incentivisation in the RIIO-2 framework, we recognise there is greater risk around achieving A3/A- under this approach in the future, but we are maintaining our target of Baa1/BBB+ for the notional company.

The purpose of targeting a Baa1/BBB+ credit rating for the notional company is both to enable access to an efficient cost of debt and ensure that we are

appropriately resilient to future financial shocks, which is important given our role as owners and operators of critical national infrastructure. For example, at a Baa2/BBB rating (one notch below our target rating), a change in RPI to CPI wedge to 50bps would reduce our interest cover nearly to sub investment grade, severely restricting the ability of the notional company to efficiently raise further debt funding. An illustration of the resilience a strong credit rating brings is that during the 2008 global financial crisis the company was able to maintain debt market access. Following the Lehmann Brothers collapse in September 2008, NGET was still able to issue a new syndicated €600m five-year bond on 1 December 2008.

A Baa1/BBB+ credit rating is also consistent with recognised regulatory practice: Ofwat targets Baa1, Ofgem have previously targeted Baa1. It is consistent with the cost of debt allowance (which is an average of A and BBB corporate bonds) and consistent with the vast majority of our peers, with currently only one utility entity in the UK rated BBB or lower. Reducing credit ratings for the energy network would also add additional risk at a time when networks are being asked to invest to meet the governments net-zero targets and when much of the industry is on negative outlook.

The lowest cost of investment comes from an equity proposition that appropriately reflects the risks of investing in transmission

To create a framework that attracts low cost funding to deliver consumer investments it is important to understand how equity investors will assess the attractiveness of the sector, these will include analysis of:

- the risk reward balance in light of a lower risk-free rate but higher political and regulatory risks when compared with the T1 period;
- the relative attractiveness of the risk reward balance compared to similar regimes in other jurisdictions (e.g. USA, EU and Australia);
- the ability of the company to maintain an efficient capital structure over the long term, without the use of short-term financing levers; and the ability for the company to maintain its financeability in a range of macroeconomic and operational scenarios.



Figure 15.2 Impact of misaligning the risk reward balance

Case Study: PR99 regulatory agreement

PR99 was a review of water companies' price limits for the period 2000/01 to 2004/05. Ofwat imposed a significant reduction in allowed rate of return compared to the previous price control.

PR99 is remembered for precipitating a 'flight from equity'. There was a sense that the price control put off investment that would have benefited customers and the owner of one company in financial distress was forced to sell up at a discount to the regulated capital value.

The House of Commons Public Accounts Committee, Pipes and Wires, stated in 2002:

"The market valuation of companies in the water industry has fallen below that estimated by Ofwat, suggesting that it might in 1999 have set the cost of capital too low"

We generate value for our investors through a combination of dividend yield and asset growth. However, equity investors do not place equal prominence on each element of the equity offering. In our latest equity shareholder survey, all respondents stated that our National Grid plc dividend policy "to grow the ordinary dividend per share at least in line with the rate of RPI inflation each year for the foreseeable future" was an important part of their investment decision. This demonstrates the fact that the level of dividend pay-out is closely monitored by our shareholders and the wider investment community to assess its sustainability and relative attractiveness within our peer group and relative to the wider equity market. To help achieve this plc level dividend policy we have an NGET dividend policy to maintain gearing at 60%, transferring any additional cash up to plc level. This maintains the efficient financing position for the operating company.

The measures that are commonly used to assess the appropriateness of the dividend pay-out are the dividend yield and dividend cover.

Over the last decade, listed utilities in the UK have averaged a 5.3% dividend yield with the FTSE above 4%. Changes to the regulatory model that increase cash generation at the expense of asset growth, such as the move from RPI to CPIH inflation, lead to investors expecting a higher dividend yield in the T2 period.

The prominence of the dividend policy in regulated utilities is explained by the long asset lives relative to other UK listed peers, as well as the regulatory price controls that set their revenues. A consistent dividend policy, both in terms of yield and cover, therefore,

provides confidence to investors of the regulatory commitment to allow equity investors to recover their initial investment and earn a stable return over the long term.

Any significant change in the level of yield would cause equity investors to question the place of National Grid as a yield stock within their portfolio and reallocate capital elsewhere in the FTSE or to regulated utilities in other jurisdictions and may lead to a 'flight from equity' such as that experienced after the PR99 regulatory agreement in the water sector.

Investors will also be aware of the wider political environment in the UK, for example since the vote to leave the European Union in June 2016 there have been net outflows from UK equities of around 10%, this move from UK equities has been reflected within the regulated energy sector with a reduction in share prices of National Grid (9%), Centrica (65%), and SSE (17%) over the same period

Shareholders also earn a return through asset growth. For example, we expect to deliver asset growth of 4% per annum on average during the T2 period based on the baseline plan. The value that investors place on asset growth is dependent on the future dividend capacity attributable to the asset growth. Our asset growth can also be compared to the higher asset growth of the FTSE100 of 8%, further underlining the prominence of the dividend within our investor proposition and the importance of differentiating the level of dividend yield at 5% within our plans, compared to that of the FTSE100.

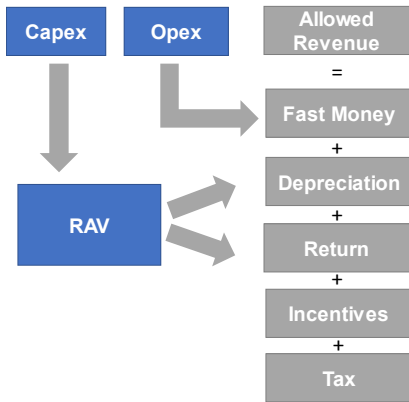
We therefore target a 5% dividend yield, consistent with the T1 period consistent with historic precedent.

2. Regulatory principles

An appropriately balanced financial framework is key to current and future consumers being fairly charged for the networks they use and the services they receive. This is because we pay for investment as we incur it but we recover the cost of that investment for as long as it provides a consumer benefit, which is currently over many decades. This timing creates a cash flow gap which we bridge through debt and equity investment



Figure 15.3 The building blocks model of regulation



The RIIO framework is based on the ‘building blocks’ model of regulation. In this model, allowed revenue should be sufficient to recover the efficient costs the network incurs in providing its services.

Those costs being:

- Fast money: the operating expenses associated running the business.

- Depreciation – the annual expense that is based on spreading the cost of investment over its useful economic life.
- Return on RAV – the cost of financing investment, i.e. paying a fair return to debt and equity investors.

As part of the regulatory framework we are allowed to recover the efficient costs of paying interest and dividends to investors. In this context, efficient means we need to balance lower consumer bills now with a funding platform which will help us to keep financing costs sustainably low by maintaining credit ratings and equity investor returns. Without this return, we would not be able to fund investments over a long time period and current consumers would bear all the cost of investments undertaken even though they would not receive all the benefit. An out of balance risk and return mix would not keep financing costs sustainably low, creating a much bigger consumer bill increase in the future when the balance is returned.

