Regulatory Financial Performance Reporting (RFPR) Commentary

Electricity North West Limited

31 March 2020

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1. Executive summary

1.1. Board Introduction

The Board are pleased to present the Regulatory Financial Performance Report (RFPR) for Electricity North West Limited (ENWL) covering the first five years of performance in RIIO-ED1 and the outlook for the remainder of ED1.

This report is written as we start to recover from the COVID-19 pandemic. Despite the year to March 2020 (FY20) ending as the pandemic unfolded, it was another successful year, with the Company continuing to deliver further improvements, building on the progress made during the first half of ED1. This has resulted in a number of best ever performances for the business in safety, network reliability, customer satisfaction and environmental performance.

The Company's plans continue to be informed by customer and stakeholder input. Our engagement process has confirmed that our stakeholders' key priorities remain clearly focussed on delivering the low carbon transition, helping vulnerable customers, providing a reliable service and delivering an efficient connections service, all at an affordable cost.

The move to a low-carbon economy continues to gather momentum. In June 2019, the Climate Change Act was amended to make the UK the world's first major economy to enshrine in law its commitment to become carbon neutral by 2050. Greater Manchester Combined Authority, a significant stakeholder in our region, has set a challenging target of the region becoming carbon neutral by 2038 – significantly ahead of the national timescale and consultations along similar lines continue in Lancashire and Cumbria. This regional acceleration presents both challenges and opportunities for the business and has become central to our strategic thinking.

The Company is well placed to respond to the low carbon challenge. Innovations such as Customer Load Active System Services (CLASS) and Smart Street address the dual challenge of supporting decarbonisation and ensuring customer bills remain as affordable as possible.

Our significant investment in the next generation Network Management System (NMS) and Active Network Management (ANM) will enable granular real time control of the network at all voltage levels and position the business for the next stage of the transition to a Distribution System Operator (DSO). CLASS is now active in the Fast Reserve market, helping to create network capacity, reducing the need for traditional reinforcement and driving down carbon emissions by avoiding the need for additional fossil fuelled generation at times of peak demand. We estimate that CLASS has saved nearly 2,500tCO2e over the last year, representing 15% of our operational carbon footprint.

Innovation is core to the Company's strategic plans. We have demonstrated the capability for technical innovation and the practical application of the technology, to deliver customer benefits. In addition to CLASS and NMS we are now working on the roll out of Smart Street, with its concomitant customer benefits.

The Company continues to strive to maintain and improve the provision of a highly reliable network (at an upper quartile level), an efficient connections service and a high-quality customer service at the lowest efficient cost, whilst providing additional support to the most vulnerable customers when it is most needed. A good example of this was our rapidly introduced emergency customer support during the early days of the COVID-19 crisis. Recognising that Energy Suppliers had reduced call centre operations, we started to receive calls from vulnerable households requiring financial assistance, who had been unable to contact their suppliers, particularly out of hours. As we continued to operate on a close to 'business as usual' basis, we were able to provide financial support via vouchers, rather than leaving people off supply until they could find support. Whilst the financial cost was relatively small, the benefit to customers who might otherwise have been off supply for a weekend was immense.

The customer centric programme of investments we have made in recent years have secured measurable performance improvements and cost efficiencies that we share with our customers. Our average domestic bill for 2019/20 was £87, compared to the UK average of £93. Since the start of the regulatory period, we have shared £64.5m (2012/13 prices) of efficiency savings with our customers (customers' share £27m).

The legitimacy of the returns made in the energy networks sector remains an area of focus. Our Return on Regulated Equity ('RoRE') on average for the first five years of the ED1 is 7.6% (on an actual gearing basis), with totex outperformance and output incentives generating additional returns, partly offset by financing and tax under performance from insufficient debt and tax allowances.

Based on our current view, the RoRE on average for the RIIO ED1 period is forecasted to be 7.7%, down from 8.1% in the 2019 annual report. The -0.4% year-on-year movement is driven by a worsening in the forecast debt performance for the second half of ED1, primarily due to a reduced outlook for inflation following the onset of Covid-19.

The sensitivity of financing performance to inflation highlights the inherent risk retained by networks, that is managed in part through holding inflation linked debt and derivatives. We also note that the 'inflation in interest' adjustment continues to be calculated based on the average gross debt position rather than the average net debt position. The effect of using net debt would be to reduce the average RoRE for ED1 position from 7.7% to 7.4%, on an 'actual gearing' basis.

We are pleased to announce that the Group was awarded the Fair Tax Mark in July 2020, demonstrating our commitment to responsible tax practices and tax transparency.

The Board continues to monitor the changing political and economic environment including the impact of the Coronavirus pandemic. The decisive election result in 2019 has reduced political uncertainty. Although the ultimate outcome from Brexit remains unknown, this is expected to have a limited direct impact on the business aside for the need for a modest increase in stock levels to manage supply chain risk. This increase, put in place last year has already proved helpful in managing the COVID-19 crisis and has been retained as we await clarity on the Brexit process.

Following a strategic review by the previous shareholders and the subsequent successful sales process, there has been a change in ownership of our ultimate parent company during the year. This has brought about a significant change in the composition of the Board during the year. The new shareholder appointments increase the diversity of the Board and bring expertise and insight in network operation from across the globe. This change complements the continuity of the independent Non-Executive Directors who have remained in post following the change in ownership. The new Board continues to support the company's long term strategic plans, with a particular emphasis on innovation to address the challenges of the low carbon transition and meet the needs of our customers.

This document should be read in conjunction with the ENWL Annual Report and Consolidated Financial Statements for the year ended 31 March 2020:

https://www.enwl.co.uk/globalassets/investor-relations/documents/financial-reports/enw-limited/electricity-north-west-limited-annual-report-and-financial-statements-31-march-2020.pdf

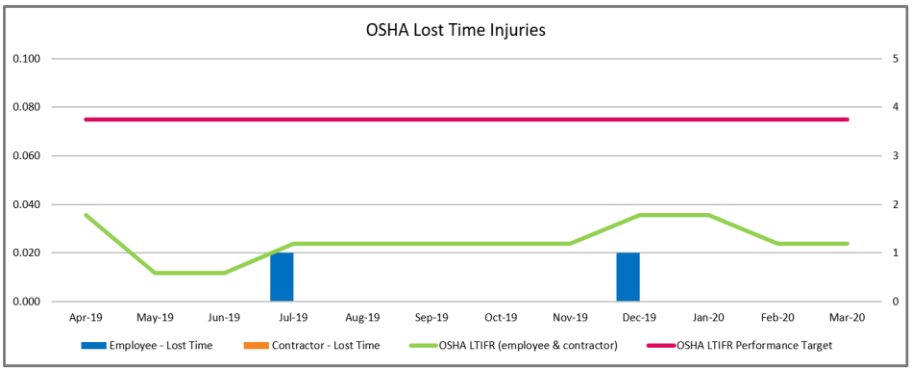
1.2. Company performance

We are pleased to report that we have continued to make progress in our operational performance, including significantly improving customer satisfaction, securing a step change in network reliability, and improving our support for customers in vulnerable situations. Progress is also evident in our improving personal safety performance and the safety and integrity of our network operation.

