





[External] UKRN guidance for regulators on the methodology for setting the cost of capital - consultation

@anglianwater.co.uk
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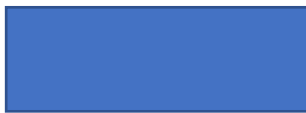
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Wed 16/11/2022 17:36

Thanks for the opportunity to input views on the UKRN consultation. We have reviewed the consultation and are fully supportive of the Water UK submission to the consultation which has already been submitted.

We have one further consideration in response to the question posed in the document on whether we have any views on how this guidance could evolve over time, including views on potential issues for further investigation.

One area which gives us concern is the lack of consideration in the guidance of the relationship between the cost of new debt and the cost of equity. In order to encourage equity investment there should be sufficient reward for the risks undertaken. Without a sufficient margin over the cost of new debt there is no incentive for investors to risk their equity. For the previous four UK water price determinations the spread between the real allowed equity return and the real allowed cost of new debt has averaged 340 basis points and been relatively stable across price reviews. We have noted the Northern Ireland Utility Regulator's recent GA23 final determination, in which the real return on equity is only 28 basis points above the allowed real cost of debt. We cannot see how equity can be attracted by such a small margin, given the risks compared to holding debt in these companies. We consider the forward guidance could have a role in informing the appropriate spread reflecting the relative risk to equity holders.

We hope this is useful and would be happy to discuss further.



Anglian Water Services Limited

Lancaster House, Lancaster Way, Ermine Business Park, Huntingdon,
Cambridgeshire, PE29 6XU