A balance between current and future consumer bills is achieved by using a regulatory framework which

Table 15.4 Required attributes of the regulatory framework

1	<p>Balances risk and reward: by ensuring risks best managed by network are not passed on to consumers</p> <p>A key attribute of the regulatory framework must be a transparent and fair balance of risk and reward between consumers and networks. Removing risks for networks can reduce the cost of capital, and therefore short-term consumer bills. However, the risks removed will still exist only now they will sit with consumers. This creates little incentive or financial capacity for the networks to control costs because of the limited opportunity to be retained from any reductions. This will ultimately drive higher and more variable long-term consumer bills.</p>
2	<p>Demonstrates regulatory commitment and a stable regime: to keep financing costs low for consumers</p> <p>Our costs of borrowing will depend on how our credit rating is assessed. If our credit rating deteriorates, then borrowing costs will go up. Furthermore, it is reasonable for equity investors to expect returns which are broadly stable over time so that returns which were considered appropriate at the time of investment would still be considered appropriate now and in the future. Unpredictability increases risk perception placing upward pressure on the cost of capital. Only by maintaining a consistent approach will the financial framework allow network companies to attract the required investment and keep bills as low as possible for consumers.</p>
3	<p>Takes a long-term sustainable approach: to ensure investment is recovered fairly from both current and future consumers</p> <p>Financeability is not just a consideration of short-term liquidity ratios but considers the long-term sustainability of the company’s financial position which is important in safeguarding future investment. We consider trends across several price controls. This helps us to avoid short-term fixes to address immediate cashflow issues that might create financeability problems in the future.</p>
4	<p>Provides strong incentives: so the networks demonstrably strive to deliver benefits for consumers</p> <p>An effective incentive framework ensures delivery of services at the price and levels consumers are willing to pay by aligning their interests with those of investors. Networks are encouraged to seek out lower costs, through the potential to share benefits, whilst still being held to account for delivering the outcomes they have committed to with clear consequences of non-delivery. Outcomes should be measured and monitored against targets set at the start of the price control providing the transparency which is important for maintaining consumer confidence.</p>



3. Financeability

3.1 Approach to the financeability assessment

The majority of our investment is added to the RAV with the regulatory framework allowing recovery through depreciation and a return on investment. The cost to consumers is spread over the life of the asset and requires us to finance the initial investment from debt or equity investors. Ofgem have a duty to have regard to our financeability by allowing us to recover revenues that are sufficient to pay interest and dividends to our finance providers. We also have a financeability duty by ensuring that we can maintain an investment grade credit rating.

It is in consumers' interests that we fulfil our financing duties efficiently, so the return and interest costs funded by consumers are as low as reasonably possible. Maintaining a strong credit rating and providing confidence to investors that their investment is secure minimises financing costs. We also retain sufficient financial capacity and flexibility to continue operations and investment programmes in the event of economic downturn and outturn of downside risk. At its very basic level, the financeability assessment is a review of the projected levels of financial ratios, which test this financial capacity against target levels. Our network is financeable if we can meet the expectations of both our debt and equity investors. Within this context, we have adopted the following approach to assess financeability:

Table 15.5 Our approach to assessing financeability

1	Focus first on the notional company	Assess financeability for a notionally efficient company with a capital structure consistent with that used to determine the weighted average cost of capital. This ensures companies and their shareholders bear the risk of their capital structure and financing, not customers.
2	Target a strong credit rating	Use a target rating of Baa1/BBB+ to ensure financial resilience and consistency with the index used to set cost of debt allowances.
3	Consider a range of financial ratios for debt and equity investors	Follow methodologies and focus on key metrics used by credit ratings agencies to aid transparency and consistency. For equity metrics, we target a dividend policy consistent with investor expectations and review trends for dividends and earnings profiles. Table 15.6 summarises the ratios targeted.
4	Assess resilience within and beyond the RIIO-2 period	Consider trends across several price controls to assess the long-term sustainability of the financial package, stress test financial resilience through the application of a range of sensitivities and alternative scenarios. This helps us to avoid short-term fixes which would increase overall costs.

Table 15.6 Target thresholds for key financial ratios

	Ratio	Threshold	Rationale
Debt	Adjusted interest cover ratio (AICR) measures how many times a company can cover its interest payments using available cash	1.5	Based on Moody's methodology AICR – mid-point of Moody's range
	Net debt/RAV (Gearing) ensures we maintain an efficient financing structure	60%	Gearing – notional gearing assumption
	FFO/Net debt measures the ability of a company to pay off its debt using available cash	10%	Based on S&P's methodology Mid-point of 9-11% range
Equity	Dividend yield enables investors to measure how much they could earn in dividends by investing in stock	5%	Consistent with the RIIO-1 framework, in line with UK utility peers and reflective of growth / yield mix versus FTSE.

We use the scorecard methodology adopted by Moody's (Moody's Grid) and core metrics applied by Moody's and Standard and Poor's (S&P) as our primary tools to assess financeability from a debt investor's perspective.

We have applied the Moody's approach in line with how Moody's themselves apply the methodology for the overall Grid rating. This involves putting an additional focus on the core metrics: AICR and net debt/RAV.

We have also focussed on FFO/net debt as the core ratio used by S&P in their rating assessment.



Engagement with S&P, review of their rating methodology and consideration of peers' ratings leads to the interpretation of 9–11% as a BBB+ threshold.

Our assessment considers credit metrics as being achieved when the mid-point of the relevant thresholds is met. This is for two reasons.

Firstly, it is in line with credit rating agencies practice, where it is expected that metrics will have a buffer above the threshold for the relevant rating to apply. If we were to achieve only minimum thresholds throughout the period, the potential for downside risks would result in a network with weak financial resilience, increasing the likelihood of downgrade or being placed on negative watch. This should not be the case for a “notionally efficient” company which we are modelling.

Secondly, Moody's has the majority of UK water companies on negative outlook, reflecting concerns over Ofwat's PR19 determinations. Given the rise in the perception of regulatory intervention through items such as the performance wedge it is credible that this could be applied to energy networks.

Recently, both Moody's and Fitch assessed that the water sector has become riskier and therefore increased the ratio headroom required for AICR by 10bps. We have assumed that the thresholds applied to energy networks do not change from where they are today with this risk partially reflected in our targeting the mid-point of the thresholds ranges for key ratios.

For the context of this chapter, we concentrate on key financial ratios in line with the rating agency methodologies and include a wider range of metrics, including those set out by Ofgem's guidance, in NGET_A15.01 Finance Annex.

Given energy transition and the uncertainty inherent in proposed investment for the T2 period, the network needs to be financeable at different funded levels of totex and we stress test the financial package using Ofgem's proposed scenarios. The impact of downside risk is assessed through:

- totex ranges, including credible outturn scenarios and contestable projects;
- interest rate scenarios based on -1% compared to forward implied rates as per the base case in each year
- inflation rate scenario based on +1% in each year
- RPI – CPI divergence scenario based on -0.5% movement from assumed wedge
- 10% totex overspend
- proportion of index linked debt issued -5% lower than assumed in the base case.

3.2 Financeability assessment of Ofgem's working assumptions

We test the financeability of the notional company in the first instance using the following assumptions set by Ofgem:

Table 15.7 Ofgem's working assumptions including incentives performance

Parameter	Ofgem assumptions
Allowed equity return	4.3% post-application of the 0.5% outperformance wedge
Incentives performance	0.5% equivalent = £35m p.a.
Dividend yield	3%
Gearing	60%, set at beginning of RIIO-2 and maintained throughout the period
Allowed debt funding	Full indexation, 11-15 year trombone
Debt profile	25% inflation linked debt throughout the period with RPI debt switched to CPIH
Inflation indexation	Immediate transition to CPIH, CPIH assumed to be 2% per annum
Depreciation	45 years, straight line
Capitalisation rate	Natural rate

Our baseline plan has annual totex ranges which vary between £1.3bn to £1.6bn, totalling £7.3bn across the 5-year price control, when real price effects are included. However, our plan also shows there are credible scenarios where much higher investment is required. This is particularly the case for facilitating net zero by 2050 and if potentially contestable projects are delivered by ourselves under either the T2 framework or the Competition Proxy Model (CPM). Our high scenario forecasts over £10bn of totex in the T2 period.