Safety performance

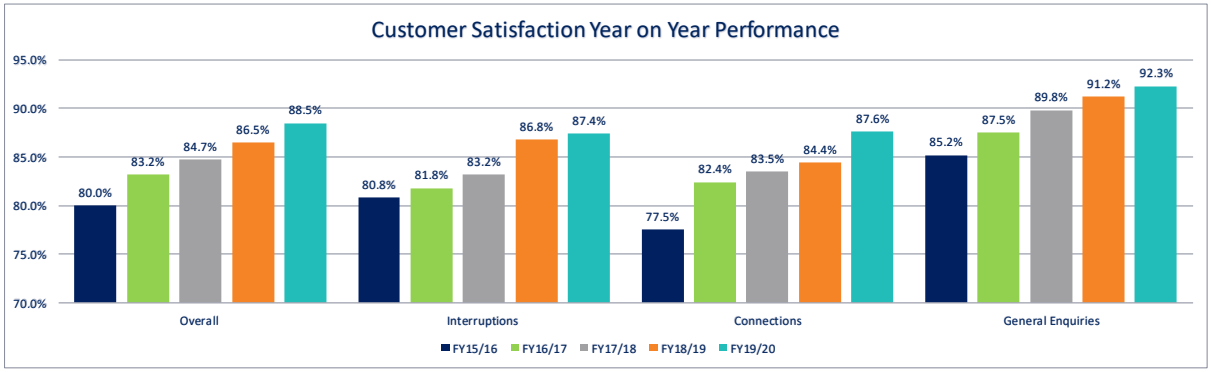
The continued focus on the safety culture has resulted in a sustained reduction in lost time injuries and recordable injury rate.

Our lost time injury (LTI) frequency rate (#/100,000hrs) for FY20 was 0.024 (FY19: 0.047), having had just two lost time injuries during the year (2019: 4). We also maintained our total recordable injury rate position, at 0.13 (FY19: 0.13). We continue to work with our contractors on their safe systems of work. The graph below shows the LTIs in FY20 for both employees and contractors, with just two employee LTIs.



Customer service and connections

Significant progress continued to be made in 2019/20, building on the performance improvement in recent years, illustrated in the graph below. We continue to focus on our priority service register (PSR) customers, providing targeted services to higher risk customers and developing links with other utilities in our region to support and engage with those customers.

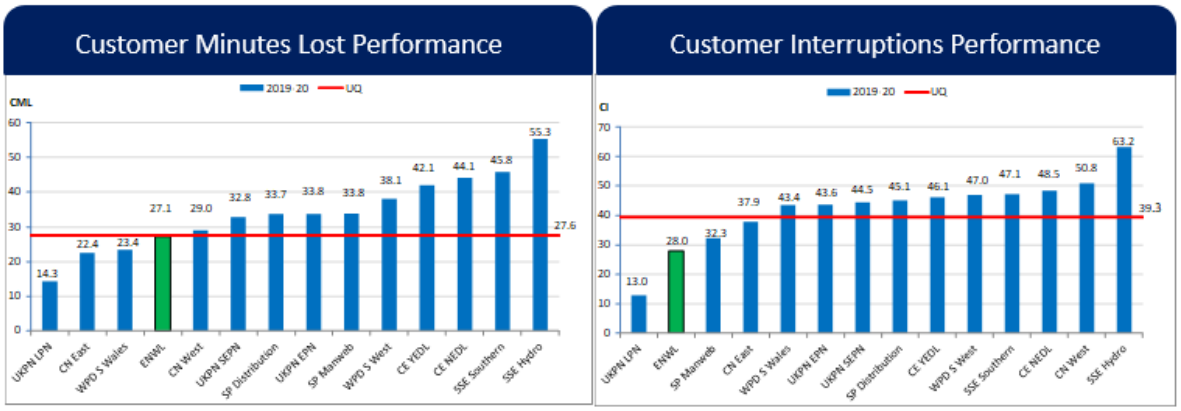


The number of complaints we receive has reduced significantly, with complaint volumes down 32% compared to the prior year. Complaints resolution performance has also improved, currently achieving an 84.0% 24-hour resolution performance (2019: 82.1%).

Time to quote and time to connect performance has continued to improve, supported through the new on-line quotations service, with all time to connect measures achieving maximum incentive reward, despite the tightening of the targets for FY20.

Network reliability and resilience

Following the completion of our QoS2 project (a reinvestment of savings of £18m) mid-way through the year, we have seen a step change in performance in both Customer Interruptions (CIs) and Customer Minutes Lost (CMLs). We are now delivering some of the lowest levels of CIs and CMLs across the industry, achieving upper quartile performance across the DNO companies for both measures. In 2019/20, we saw a reduction of 17% in CIs and 18% in CMLs. The success of the QoS2 project has been reinforced by our ongoing focus on operational excellence aimed at reducing restoration times and reducing the fault impact on planned supply interruption work through our engineering risk management process.



We continue to make significant investment in flood defences and interconnectivity at key sites to provide protection to a 1 in 1,000-year flood risk. Our operations were largely unaffected by the floods during early 2020.

1.3. Future Outlook - Leading the transition to the zero carbon economy and innovation

We are proud to be leading the transition to a low carbon future, whilst limiting the impact on customer bills through innovation. Our Company purpose states that 'Together we have the energy to transform our communities'. There is no bigger transformation for the country than the transition to low carbon.

In response to our stakeholders setting such ambitious targets, we have created our 'Leading the North West to Zero Carbon' plan articulating how we will lead and encourage businesses, our customers and our colleagues on the decarbonisation journey. A near term highlight which we expect to complete before the end of this calendar year is the improvement of two of our facilities into zero carbon exemplar sites; one in Blackburn and one in Oldham.

www.enwl.co.uk/zero-carbon/leading-the-north-west-to-zero-carbon/

Through our leadership and expertise as well as the continued investment in our own network and systems, we are uniquely placed to facilitate the growth in low carbon technologies. It is clear that we will be more effective in this endeavour if we secure the hearts and minds of our employees and contractors. To this end, we are working towards achieving the carbon literacy silver standard, up from our current bronze standard by training all our supervisors and managers in the facts behind global warming and the imperative for action to address it. In addition, we are working with our supply chain to encourage them to follow our responsible business framework as well as embracing decarbonisation.