The T2 framework must enable our plan to be financeable under all credible scenarios. To do otherwise would risk constraining investment and risk delivery of the net-zero targets. For this reason, whilst we focus our financeability assessment firstly on our baseline plan we also assess higher capital scenarios.

Before setting out the detailed financeability assessment, it is worth outlining why our conclusions from this work are that we do not believe our plan is financeable on a notional basis using Ofgem's working



assumptions and a higher equity return is required to keep consumer costs lower over the longer term:

- Cashflows are close to Baa1 AICR thresholds but only due to the inclusion of highly uncertain incentive performance of c£35m per annum. This revenue would be disregarded by rating agencies and is higher than the likely T2 incentive package so should not be included in any assessment.
- Without the implausible incentive performance adjustment, credit metrics are not consistent with a Baa1 investment grade, reducing the financial capacity to carry the risk of capex uncertainty and bringing a more risk averse approach to investment and innovation.
- Dividend yield and allowed equity return will not attract required investment, particularly to the levels required to deliver net-zero targets.

- CPIH transition is being used as a way of supporting short term financeability and a reduction in allowed equity returns. This is a short-term fix which will require compensating adjustments to the price control in future periods.
- Economic and totex sensitivities show cashflows reducing to near sub investment grade e.g. if the CPI to RPI wedge was 0.5% rather than 1% and totex was overspent by 10%.
- If we were required to deliver potentially contestable projects, then cashflows would only be consistent with a low Baa2 rating with use of the CPM reducing cashflows to sub investment grade.

These points are explained in more detail through the following sections. We also show the results of analysis using our proposed assumptions.

Table 15.8 Key metrics based on Ofgem’s package including incentives performance

Quantitative Metrics	T1 Final Proposals	T2 period				
	Dividend Yield	5.00%	3.06%	3.10%	3.11%	3.09%
Dividend Cover	2.36	2.95	2.86	2.79	2.76	2.59
Indicated rating from Moody’s Grid	43	Baa1	Baa1	Baa1	Baa1	Baa1
Core Metrics						
AICR	1.64	1.46	1.45	1.45	1.46	1.47
Net Debt / RAV	60%	60.7%	61.2%	61.4%	61.2%	61.1%
S&P : FFO / net debt	11.91%	10.99%	10.53%	10.37%	10.30%	10.15%

Consumer implications

This package leads to higher consumer bills by risking equity investment which will ultimately increase financing costs

Credit metrics are only close to thresholds due to implausible incentives performance

A rating
Target investment grade
Below target investment grade

Dividend yield and allowed equity return will not attract required investment

Ofgem’s working assumption is a 3% dividend yield but this does not align with our investor expectation of stable dividend growth and is less than the 4% average of the FTSE 100 and 5% of our peers.

It is not appropriate to resolve debt financeability constraints through assuming lower dividends. Given that energy networks hold greater risk than water companies, investors could see this as an opportunity to invest in an alternative sector where they can earn higher dividends for lower risk. The implication is that Ofgem’s package does not balance risk and reward appropriately or adequately reflect the risks inherent in running a transmission network.

We are competing for funds globally which, when combined with the significant level of investment required in UK infrastructure, means returns must be sufficiently attractive to equity investors. A sustainable and predictably growing dividend is key to accessing funds for investment. Ultimately, if it is not high enough, many investors will cease to hold stock as they see dividends placed at risk through lower revenues and structures which have little headroom to absorb any financial

shocks. This impacts the ability to attract investment, which has implications for raising further financing efficiently. New equity investment will be more expensive to raise and if equity is replaced with higher levels of debt, the risk to debt investors will increase borrowing costs.

Assumed incentives performance is not credible

An assumed 0.5% incentive performance adds c£35m p.a. to revenues and provides significant support for credit metrics in the T2 period. Without this assumption, AICR falls below Baa1 thresholds during the T2 period. The incentives package has not been finalised, but our current view is that ~£30m per annum is the maximum that could be achieved, lower than the assumed performance. It is also incredible to assume we would achieve maximum performance each year of the T2 period given Ofgem’s focus on reducing incentive performance opportunities. Even taking our T1 performance where the maximum reward available is currently c£40m, and our achieved performance averages around £10m shows the implausible nature of the assumption.

The notional company should be financeable without the need to rely on assumed outperformance, which is



in line with how credit rating agencies will undertake their assessment. Moody's have referred to the scope of outperformance being limited by low-powered incentives in transmission and likely challenging cost allowances, meaning they will not include any outperformance in their modelling until a track record has been established. Financeability therefore needs to be assessed without assuming incentives performance.

Sensitivity analysis highlights limited financial resilience

As illustrated in Figure 15.9, sensitivity analysis shows the financial resilience of the network is much more limited than Ofgem's base case would suggest which also needs to be considered in assessing financeability:

Figure 15.9 Sensitivity analysis to assess implications for FFO/net debt and AICR using Ofgem's working assumptions including incentive performance

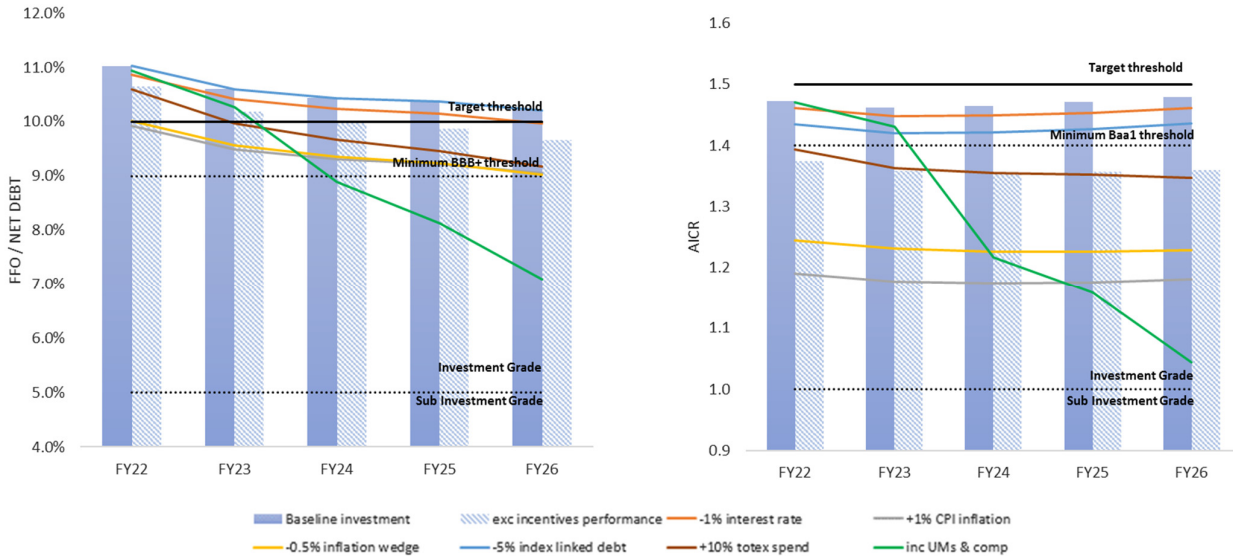


Table 15.10 key metrics based on Ofgem's working assumptions excluding incentive performance