2. Key Financial Performance measures

£m 12/13	Cumulative to 2020	RIIO-1 period
Customer share of Totex performance	*27.0*	*53.3*
NWO share of Totex performance	*37.4*	*73.9*
Totex out(under)performance, after EV adjustment	64.4	127.2
Output incentives	58.4	102.9
Cost of Debt out(under)performance at actual gearing (pre tax)	(39.5)	(81.4)
Regulated tax out(under) performance at actual gearing (not adjusted for financing)	(0.7)	6.1
	Average to 2020	**Average RIIO-1 period**
Equity RAV	587.9	602.7
Average Net Debt (per Regulatory Definition)	935.9	945.8
Adjusted RAV - including (EV) adjustments	1,523.7	1,548.4
RoRE based on actual gearing	7.6%	7.7%

In the first five years of the RIIO ED1 period we delivered £64.4m totex outperformance post enduring value adjustments (2012/13 prices), £27m of which is shared with our customers. We are forecasting to share £53.3m of outperformance with our customers over the full RIIO ED1 period.

We have committed significant investment in a number of projects in ED1 to enhance the customer experience. This investment has contributed to improved performance in the areas of customer satisfaction, connections time to connect and the reliability of our network. As a result, we have earned £58.4m of output incentive revenue for the first five years and this good performance is expected to continue for the remainder of ED1.

We believe that when evaluating and understanding our returns against allowance, the cost of debt and taxation are important components. Our cost of debt is higher than our allowance - we expect to underperform our cost of debt allowance by £81.4m for ED1 (on a pre-tax adjustment basis). The debt and hedging instruments were set up with interest rates competitively negotiated at the time.

The key financial performance measures discussed are in more detail in section 4.

3. Key operational performance measures

		2016	2017	2018	2019	2020
Safety	Lost time incident frequency rate	0.06	0.10	0.04	0.05	0.02
Reliability and availability	Customer Interruptions (CI)	36.7	32.9	32.8	33.66	27.82
	Customer Minutes Lost (CML)	32.5	33.7	34.4	32.98	27.15
Environment	Business carbon footprint, excl. losses (BCF) (tCO2e)	23,133	21,012	20,599	20,417	18,051
Connections	Time to Quote (LVSSA)	4.00 days	2.96 days	3.7 days	3.7 days	2.5 days
	Time to Quote (LVSSB)	7.43 days	7.92 days	8.25 days	6.8 days	4.9 days
	Time to Connect (LVSSA)	30.36 days	31.91 days	31.72 days	32.9 days	27.8 days
	Time to Connect (LVSSB)	36.88 days	31.67 days	34.28 days	35.7 days	27.6 days
Customer satisfaction	Customer Satisfaction Survey Overall	80.0%	83.2%	84.7%	86.5%	88.5%
	Complaints metric	7.65	3.45	2.29	2.06	2.00
	Complaints resolved in 24 hours	51%	77%	82%	82%	84%
Social obligations	Stakeholder Engagement and Consumer Vulnerability Score	6.9	6.4	5.75	4.54	6.03

3.1. Safety

This is an industry that operates with hazards, and therefore the attention to safety needs to be top of the agenda. Central to our risk mitigation activities are operational safety, asset safety and environmental performance.

Operational safety

The Company ensures that all people are well trained and able to operate safely, backed by policy driven procedures and compliance assurance, alongside a behavioural approach that seeks to ensure that all staff and contractors approach any task with a strong behavioural attitude to safety. The continued focus on the safety culture has resulted in a sustained reduction in lost time injuries and recordable injury rate.

We finished the year ended 31 March 2020 with a lost time injury frequency rate 0.024 (2019: 0.047) having had just two lost time injuries in the year (2019: 4). We also maintained the total recordable injury rate at 0.13 (2019: 0.13).

As our safety journey continues, we are increasingly focused on the quality of, and learning from, the primary leading indicators of safety performance, being safety observations and positive challenges, rather than focusing on the volume of these. Safety observations in the year were recorded at 11,621 (2019: 12,250), plus 2,048 positive challenges (2019: 1,580).

Asset safety

The safety of the Company's employees, contractors and the public from the inherent risks of electrical assets is assured through the Company's ongoing asset investment programme and the associated asset risk management policies which define the programme scope. Safety related investments are reported regularly to the Board.

During the year ended 31 March 2020 the Company made significant progress in further reducing the risks associated with rising and lateral mains in multi occupancy premises. We have now fitted smart fuse technology in all the buildings in our region identified as highest risk.

3.2. Reliability and availability

As we are ever more dependent on electricity, customers say that "keeping the lights on" remains one of their top priorities. This is achieved by targeted investment in the network both to limit the number of faults and also to limit the number of customers affected by those faults that do occur.

In the year ended 31 March 2020, the average number of interruptions per 100 customers (CIs) continues to be industry leading, and the best level the Company has ever achieved, at 27.8 (2019: 33.7) significantly outperforming the target set by Ofgem in the ED1 price determination.

The average number of minutes for which customers were without supply during the year (CMLs) to 31 March 2020 was 27.2 (2019: 33.0), which also outperformed the Ofgem target. This represented a Company best-ever performance.

This improved network reliability has been delivered though proactive investment in the use of network automation and as well as innovative solutions, and an ongoing focus on operational response when incidents do occur. Network reliability continued to be high with a network availability of 99.995%.

Most customers enjoy excellent levels of reliability, but we recognise that there is some variability in the level of service experienced by a few customers. Some customers experience a level of service significantly worse than average, usually caused by their location or being the result of localised network issues. We have continued to invest in the year in schemes to aim to reduce the numbers of worst served customers, with the number of customers meeting this Ofgem definition being 268 in the year ended 31 March 2020 (2019: 135). Although we have seen a small increase in the numbers of worst served customers over the year, the numbers remain very low and, through proactive investment strategies, we expect to achieve our target of having no customers meeting the definition of 'worst served' by the end of ED1.

Key to delivering reliability to customers is proactive investment to improve the resilience of the network to storm and flood conditions. We continue to invest significant funds in flood defences and interconnectivity at key sites to provide protection to a 1 in 1,000-year flood risk.