Quantitative Metrics	T1 Final Proposals	T2 period				
Dividend Yield	5.00%	3.07%	3.13%	3.16%	3.16%	3.16%
Dividend Cover	2.36	2.78	2.69	2.61	2.57	2.40
Indicated rating from Moody's Grid	A3	Baa1	Baa2	Baa2	Baa2	Baa2
Core Metrics						
AICR	1.64	1.37	1.34	1.34	1.34	1.35
Net Debt / RAV	60%	60.9%	61.7%	62.0%	62.0%	62.1%
S&P : FFO / net debt	11.91%	10.62%	10.12%	9.91%	9.80%	9.61%

Consumer implications

Limiting investment funds now will **risk our ability to support net zero requirements**

As credit quality deteriorates the **costs of borrowing increase** to reflect increased risk of lending

Capex uncertainty

The network has limited financial capacity even before we have considered the potential impacts of alternative funded totex levels. So far, we have assessed the financial package using our baseline totex plan, this reflects the changing external landscape for transmission in the 2020s but there are elements which are subject to major uncertainty. We are operating against a backdrop of increased uncertainty of supply and demand with the requirements to deliver net zero by 2050 only partially clear. To remain responsive and

proactive to changes in how the network is used we need to ensure financeability in credible scenarios where funded totex outturns higher than the baseline. We also need to consider the potential impacts of competition. At this stage, the competition framework is not sufficiently developed, creating considerable uncertainty for our business plan as to how costs could be incurred and how they would be funded.

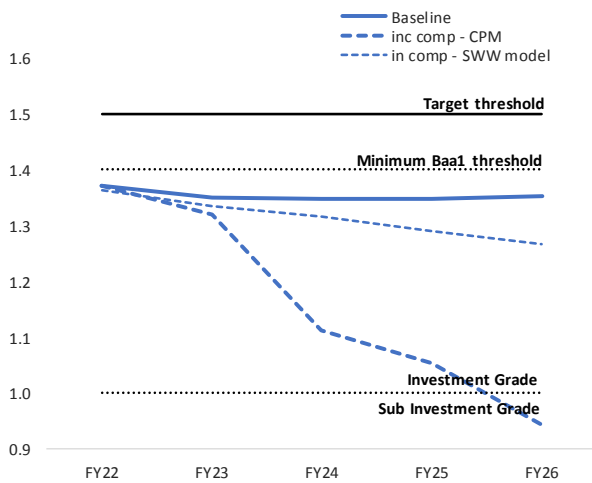
The CPM approach could still be used for the potentially contestable projects which are required in the T2 period so we need to consider the implications. In this



scenario, the construction phase of projects would not be funded for the first five years so we are exposed to the full risk of any additional costs without any allowance certainty during the T2 period.

Including the c£1.6bn of contestable projects in the plan means that by the end of the period the network becomes sub investment grade. Even up to this point there is no capacity to absorb any further shocks or cost over-runs without the network becoming sub investment, as can be shown from the AICR trends. This would severely restrict the ability of the company to be raise further funding efficiently.

Figure 15.11 Impact of potentially contestable projects on AICR



Also shown on the graph is the impact of potentially contestable projects were funded under the Strategic Wider Works model. Although the position would seem like an improvement when compared to a CPM approach, the following table shows metrics are still significantly weakened. However, even this could be considered optimistic as no funding delays have been factored into our analysis.

Table 15.12 Key metrics when including potentially contestable projects funded as SWW

Quantitative Metrics	T1 Final Proposals	T2 period				
		Year 1	Year 2	Year 3	Year 4	Year 5
Dividend Yield	5.00%	3.09%	3.18%	3.32%	3.45%	3.61%
Dividend Cover	2.36	2.76	2.64	2.47	2.37	2.13
Indicated rating from Moody's Grid	A3	Baa1	Baa2	Baa2	Baa2	Baa2
Core Metrics						
AICR	1.64	1.36	1.34	1.32	1.29	1.27
Net Debt / RAV	60%	61.1%	62.2%	63.8%	65.2%	66.7%
S&P : FFO / net debt	11.91%	10.53%	9.88%	9.18%	8.63%	7.99%

Gearing levels increase above 65% by the end of the period which, according the notional thresholds, indicates equity injection would be required to support investment.

With such a constrained financial position it is likely that we would need to be more cautious on investment, needing funding security before beginning any work leading to risks being passed onto consumers. Such an approach in the T1 period would have impacted millions of pounds of infrastructure work where we invested ahead of secured funding in areas of network resilience and renewable generation connections. The impact of these reactions and other unintended consequences would quickly offset any short term bill reductions from the currently proposed levels of return.

Limited financial resilience of the network

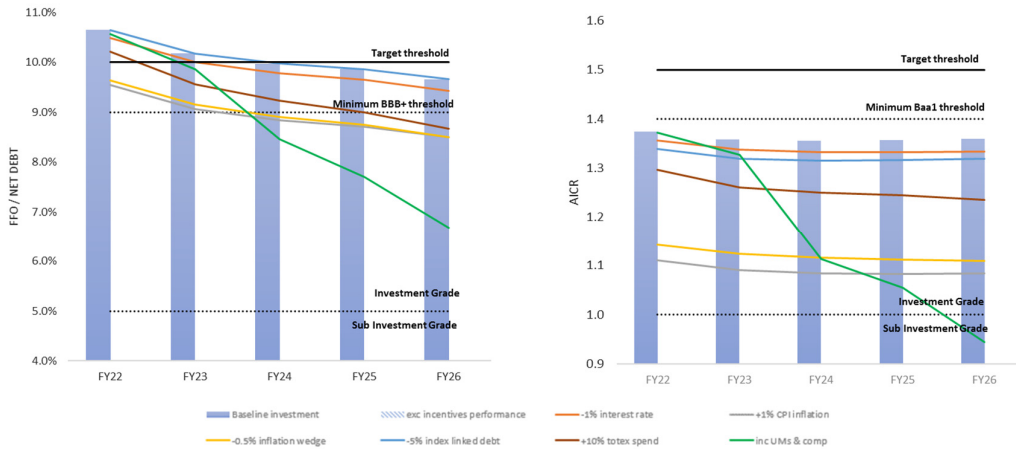
Even without capex uncertainty, Moody's Grid rating falls to Baa2 throughout the majority of the T2 period when incentives performance is excluded, providing only one notch of headroom to achieve an investment grade.

Again, of particular concern is the AICR trend. This metric measures how many times a company can cover its current interest payment with its available earnings. It is important to have headroom in AICR so that the network is still able to meet its interest payments in the event of macroeconomic shocks and outturn of downside risk.

The graphs below show the impacts on key metrics of the sensitivities Ofgem have set out to test the resilience of the financial package



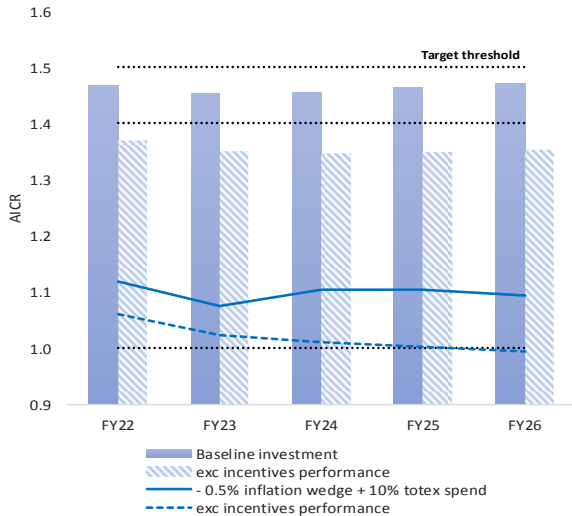
Figure 15.13 Sensitivity analysis to assess implications for FFO/net debt and AICR using Ofgem’s working assumptions excluding incentive performance



The financial package is particularly sensitive to the movement in the macroeconomic environment, where only a 0.5% change in the inflation wedge would mean that AICR deteriorates significantly. Whilst at these levels the network may still be considered investment grade, when combined with a 10% totex overspend we see credit ratings depressed even further and falling below investment grade under credible totex scenarios, indicating significant increase in the risk of lending to the company.