Health Index

A major part of our reliability strategy is to intervene on higher risk assets before they fail. This is informed by a process of condition-based risk assessment in line with the CNAIM. Our targets for risk reduction through this programme were published by Ofgem in February 2016 and equate to 11.5m risk points over ED1.

In 2019/20, we delivered 1.4m risk points through our programme of targeted replacement and refurbishment activities to generate a cumulative five-year total of 8.4m risk points, or 73% of our RIIO-ED1 target.

Non-connections GSoPs

The number of failures has continued to reduce significantly for EGS8 through the improved monitoring processes instigated, seeing a reduction in EGS8 failures from 925 in FY18 to 117 in FY20. 12 hour failures have also reduced by 51% from the prior year, a reduction from 4,417 to 2,159.

There were a total of 2,159 12 hour failures in the year. 70% of the eligible customers have claimed or proactively been made the payment (2019: 4,4173 and 61%).

The main area of increase is in EGS4 (from 297 to 538). The number of customers affected by a planned supply interruption has increased by 16,000 in comparison to last year which has resulted in additional failures, there have also been a number of jobs impacting high volumes of customers where the business has been unable to provide the required notice due to safety reasons on the network requiring the work to be completed immediately.

EGS9 has also seen an increase, this is predominantly relating to late payment to PSR customers following a 12 hour fault.

3.3. Environment

We take our responsibility for the protection of the environment affected by our activities very seriously. To this end, we are committed to achieving the highest possible standards of environmental performance. We aim to minimise emissions and spills, and we are investing to remove potentially damaging equipment, enhance the environment by undergrounding overhead cables, and supporting the UK in its move to a low carbon economy.

During the year the Company continued to implement energy efficiency measures, through the refurbishment of its buildings, and the replacement of fleet vehicles and company cars with more efficient vehicles. We have also increased the number of electrical vehicle charging points across our depots and have introduced two electric diggers.

In terms of our own direct impact on the environment our principal performance indicator is the level of equivalent carbon dioxide emissions. This measure covers the environmental impact from the use of fossil fuels in vehicles and generators and energy in buildings, as well as the impact of Sulphur Hexafluoride (SF6), which is a strong greenhouse gas, historically used as insulation in electrical equipment. Our policy is to continue to install modern SF6 equipment with lower leakage rates. Over the RIIO-ED1 period we plan to reduce our leakage rate by over 20% from a rate of 0.38% (as a proportion of the mass in service) in 2013 to 0.30% by 2023. In 2019/20 a total of 77.73kg was lost from our system; this loss equates to 0.48% of the total mass in service (2019: 0.24%).

We made a commitment to our customers to reduce carbon emissions, measured in tonnes of CO2 equivalent, by 10% from a 2014/15 base year by 2020. Through targeted investment in the efficiency of our buildings and other efficiency measures, the level of emissions has actually been reduced by 26% from 2014/15 levels (24,415 tCO2e) to 18,051 tCO2e in the year ended 31 March 2020. This was a 12% reduction on the year ended 31 March 2019 of 20,417 tCO2e.

3.4. Connections

We have had another good year during which we exceeded the targets for Time to Quote and Time to Connect metrics. We have improved performance in every category and only narrowly missed achieving maximum reward. We have also developed similar voluntary targets as part of our ICE commitments. Whilst for ENWL, ICE penalties can only apply to two small market segments out of the

nine relevant segments (ENWL having passed the competition tests in the other seven categories during DPCR5), stakeholder engagement is important to us.

We have continued to focus on our Guaranteed Standards of Performance for connections during the year and have maintained a strong performance in this area. The number of failures in FY20 was 23 compared to a target of 24 and a prior year number of 22. This gave us a 99.9% GSoP result, close to our business plan target of 100%.

3.5. Customer Satisfaction

Delivering excellent customer service is a priority for the Company. Customer satisfaction levels have improved year-on-year throughout RIIO-ED1, achieving an overall score of 88.5% in 2020 (2019: 86.5%), ahead of our internal target of 88.3% and the highest ever score for the Company. The relative ranking among the DNOs was 12th out of 14 (2019: 12th) with all DNOs now showing very tightly distributed performance.

The Company is committed to further improve customer satisfaction levels, with a clear roadmap of actions in place, driven through customer feedback, that are monitored regularly by the Executive Leadership team. The actions focus around simplification, compliance with the customer journey, improvement in systems and resourcing strategies.

We maintain a Priority Service Register (PSR) to identify those customers who are most dependent on our services. In the year ended 31 March 2020, we have continued to promote our PSR and have developed our strategy to offer more targeted services to higher risk customers, for example those who are medically dependant on electricity. Investment in staff training has also been a focus in order to help facilitate this.

In delivering for our priority customers we have managed to reach out to over 481,000 customers this year (2019: 520,000) which exceeded our internal target. The communications were carried out through various channels including letters, email and telephony.

We recognise our role in helping to tackle fuel poverty and the particular challenges this brings in our region. During the year we have engaged with a variety of partners in a bid to offer extra support to the customers in our region who are impacted by fuel poverty. Through the introduction of referral partnerships, we are now helping to provide our customers with advice on issues such as energy saving and income maximisation, as well as offering installation of free energy efficiency measures and referral to other relevant services.

The number of complaints we receive has reduced significantly during the year, with complaint volumes down 32% compared to the prior year. We track the time taken to resolve complaints when we do receive them. The overall complaints performance in the year continued to outperform the Ofgem penalty incentive and represents a significant year on year reduction, with a complaint metric of 2.00 (2019: 2.16), with 84.0% of complaints being resolved in 24 hours (2019: 82.1%). This indicates that we will be in 8th position in the DNO league table. The complaint metric reflects the percentage of complaints resolved within 24 hours, combined with the percentage of complaints resolved within 31 days.

3.6. Social Obligations

We are committed to ongoing stakeholder engagement and recognise that such engagement enhances our ability to achieve its aims and objectives and to provide the highest level of service at a price that customers can afford.

This year we have continued strong stakeholder engagement during RIIO-ED1 with our advisory panels and were one of the first DNO's to appoint our Customer Engagement Group (CEG) to provide oversight and challenge to our RIIO-ED2 engagement programme.

Ofgem has stated that it is committed to giving customers a stronger voice in setting outputs and shaping and assessing business plans. The CEG met twelve times throughout FY20 and we welcome the opportunity to work with the CEG over the coming years to demonstrate how insight from stakeholder engagement is being used to inform our RIIO-ED2 Business Plan. The CEG will also fulfil the oversight function for network reinforcement decisions in line with the requirements of the Department for Business, Environment and Industrial Strategy (BEIS).

This year the Company has undertaken a best practice review, learning from stakeholder engagement in the water industry. We have also completed research to understand how to best engage with our stakeholders, how to segment our stakeholders and understand their priorities before developing our RIIO-ED2 Business Plan.

We have also continued to embed and enhance stakeholder engagement for RIIO-ED1 working closely with our Consumer Vulnerability, Sustainability and Chief Executive Advisory Panels. We have introduced independent Chairs for our consumer vulnerability and sustainability panels and working with them, have introduced new members to strengthen strategic involvement in key areas.

These panels and our three Regional Advisory Panels, held annually in Greater Manchester, Lancashire and Cumbria have helped inform our Executive team and business decision-making.

The transition to the low carbon economy and support for vulnerable consumers continue to be priorities for our stakeholders. This is reinforced by our RII0-ED2 consumer research along with reliability of supply and value for money. This insight will be critical to informing our emerging Business Plan as we progress to the next stage of willingness to pay testing.

To support adherence to these initiatives, the Company has engaged auditors for a non-financial assurance of its Stakeholder Engagement and Customer Vulnerability (SECV) Submission and its commitment to Accountability Principles for Sustainable Development (AA1000APS).

Our SECV score for 2019/20 has recently been confirmed at 6.03, a significant 1.49 point improvement on the prior year score. We are pleased that embedding our enhanced stakeholder engagement approach within the organisation and greater use of Social Return on Investment within our decision-making has been recognised in an increase to the score and we are continuing to build upon this further, including reviewing the feedback received from the panel.

4. Overview of regulatory performance

4.1. RoRE

RoRE based on Actual Gearing	Cumulative to 2020 £m	RIIO-1 period £m
Allowed Equity Return	***5.4%***	***5.4%***
Totex outperformance	1.3%	1.5%
IQI Reward	0.3%	0.2%
Output Incentives	2.0%	2.1%
Other	0.0%	0.0%
RoRE - Operational performance	***9.0%***	***9.3%***
Debt performance - at actual gearing	-1.1%	-1.4%
Tax performance - at actual gearing	-0.3%	-0.2%
RoRE - including financing and tax	***7.6%***	***7.7%***

The legitimacy of the returns made in the energy networks sector remains an area of focus. As a result we continue to disclose our Return on Regulated Equity ('RoRE') in our most recent Annual Report and Financial Statements. Our RoRE on average for the first five years of the ED1 is 7.6%, on an actual gearing basis. For the first five years our totex outperformance contributes 1.3% whereas the output incentives that we have earned add 2.0%. This is offset by the 1.4 impact of financing and tax performance, being important components in both shareholder returns and customer understanding.

Based on our current view the RoRE on average for the RIIO ED1 period is forecasted to be 7.7% compared to 8.1% in the 2019 annual report.

This is driven by a worsening in the forecast debt performance for the second half of ED1, primarily due to lower inflation.

Annual RPI inflation forecasts for FY21-23 were revised markedly lower following the onset of the Covid-19 pandemic.

For inflation-linked debt (including fixed debt swapped to inflation-linked using derivatives), lower inflation is largely neutral, with lower indexation and accretion charges broadly offset by a lower 'inflation in interest' adjustment.

This is not true however for fixed nominal debt. These debt costs are, by nature, fixed and any reduction in inflation forecasts will only reduce the 'inflation in interest' adjustment, thereby increasing the 'real' debt costs.

By contrast, the debt allowance is only minimally impacted by changes in annual inflation forecasts, partly due to its historic tromboning construct and partly due to the use of more stable 10yr breakeven rates when calculating real allowances.

Economically, this highlights the inherent inflation risk retained by networks and the associated risk reduction from holding inflation linked debt, either from direct inflation linked issuances or through the use of derivatives.

As an important final point, we note that the 'inflation in interest' adjustment continues to be calculated based on the average gross debt position rather than the average net debt position. This is inconsistent with other elements of the calculation, with net financing costs effectively including cash interest income at nominal (unadjusted for inflation), with cash interest expense at real (adjusted for inflation). The effect of using net debt would be to reduce the 'cumulative to 2020' RoRE position from 7.6% to 7.3% and the ED1 position from 7.7% to 7.4%, on an 'actual gearing' basis.

4.2. Allowed Revenue

Nominal prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m
Nominal Base Revenue	403.6	409.4	389.9	399.0	410.3
Incentive revenue adjustment	8.4	15.8	17.2	16.7	15.8
Adjustments for Allowed Pass-Through items	-	-	(0.9)	(0.8)	(4.2)
Network Innovation Allowance	2.5	2.9	2.7	2.8	2.9
Low Carbon Networks Fund revenue adjustment	1.6	0.1	0.3	0.7	0.1
DPCR4 residual distribution losses incentive and Growth Term	(11.6)	(10.7)	-	-	-
Correction factor	-	(30.6)	11.1	4.2	(3.8)
Allowed Network Revenue	**404.6**	**448.1**	**398.1**	**414.1**	**428.7**

2020 allowed revenue at £428.7m represents a 3.5% increase in allowed revenues compared to 2019. The underlying revenue increase, i.e. prior to correction factor from prior years, can broadly be attributed to the increase in base demand revenue of £11.4m reflecting Final Determination profiling.

Including the year-on-year movement of -8.0m for the K-factor prior year recovery term results in a total increase of £14.6m in allowed revenue.

Our incentive revenue forecast is reviewed in detail in Section 4.3.

Forecast nominal base revenue for 2021 – 2023 is predicted to increase due to the uncertainty created by the COVID-19 pandemic and its effects on current collected revenue and future years' correction factors.

4.3. Output incentive performance – earned basis

12/13 prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m	*Forecast* 2021 £m	*Forecast* 2022 £m	*Forecast* 2023 £m	Cumulative to 2020 £m	RIIO-1 period £m
Broad measure of customer service	(0.2)	0.5	1.5	2.0	2.5	2.6	2.8	3.1	6.3	14.8
Interruptions-related quality of service	10.3	9.6	7.8	8.0	11.0	11.0	11.0	11.0	46.7	79.7
Incentive on connections engagement	-	-	-	-	-	-	-	-	-	-
Time to Connect Incentive	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	4.8	7.8
Losses discretionary reward scheme	-	0.6	-	-	-	-	-	-	0.6	0.6
Post-Tax Earned Incentive revenue	**11.1**	**11.6**	**10.3**	**10.9**	**14.4**	**14.6**	**14.8**	**15.1**	**58.4**	**102.9**

The output incentives are an important component of RoRE; in the first five years of the price control they contribute 2.0% of RoRE on average with the Interruptions Incentive Scheme (IIS) incentive contributing the most. The output incentives are dependent on our key operational performance metrics as discussed in the Key Operational Performance Measures section above. We forecast those incentives to contribute around 2.1% of RoRE for the full price control. Importantly the rewards we earn under these incentives have been set by Ofgem so that the rewards, reflected in our RoRE reflect the benefits delivered to customers so customers are net beneficiaries of our incentive performance. We invest both financial resources and management time to achieve these outcomes for customers.