As credit quality deteriorates, a narrowing pool of debt investors combined with increasing costs will ultimately drive higher bills for consumers. Consistent financial ratios are also used by equity investors as a proxy for dividend affordability. Any additional risk faced by the shareholder is likely to place upward pressure on the cost of equity.

Figure 15.14 Combined totex and macroeconomic sensitivity analysis



CPIH transition is being used to alleviate short term financeability concerns

The transition to CPIH should not be used as a lever to address financeability issues that may be caused by setting returns at a level which is too low. We would therefore expect financeability assessments on both a RPI and CPI basis to be able to test value neutrality.

Whilst this combination is modelled based on scenarios set out by Ofgem, we have tested their credibility by assessing further scenarios based on the principal risks identified by our own risk management processes. Through this we have a clear understanding of the events that could impact the delivery of the plan with our analysis supporting a change in inflation wedge with a 10% totex overspend as a severe but plausible scenario. The details of the additional scenarios we have considered in addition to Ofgem’s are set out in Annex 15.01

Figure 15.15 AICR using Ofgem’s working assumptions for 100% CPIH transition and RPI counterfactual

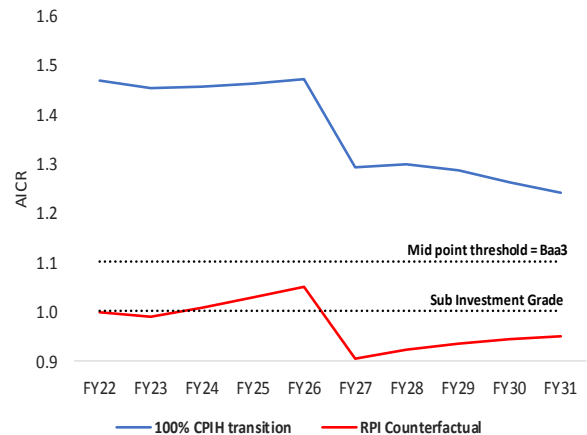


Figure 15.15 illustrates the impact of changing to CPIH on AICR and shows how key financial ratios are being supported by the one-off cash acceleration created by switching to CPIH indexation. If RPI indexation were retained, AICR falls to sub investment grade meaning



that the network is no longer generating sufficient revenue to meet its interest costs.

Short term cash flow increases, whilst supporting metrics in the T2 and T3 periods, will create financeability issues in the longer term. Ensuring NPV neutrality means that initial positive cashflow impacts from the transition will subsequently become negative. This is likely to be exacerbated by other long-term implications, particularly when future funding will reflect CPIH but a significant proportion of costs are likely to remain nominal or RPI linked creating a mismatch between revenue and costs.

As a result, using CPIH transition to support Ofgem’s proposed package will have a detrimental impact on the :

long-term sustainability of the network, which is key to safeguarding future investment and providing confidence that transition is neutral to investors.

3.3 Application of financeability levers

As we have shown, the notional company is not financeable using Ofgem’s working assumptions, the company has limited financial headroom and limited resilience to cost shocks highlighted by weak financial ratios. Ofgem have set out four potential levers (the first four actions set out in Figure 15.16) to address these issues to which we add balancing the risk reward offering through use of the appropriate allowed return

Table 15.16 Financeability levers proposed by Ofgem

Adjust capitalisation rates	Percentage of totex to be added to the RAV is set to balance costs paid by existing and future consumers, considering the proportion of capex costs expected during the price control period.
	Use as financeability lever: The simplest to understand and arguably most economic lever to use. However, use should be limited to marginal changes otherwise the impact of bringing cash forward is unlikely to be sustainable in the long term, will be disregarded by ratings agencies and will create intergenerational mismatches in bills.
Accelerate regulatory depreciation	Set to balance costs paid by existing and future consumers, taking into account expected economic life of assets and uncertainty in their future use.
	Use as financeability lever: Any adjustment to address short term financeability concerns will reduce the transparency of how cost recovery is set to match the benefits consumers receive.
Reduce notional gearing	Demonstrates the financial risk of the company as it measures the level of net debt in the context of the total value of the RAV.
	Use as financeability lever: Lower gearing levels can enable companies to maintain credit metrics under a wide range of market conditions, but only if set to reflect the cashflow risks from the overall business plan submission. Any further reduction should be supported by our current business plan or framework; as any change, purely to enable cashflows to support short-term credit metrics, risks inconsistency with the underlying risk profile of the business and how the weighted average cost of capital has been calculated.
Reduce dividend yield	Dividend yield should be set to align with equity investor expectations.
	Use as financeability lever: The notional company should be financeable based on an appropriately calibrated package and should not therefore require dividends to be cut.
Risk reward balance	There must be a transparent and fair balance of risk and reward between consumers and networks.
	Use as financeability lever: Allowed return needs to be set at a level high enough to not require the use of short-term levers which bring cash forward but also erode future value.

For the reasons set out in section 1, dividend yield is not a valid lever, leaving depreciation profiles, capitalisation rates and notional gearing as potential levers to address the limitations of Ofgem’s financial package. We also consider the allowed return and what is an appropriate level to reflect the risks of a transmission network and ensure a balanced risk and reward package. AICR, as calculated by Moody’s, is typically our most constrained metric; therefore, we focus on how the levers could be used to achieve financeability based on this ratio.

Adjustment of capitalisation rates

We first consider adjusting the capitalisation rate, using this single element would require fixing the rate to 77% versus a natural rate of 79% to ensure credit metrics achieve target thresholds in the T2 period. A 2% change may seem marginal but as a proportion of totex,

the level of cash brought forward is significant, at circa £250m over the T2 period.

We have assessed what the capitalisation rate would need to be without including the cash equivalent of the performance wedge, as we do not consider it appropriate to assume outperformance in our financeability assessment. However, if the wedge were to be applied, the capitalisation rate required to meet target thresholds would be more marginal, c0.5% equating to c£75m of cash.

The materiality of the cash levels brought forward to correct financial concerns, undermines Ofgem’s primary obligation of ensuring fair charges for existing and future consumers for the services they receive. This is also true when considering the acceleration of regulatory depreciation purely to address financeability concerns.



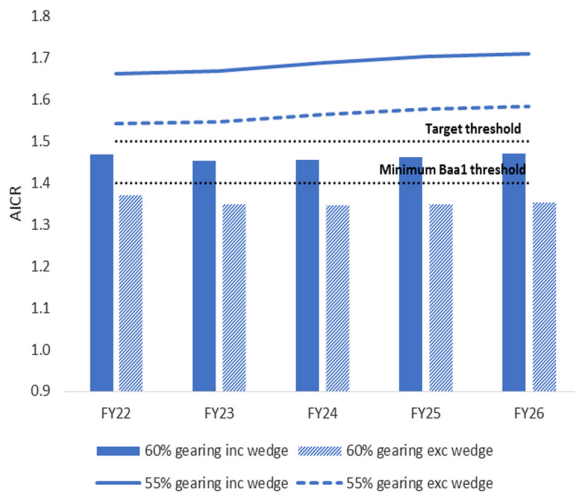
Making companies financeable through levers which bring cash forward and erode future value cannot be sustained in the long term and should not be considered as a substitute for setting allowed equity returns at a high enough level. Particularly, as credit rating agencies disregard changes to capitalisation rate and depreciation profile on the basis that adjustments are NPV neutral.