The IIS ED1 incentive income reflects our strong performance and ongoing commitment to minimising and managing network outage for our customers. Customer interruptions and minutes lost have reduced as a result of ongoing investment in network automation and interconnection. The underlying improvement in incentive revenue earned from the customer satisfaction survey reflects another performance improvement this year to 88.5% from 86.5% in 2019. Delivering and improving excellent customer service standards remains a key area of focus for ENWL.

4.4. Totex performance

12/13 prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m	*Forecast* 2021 £m	*Forecast* 2022 £m	*Forecast* 2023 £m	Cumulative to 2020 £m	RIIO-1 period £m
Latest Totex actuals/forecast	230.5	195.4	226.6	232.7	212.7	209.9	220.2	206.7	1,097.9	1,734.7
Totex allowance including forecast allowed adjustments and uncertainty mechanisms	237.4	226.9	228.9	231.2	231.5	235.2	242.6	228.3	1,155.9	1,861.9
Totex out(under)performance	6.9	31.5	2.3	(1.4)	18.8	25.3	22.4	21.6	58.0	127.2
Customer share of out(under) performance	2.9	13.2	1.0	(0.6)	7.9	10.6	9.4	9.0	24.3	53.3
NWO share of performance	4.0	18.3	1.3	(0.8)	10.9	14.7	13.0	12.5	33.7	73.9
Total enduring value adjustments	(3.3)	(20.4)	1.9	28.6	(0.4)	(3.1)	(1.2)	(2.2)	6.5	(0.0)
Enduring Value: Customer share of performance	(1.4)	(8.5)	0.8	12.0	(0.2)	(1.3)	(0.5)	(0.9)	2.7	(0.0)
Enduring Value: NWO share of performance	(1.9)	(11.9)	1.1	16.6	(0.2)	(1.8)	(0.7)	(1.3)	3.8	(0.0)
Total out(under) performance (including enduring value adjustments)										
Customer share of performance	1.5	4.6	1.8	11.4	7.7	9.3	8.9	8.1	27.0	53.3
NWO share of performance	2.1	6.4	2.5	15.8	10.7	12.9	12.3	11.3	37.4	73.9
Total	**3.6**	**11.1**	**4.2**	**27.1**	**18.4**	**22.2**	**21.2**	**19.4**	**64.4**	**127.2**

Totex spend for the year ending 31 March 2020 was £212.7m compared to an Ofgem allowance of £231.5m in 2012/13 prices. In the first five years of the RIIO ED1 period we spent £1,097.9m on operating and managing the network; this is compared to an allowance of £1,155.9m, 5% lower than allowance before taking delivery of outputs into account. Making the appropriate adjustments for timing of delivery compared to the original Business Plan submitted in 2013 is therefore important to assess performance. An Enduring Value adjustment of £6.5m has been included to take into account such timing differences, generating underlying totex outperformance of £64.4m. Of these savings, £27m is returned to customers. The ED1 forecast period shows expected outperformance of £127.2m. The performance to date reflects efficiencies earned of £146m, net of reinvestment of £73m not otherwise reflected in the enduring value adjustment.

The period to date under spend is principally in load related expenditure (mainly timing) where in general, demand increases have not warranted the forecast level of reinforcement interventions seen in the early years of RIIO-ED1. We are however starting to see increasing spend in this area as a number of major infrastructure investments, particularly in the Greater Manchester area, supporting required significant increases in capacity. We are also generating efficiencies in non load capex as targeted investment has delivered risk point reductions in excess of our linear target (73% of our 11.5m risk point target has been delivered at March 2020), combined with the use of innovative solutions in other investment areas.

There is additional spend compared to allowances in network operating costs (including the impact of storms Desmond and Eva in 2016 and higher volumes of non smart cut out interventions) and in non operational capex to deliver service enhancements and to facilitate business change, offset by savings in indirects and business support costs (which include £10m storm insurance recovery).

We have worked hard in the first five years of the price review to deliver cost efficiencies and to both make judicious reinvestments and to share that benefit with our customers. By identifying and delivering these efficiencies, we have been able to make significant reinvestment in our operations to deliver improvements for our customers in reliability, resilience and customer service and proactively invest in in the next generation Network Management Systems (NMS). This investment, combined with the recent investment in our telecoms network, significant investment in data cleanse activities and Active Network Management (ANM), the business will be well placed to lead the transition to a Distribution System Operator (DSO).

Additional investment to date includes the investment in the commercialisation and expansion of CLASS (£12m), quality of supply (£29m), operational IT spend above allowances to support NMS / ANM (£13m) and non-operational IT to improve business systems and processes (£17m). These are all

expected to deliver shared totex efficiencies or performance improvements over the second half of ED1.

The Enduring Value methodology and adjustments are outlined in Appendix 1. The most significant elements of the calculation are the deferral of load related expenditure into the second half of ED1 offset by advanced delivery of the asset replacement network investment programme. Load related expenditure has been below allowances where in general, demand increases have not warranted the forecast level of reinforcement interventions in the first four years of RIIO-ED1. We are however now in early delivery stages for a number of major infrastructure investments in the Greater Manchester area which will require significant increases in capacity and we are now seeing significant increases in load spend, which we expect to see continue in the last 3 years of ED1.

4.5. Innovation performance

The challenges faced by electricity network operators such as ENWL from the UK's ongoing decarbonisation of heat and transport are significant. A key part of the UK's journey to zero carbon is the revolution of our electricity industry – the way electricity is generated, stored, transported and traded.

As the region's network operator, it's our responsibility to lead the way in this transformation. Through investment and innovation in energy infrastructure, we will help the North West to decarbonise and pave the way for the growth of renewable energy.

All our innovation projects are aligned with our innovation strategy – to maximise the use of our existing network and combine new technology and creative thinking to provide real solutions to real problems.

To enable this alignment we have six key innovation themes which relate to the challenges of the low carbon future and to our business plan and each project supports one or more of these themes.

1. ***Safety & environment***: We will strive to continuously improve safety and reduce the impact on the environment.

2. ***Network resilience:*** We will improve network performance and reduce risk.

3. ***Capacity:*** We will maximise the use of existing assets to increase demand and generation capacity.

4. **Efficiency:** We will provide our existing services at a lower cost.

5. **Customer service:** We will improve our customers' experience and offer new services along with more choices.

6. ***Commercial evolution:*** We will change our role from network operator to system operator.

We are in the process of updating our Innovation Strategy to modify our themes to align with the new themes in the National Innovation Strategy - Consumer vulnerability; Net zero and the energy system transition; Optimised assets and practices; Flexibility and commercial evolution; Whole energy system.

Our strategy aims to achieve innovation across our business to provide new and improved services for our customers, which increases flexibility and allows customers greater choice in the way they interact with our network.

We do this by embracing the opportunities provided by:

- New technologies;
- New business and commercial models;
- Our regulatory framework and incentives.

We continue to seek collaboration with partner organisations to enable us to fully utilise the ideas and industry opportunities available for providing customers with more reliable, more efficient and more cost-effective services.

During FY20, we have continued to use innovative solutions within the business to reduce costs and avoid reinforcement.

Following the successful Smart Street Second Tier project we applied for an adjustment to the RIIO-ED1 price control, under the Innovation Rollout Mechanism, to facilitate the deployment of the Smart Street system. This was successful with an award of £15.1m (2012/13 prices) or £18.0m (current prices). Once the roll out is completed it will bring energy savings of up to 8% to customers within the deployment areas and as such have a material impact on their costs. The installation of this system will allow for the connection of greater penetrations of LCTs before it becomes necessary to reinforce the network. The Smart Street system should save around £45k per substation in avoided reinforcement costs and is expected to lead to a reduction in CO2 of around 16,500 tonnes within the RIIO-ED1 period.

The impact of innovation in the RIIO-ED1 price control is continuing to grow. Some examples are shown below.

CLASS

The initial CLASS site installations were substantially completed in April 2020 and continue to be used to provide services for NGESO.

ENWL can use CLASS internally to reduce peak demand and avoid the need for reinforcement which will also lead to environmental benefits.

Celsius

The Celsius project successfully delivered an improved understanding of the thermal performance of distribution assets. It identified that nameplate ratings do not reflect the true capacity of an asset and that existing, unused capacity could be made available. It also developed a highly innovative and cost-effective method of releasing this capacity. Releasing that additional capacity will reduce the need for asset replacement, which has large financial and carbon impact benefits.

Enhanced Voltage Control (EVC)

Following completion of the project ENWL we are publishing the new voltage control policy which will provide better management of sites which have large concentrations of generation.

4.6. Financing and Net Debt position

£m 12/13	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m	*Forecast* 2021 £m	*Forecast* 2022 £m	*Forecast* 2023 £m	Cumulative to 2020 £m	RIIO-1 period £m
Assumed regulatory finance cost at actual gearing	31.5	19.4	2.3	10.8	15.2	23.6	18.1	17.0	79.2	137.9
Assumed regulatory finance cost at notional gearing	33.5	20.7	2.5	11.2	16.0	25.2	19.4	18.4	83.8	146.9
Forecast revised Cost of Debt Allowance	24.9	23.8	22.6	20.8	19.5	18.1	16.8	15.5	111.7	162.2
Cost of Debt out(under)performance at actual gearing (pre tax adjustment)	(11.0)	(9.8)	(3.7)	(6.1)	(8.9)	(15.0)	(11.9)	(14.9)	(39.5)	(81.4)
Cost of Debt out(under)performance at notional gearing (pre tax adjustment)	(13.2)	(12.0)	(5.6)	(7.3)	(10.3)	(17.3)	(14.0)	(17.4)	(48.4)	(97.1)
Impact on out(under) performance relating to deviating from notional levels of gearing (pre tax adjustment)	2.2	2.2	1.8	1.2	1.5	2.3	2.0	2.5	8.9	15.7
Notional Gearing	65.0%	65.0%	65.0%	65.0%	65.0%	65.0%	65.0%	65.0%	65.0%	65.0%
Actual Gearing	61.2%	61.0%	60.8%	62.3%	61.8%	60.8%	60.8%	60.0%	61.4%	61.1%
Average Net Debt (per Regulatory Definition)	920.9	922.5	924.2	955.5	956.3	952.4	965.9	968.4	935.9	945.8
Equity RAV	583.8	590.1	596.6	578.0	590.8	613.1	623.7	645.1	587.9	602.7
Adjusted RAV - including latest forecast and Enduring Value adjustments	1,504.7	1,512.6	1,520.8	1,533.5	1,547.1	1,565.5	1,589.6	1,613.6	1,523.7	1,548.4

Our debt structure comprises of the following debt and hedging instruments:

Debt Instruments

- £450m 8.875% fixed rate bond maturing in 2026. An original bond issuance of £200m was transacted in 1995, followed by three re-taps issued at varying premia between July 2001 and February 2002. All issuances have been separately included in the RFPR tables, in-line with the guidance provided.
- £100m 1.4746% +RPI index linked bond maturing in 2046
- £75m 1.656% + RPI index linked loan from EIB maturing in 2024
- £60m 1.51% + RPI index linked loan from EIB maturing in 2024
- £50m 0.38% + RPI index linked loan from EIB maturing in 2032
- £50m 0% +RPI index linked loan from EIB maturing in 2033
- £200m 6.125% fixed rate back to back bond from ENW Finance plc maturing in 2021 (ENW Finance plc being a special purpose vehicle set up with the sole purpose of raising bond finance for ENWL)
- £77.4m of various intercompany loans at differing fixed nominal rates issued maturing in 2023. All rates were set as third party market rates at the time of issue
- £50m revolving credit facility, of which £30m was drawn at year end, forecast to be nil drawn by the 2021 year end.

Hedging Instruments

- A set of RPI swaps totalling £200m (receive fixed to 2021, floating to 2038, Pay RPI to 2038, which cumulatively hedge the £200m fixed rate inter-company debt (ref C6) maturing in 2021. After this debt is refinanced, these swaps will continue to hedge the replacement debt until 2038, hence the maturity date of the swaps of 2038 and the change from fixed to floating interest receivable from 2021. These swaps are structured on a PAYG basis, with accretion payable at either five or seven year intervals, dependant on the swap. All interest rates were competitively negotiated at inception of each instrument.
- A set of RPI swaps totalling £100m (Receive fixed to 2026, floating to 2050, pay RPI to 2050) which have the cumulative impact of hedging £100m of the £250m fixed rate debt maturing in 2026.