Reduction in notional gearing

We have also considered the impact of reducing the notional gearing level to 55% as a lever to achieve acceptable debt metrics under Ofgem’s proposed package.

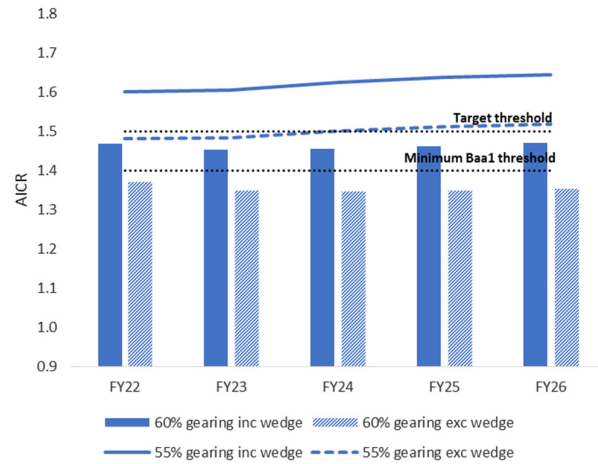
Firstly, we have assumed a view keeping equity return at 4.3% but changing gearing. A change to the notional gearing changes the reference point for equity injections and the absolute level of debt and, therefore, impacts the weighted average cost of capital (WACC) used in revenue calculations. This would imply we are setting an equity return without reference to the change in notional gearing, increasing the WACC.

Figure 15.17 AICR at 60% and 55% notional gearing with allowed returns increasing



The alternative is to reflect the lower gearing levels in the equity return. This would reduce the headline equity return figure which would mean that the allowed WACC has little movement but financeability ratios would still show improvement given the reduction in net debt.

Figure 15.18 AICR at 60% and 55% notional gearing keeping allowed returns aligned



The graphs show that a reduction in notional gearing to 55% could lead to the network being considered financeable. The concern however, is that at these levels, financial structures are not efficient and sustainable in the long term.

At 60%, gearing remains consistent with the market. Whilst levels have been set lower, this has only been considered appropriate for companies undergoing significant RAV growth, a position not aligned with our baseline plan. As the risk profile of the network has also not decreased there seems to be limited justification in adjusting notional gearing simply to address financeability concerns.

Using gearing as a lever to support a return which has been set too low, further deteriorates the investor proposition by transferring additional risk to equity and reducing asset growth.

Dividend policy

The focus so far is on achieving credit metric target thresholds in the T2 period. However, the equity investor proposition is not in line with the feedback from our shareholders or other regulated entities. When we adjust to a 5% dividend yield, Ofgem’s proposed financial package AICR falls even more significantly.



Table 15.19 Key metrics based on Ofgem’s working assumptions with a 5% dividend yield excluding incentive performance

Quantitative Metrics	T1 Final Proposals	T2 period				
Dividend Yield	5.00%	5.23%	5.45%	5.62%	5.76%	5.92%
Dividend Cover	2.36	1.66	1.59	1.53	1.49	1.37
Indicated rating from Moody's Grid	A3	Baa2	Baa2	Baa2	Baa2	Baa2
Core Metrics						
AICR	1.64	1.36	1.32	1.30	1.28	1.27
Net Debt / RAV	60%	61.8%	63.3%	64.4%	65.3%	66.2%
S&P : FFO / net debt	11.91%	10.45%	9.78%	9.42%	9.14%	8.80%

Consumer implications

Dividend policy is not sustainable, as gearing increases above threshold by the end of the period.

Limited ability to facilitate changing consumer requirements.

There is also a deterioration in the debt investor proposition as Moody’s rating grid falls to Baa2 during the period. Using downward changes to the equity investor proposition to address short term concerns for debt metrics is not a substitute for setting base returns

at a high enough level with an appropriately calibrated package.

Neither the reduction of the equity investor offering, nor the use of short-term cash acceleration levers are aligned with regulatory principles:

Figure 15.20 Assessment of Ofgem’s proposed financial package against regulatory principles

Is the regulatory principle met?	Reasoning
Balances risk and reward	Return is insufficient to reflect the risks inherent in running a transmission network and is not aligned with investor expectations or market comparators
Demonstrates regulatory commitment and a stable regime	Ofgem’s assumptions are inconsistent with past regulatory precedent, particularly in relation to setting allowed equity returns. Increasing perceptions of regulatory risk impacts investor confidence leading to increased cost of capital, and therefore bills, in the long term.
Takes a long-term sustainable approach	Short term fixes are required to make Ofgem’s package debt financeable, these can address immediate cashflow problems but only by deferring underlying issues into subsequent price controls and creating an unfair balance of charges between current and future consumers.
Provides strong incentives	There is no financial capacity to compensate networks for assuming more risk for developing new, innovative ways of working which drive lower consumer bills in the long term.

Investors continually trade off risk and return when they evaluate investment opportunities and they need to be rewarded for the risk they take for investing in National Grid. This requires an allowed equity return which is comparable and allows the company to maintain financeability.

In NGET_ A15.01 Finance Annex. we set out in detail our principle-based approach to determining our

financial package. The package we propose can both maintain credit ratings and offer an equity investor package which can attract and retain investment to keep financing costs efficient and as low as possible.

It also provides the capacity to compensate networks for assuming more risk, enabling delivery of the stretching outcomes stakeholders are telling us are important to them.



Table 15.21 Our proposed financial package

Parameter	Our proposed assumption
Allowed equity return	6.5%
Incentives performance	-
Dividend yield	5%
Gearing	60%, set at beginning of RIIO-2 and maintained throughout the period
Allowed debt funding	Full indexation, 15 year index plus 68 basis points additional borrowing costs
Debt profile	25% inflation linked debt throughout the period with RPI debt switched to CPIH
Inflation indexation	Immediate transition to CPIH, CPIH assumed to be 2% per annum
Depreciation	45 years, straight line
Capitalisation rate	Natural rate

Table 15.22 Key metrics based on National Grid's proposed financial package with a 6.5% cost of equity (CPI-stripped) and a 5% dividend yield

Quantitative Metrics	T1 Final Proposals	T2 period				
	Dividend Yield	5.00%	5.12%	5.21%	5.26%	5.26%
Dividend Cover	2.36	2.08	2.01	1.97	1.95	1.85
Indicated rating from Moody's Grid	A3	Baa1	Baa1	Baa1	Baa1	Baa1
Core Metrics						
AICR	1.64	1.56	1.54	1.55	1.58	1.62
Net Debt / RAV	60%	60.9%	61.6%	62.0%	62.0%	62.0%
S&P : FFO / net debt	11.91%	11.96%	11.42%	11.21%	11.11%	10.93%

Consumer implications

Dividend yield is sustainable, and in line with investor expectations

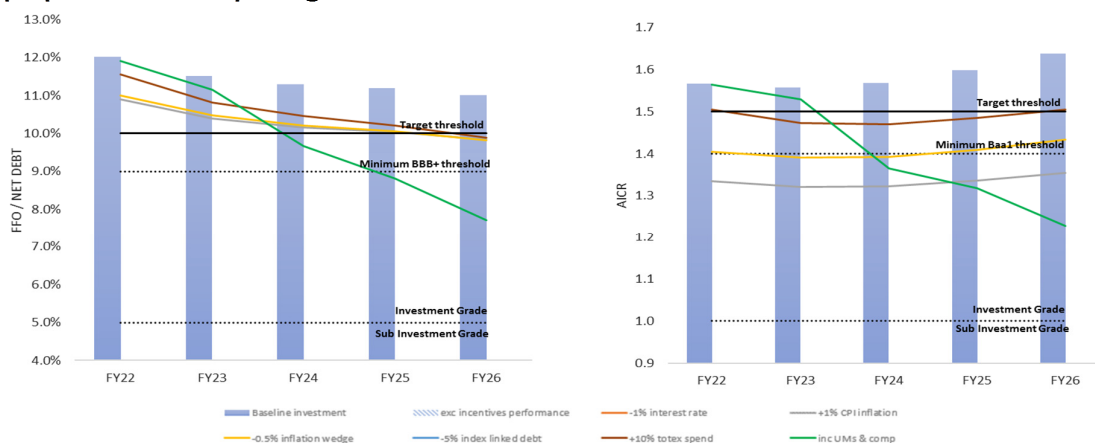
Network is able to borrow more cheaply and can absorb the impact of cost shocks

Network can operate flexibly to facilitate changing consumer requirements

We have tested our package against a range of macroeconomic and operational scenarios to ensure the notional company has sufficient headroom to absorb downside risks.

As the following graphs show, we are able to maintain financeability and remain resilient, a position which is key in safeguarding our future investment, ensuring we have the capacity to facilitate change to a low carbon economy and deliver the energy networks of the future.

Figure 15.23 Sensitivity analysis to assess implications for AICR and FFO/net debt using National Grid's proposed financial package





3.4 Financeability assessment of the actual company

Our assessment so far has focussed on the financeability of the notional company, but we also need to assess financeability of the actual company. The onus for ensuring the financeability of the actual companies lies with networks, but this can only be assured on a sustainable basis if supported by a package which delivers a financeable notional company.

For the actual company, notional gearing is adjusted to actual gearing and actual debt and tax costs are included with other financial parameters remaining at notional values. We also include any cashflows which will be recovered/incurred during the T2 period but are related to the T1 price control. We align our assessment with credit ratings agencies' methodology.

Considering Ofgem's package, including 0.5% of incentive performance, we see an improvement in the results of our financeability assessment when using actual financing. This relates to the debt financing strategy we adopt. We work hard to ensure debt is issued as efficiently as possible to minimise total interest rate charges, but as a consequence tax performance will reduce because of the additional charges incurred.

As already outlined for the notional company, assuming incentive performance at this level is neither a credible assumption nor is it in line with how credit rating agencies will view the network in practice.

Taking out any assumed outperformance shows the significant support the additional revenue provides. We still show an improvement in the credit metric results when compared to the notional focus, but the equity investor proposition remains misaligned with both our peer group and shareholder feedback.

Adjusting to a 5% dividend yield, Moody's Grid is below the A- credit rating we aim to support for the actual company for the whole of the T2 period. We target A- because this ensures access to a wide range of debt instruments and capital markets at an efficient interest rate which is key to supporting our debt financing strategy.

Trends also show a gradual increase in gearing levels, by the end of the period we are very close to the threshold (64.9%), suggesting equity issuance will be required to ensure alignment with an efficient capital structure.

It is unlikely that we would be able to attract additional investment when higher returns can be earned in comparable sectors (e.g. water, tobacco). In reality, it is likely that returns would need to be higher to compensate investors for increasing their exposure to a sector which may be perceived as being riskier because of the political and regulatory uncertainty.

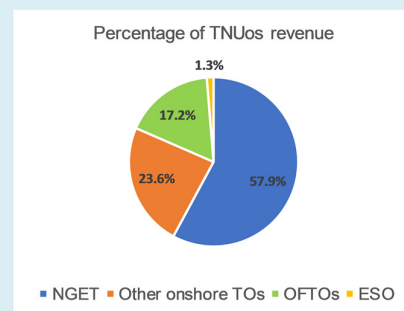
In our assessment, the limiting factor is the notional company, yet in this scenario it is debt and tax performance which is ensuring financeability for the actual company. In assessing an overall package, we shouldn't rely on financing performance which may not be achievable in all credible macroeconomic and totex scenarios, particularly given the low interest rate environment we are currently in and the potential for additional capex spend.

The only sustainable way to support both debt and equity financeability is to set an appropriately calibrated package. The package we propose ensures financeability for both the notional and actual company and allows us to continue efficiently financing our activities whilst supporting sustainably lower consumer bills in the long term

Figure 15.24 revenue proportions of TNUoS tariffs

In March 2019, the ESO published the five-year view of TNUoS tariffs for 2020/21 to 2024/25 including the impact of inflation.

The tariffs are based on the revenues forecasts for onshore and offshore transmission owners and ESO. NGET TO revenues are on average 58% of the total and our revenues do not increase before inflation. The 23% increase in ESO forecasts tariffs from £6.52 in 2020/21 to £8.00 in 2024/25 are due to increases from other factors, inflation and OFTO revenues in particular.



4. Bill impacts

The application of the RII0-2 regulatory framework to our business plan determines the revenues we are allowed to recover through the price control period. The Electricity System Operator (ESO) recovers revenue from transmission network users by applying the

charging methodology in force at the time. The ESO publishes its forecast tariffs, for example through the Forecast of TNUoS tariffs. Our revenues form only part of ESO's published tariffs as the ESO also collects

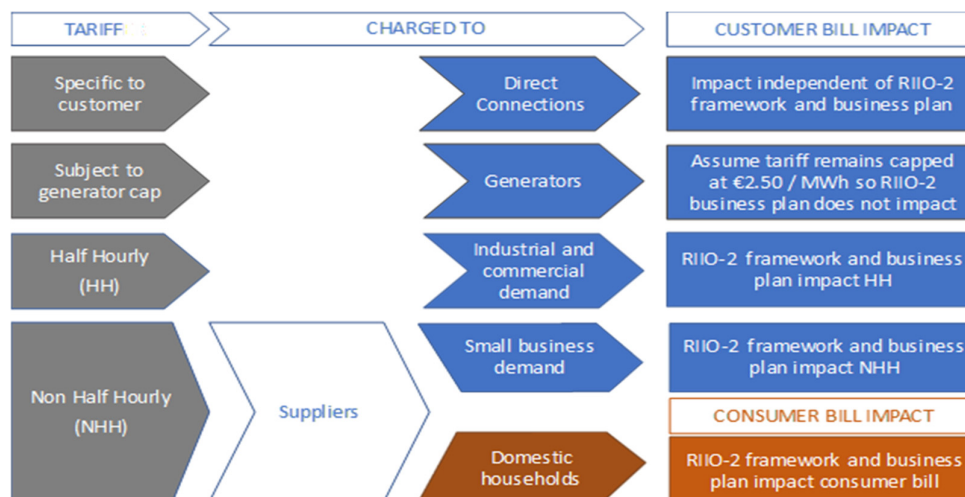
revenues for other onshore and offshore Transmission Owners. Application and engagement on the charging



methodology fall within the ESO's activities. We therefore make the simplifying assumption that the charging methodology will not change from its current form allowing us to quantify the specific impact associated with our business plan and to directly compare T2 period charges with those under the previous price control.

Our revenues are paid for by the customers of the ESO. Customers of the ESO are generators and suppliers. Costs charged to suppliers are passed onto commercial and domestic end users. We consider the impact of our plan both on our customers and the end consumer

Figure 15.25 TNUoS customers and tariffs



4.1 Customer bills

We have built this plan with the help of our customers and have incorporated their views in our proposals.

When we have engaged with our customers on how we can help them understand their bill impacts for the T2 period, they have told us that we should give them visibility of our revenue trends including potential tariff implications. This will allow them to calculate their own

specific bill impacts based on their individual circumstances.

We calculate the impact of our business plan on the half hourly and non-half hourly tariff and therefore on our industrial and commercial and small business and domestic users, respectively. The demand tariff is reflective of revenue. The forecast revenue ranges for our draft business plan submission which are charged to generators and those on Half Hourly (HH) and Non Half Hourly (NHH) tariffs are:

Table 15.26 Revenues charged to generation and demand customers

£m (2018/19 price base)	2021/22	2022/23	2023/24	2024/25	2025/26	T2 average	T1 average
National Grid framework	1847	1929	1801	1747	1704	1806	1769
Ofgem framework	1632	1717	1591	1549	1523	1602	1769

Assuming that forecast demand remains at 2019-20 levels across the T2 period, results in the following forecast impact of our plan on customer tariffs.

Table 15.27 Customer bill impacts

Customer	Impact of our T2 plan on demand tariff	Average customer case study
Industrial / Commercial (HH)	Increase in bills of c.1% 2019-2020 average of £49.9/kW T2 average of £47.2 to £50.6/KW	Half hourly tariff for a 1MW user Change in annual bill of -£2,800 to +£600
Small businesses (NHH)	Increase in bills of c.1% 2019-2020 average of 6.45p/kWh T2 average of 6.09p to 6.53p/kWh	Non-half hourly tariff for an average annual usage of 50kMWh Change in annual bill of -£180 to +£40



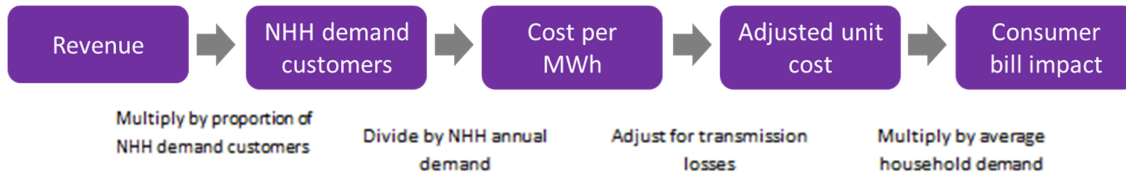
We have engaged on this approach through the Independent Stakeholder Group focusing on the impact of our business plan and will continue to engage with individual customers.

described by Ofgem. The consumer bill is expressed as National Grid's element of the TNUoS tariff passed on to households by suppliers. We use the following five step process to forecast the T2 consumer bill:

4.2 Consumer bills

We calculate our consumer bill impact using a simple top-down approach that follows the methodology

Figure 15.28 Methodology for calculating consumer bill impacts



Our approach is based on the charging methodology and inputs from 2019-20, so our forward-looking estimates, such as demand assumptions, do not include potential future changes to these variables.

Using this methodology, on average across the T1 period, National Grid's direct charges to end consumers account for c4% of the average household electricity bill. This is on average around £24 a year.

All values are quoted in the equivalent of 2018-2019 prices. This gives transparency to the impacts expected from our business plan by removing the effects of inflation on bills. We also specifically isolate the impact of our T2 business plan on the T2 bill by separately stating bill effects which are as a result of previous price controls.

Applying Ofgem's proposed financial package, with the capitalisation rate adjustment to ensure that the company remains able to achieve credit metrics at Baa1 grade for the T2 period (section 3.3 in this chapter), results in an average T2 consumer bill of £20.95, an

average reduction in the annual bill of £3.20 compared with the T1 period.

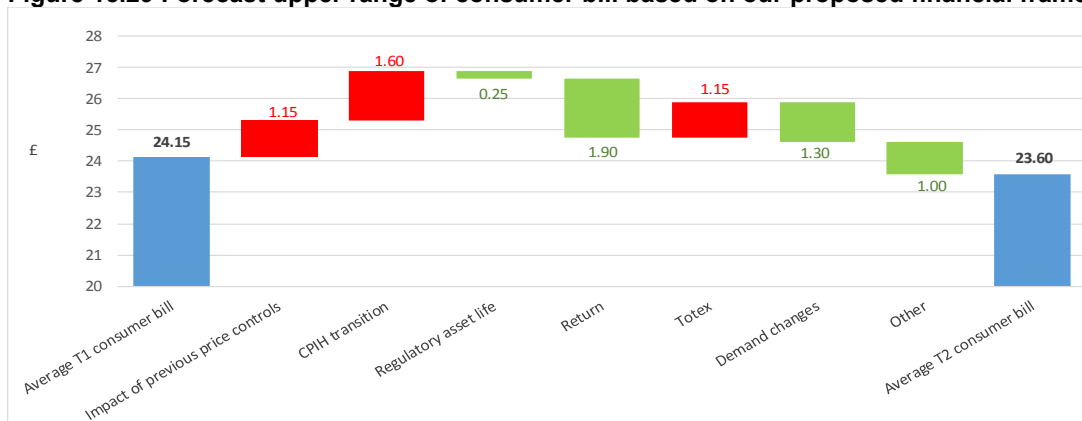
However, by adopting Ofgem's proposed framework, we recognise that there are additional risks for consumers:

- The equity investor offering is reduced and is not in line with that of our peers which limits our ability to make the required investment.
- The short-term fix of amending the capitalisation rate moves away from the principle of matching consumer charges to asset use.

Our proposed financial package mitigates these risks and ensures that charges are set to reflect consumers' use of the electricity transmission network. Under our proposed package, the average T2 consumer bill is £23.60, an average reduction in the annual bill of £0.55 compared with the T1 period.

The drivers which result in the change in the average consumer bill from the T1 to the T2 period can be categorised as follows:

Figure 15.29 Forecast upper range of consumer bill based on our proposed financial framework





- **Previous controls : + £1.15**

The level of RAV additions in the T1 period, and the inclusion of legacy adjustments will flow through to the T2 bill but arise as a result of the previous price control.

- **Framework changes : +£1.35**

The transition to a CPIH indexed price control accelerates cashflow. The continuation of the 45 year regulatory asset life is an increase from the average T1 asset life which delays revenues.

- **Financial package : -£1.90**

This category covers changes to financial parameters; allowed equity return, cost of debt allowances and gearing. Under both our and Ofgem's proposed financial package the cost of capital decreases mainly due to lower allowed equity return when compared with the T1 period.

- **Totex plan : +£1.15**

Our totex plan is driven by what our stakeholders require from the transmission network and the investment needed to deliver a safe, reliable network which will be key to realising the UK's clean growth ambition. We will continue to communicate and test elements of the plan with stakeholders, for example, through the Willingness to Pay exercise.

The upper end of the range representing the impact of Ofgem's package, includes the increased capitalisation rate required to deliver a framework which delivers target credit ratings in the T2 period.

- **Demand projection: -£1.30**

We have continued the 2019-20 charging methodology and demand assumptions through the remainder of the current price control and into subsequent periods.

- **Other movements: -£1.00**

A further reduction is attributable to forecast changes in mainly in pass through costs but also incentive income.

We have engaged with stakeholders on our communications on the consumer bill. In November 2018, we commissioned a study that included awareness of the energy industry amongst the public including the understanding of what makes up the energy bill. Based on the results and feedback we have engaged with stakeholders to explain our portion of the consumer bill and how it is calculated. This information is available at <https://www.nationalgrid.com/about-us/breaking-down-your-bill>. We have also explained how the bill impacts reflect value for the network they use and the services they receive while being fair to current and future generations. This engagement will continue throughout and contribute to development of our plan.