Similar to above, these swaps mature in 2050 and it is our intention to use them to hedge future debt. These swaps are structured on a PAYG basis, with accretion payable at ten year intervals, from 2030.

Without these hedging instruments, the proportion of nominal fixed and floating debt to index-linked debt would be 66%:34%. With these financing instruments in place, the proportion of nominal fixed and floating debt to index-linked debt is 31%:69%, in line with our treasury policy guidance for the proportion of index-linked debt held by the company, as approved by our Board.

The real interest coupon payable on index-linked financing is aligned with the real debt allowance (and RAV RPI indexation) received under the RIIO framework. Holding a high proportion of index-linked finance minimises the cash flow mismatch between the inflation expectation 'wedge' built into nominal fixed interest payments and the actual, variable RPI outturn.

Forecast Debt issuance summary

Date of Issue	Amount	Interest Rate Assumption	Financing Rationale
ED1			
2020/21	£300m	2.00% nominal	We are currently progressing a £300m financing with an estimated completion of Summer 2020. This will serve to refinance the £200m 6.125% bonds and to cover the requirement for an additional £100m of debt at ENWL level to deliver target gearing on the forecast Regulatory Asset Value.
2022/23	£77.4m	2.74% nominal	Intercompany loans maturing March 2023 refinanced with like for like intercompany loans at an arms length, market rate basis
			Note: Forecast debt financing in ED2 is provided for information only below and is not included in the RFPR data tables
ED2			
2023/24	£300m	0.91% index-linked (CPI)	Refinance of £135m EIB index-linked debt (accreted value c.£190m) plus an additional £110m to cover the incremental debt requirement for target gearing
2025/26	£580m	3.14% nominal	Refinance of £450m 8.875% bonds maturing in 2026 via a bond issue. £130m to cover incremental debt requirement

Debt performance

On an actual gearing basis our cost of debt underperformance is £39.5m for the first five years of the price control and expected to be £81.4m cumulatively for RIIO-ED1. Our underperformance is due to the mechanics of the current debt allowance, which give rise to the following:

- We have large embedded debt costs (£450m bond finance raised pre 2005) which pre-date the current trailing average mechanism. As this debt matures in 2026, this represents an ED1 problem, which will only impact two and a half years of ED2.
- Due to our size as a small DNO, we are unable to raise 1/20th of our debt every year to match the current trailing average mechanism allowance, due to minimum issuance sizes in the markets.

- Debt with longer maturities of over 20 years are common within infrastructure, and help us to manage liquidity risk in particular, as well as ensuring market-backed sizes and reducing double handling.
- The pricing of smaller debt issuances is often at a premium to larger, issuances. There is no adjustment for this 'small company premium' within the current debt allowance.
- ENWL is an efficient, well performing company with gearing below notional level, but is rated BBB only. However, the trailing average mechanism uses a blend of iBoXX A and iBoXX BBB indices to estimate reference debt pricing.
- There is no allowance for the debt carry costs of refinancing ahead of debt maturity ("double-handling") within the trailing average mechanism. In order to support our investment grade credit ratings, we need to refinance in advance of our maturities.
- The trailing average mechanism assumes that debt is raised at the average annual pricing level. Debt pricing can fluctuate materially within the year. Again this can create windfall gains or underperformance due to lucky timing rather than good management performance.
- The debt mechanism strips out an estimate of forward RPI from the nominal cost of bonds, at the point of issuance. The RAV is then inflated by actual RPI. In those years where RPI inflation is low, and to the extent that there is no hedging in place, debt underperformance takes place.

Overall, we consider the current cost of debt allowance methodology to favour the 'lucky' – those who have been lucky in their timing of refinancing and issuance, and the 'large' – larger, higher investment rated companies who are able to access the market more frequently with larger amounts.

4.7. Taxation

12/13 prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m	*Forecast* 2021 £m	*Forecast* 2022 £m	*Forecast* 2023 £m
Adjusted/ forecast regulated tax liability with timing differences	24.4	25.6	14.9	19.2	21.6	16.3	14.6	16.7
Revised regulated tax liability for comparison against allowance	23.8	24.9	14.1	18.7	21.0	15.6	13.9	15.8
Net forecast tax allowance	20.9	26.5	20.3	18.9	18.4	18.9	18.2	17.3
Regulated tax out(under) performance at actual gearing (pre adjustment for financing)	**(3.5)**	**0.9**	**5.4**	**(0.3)**	**(3.2)**	**2.6**	**3.6**	**0.7**
Regulated tax out(under) performance at notional gearing (pre adjustment for financing)	**(2.9)**	**1.6**	**6.3**	**0.2**	**(2.7)**	**3.3**	**4.3**	**1.6**
Impact on out(under) performance deviating from notional levels of gearing (pre adjustment for financing)	(0.6)	(0.7)	(0.9)	(0.5)	(0.5)	(0.7)	(0.7)	(0.9)
Tax performance - at notional gearing (RoRE)	**(5.9)**	**(1.4)**	**4.4**	**(1.5)**	**(4.8)**	**1.2**	**1.9**	**(1.9)**

The adjusted forecast regulated tax liability with timing differences has been calculated by taking the actual tax liability (per the CT600) or the forecast tax liability (per the statutory accounts for 2019/20 and per our forecasting model for subsequent years) and adjusting for tax in relation to non-regulated activities or items excluded from the Price Control Financial Model (PCFM).

We have a gearing level which in any given year is circa 3 to 5% less than the gearing level used to calculate the tax allowance and, as a result, each year we report a higher level of tax under-performance at actual gearing level than at notional gearing level.

The revised regulated tax liability for comparison against allowance represents the tax liability that would have arisen had the actual gearing level been at the same level as the notional gearing.

The forecast tax allowance has been calculated using an extended PCFM, including Enduring Value adjustment.

The tax under-performance in FY16, FY19 and FY20 relates to the fact that net revenue was greater than per the PCFM, resulting in a higher actual tax charge compared to the tax allowance.

There was a tax out-performance in FY17 and FY18. Although actual net revenue was higher than the PCFM in FY17, the collected revenue adjustment resulted in a tax out-performance. In FY18, this was due to net revenue being lower than actual revenue, resulting in a lower tax charge compared to the tax allowance.

The difference in the capital allowances between the PCFM and the actual CT600 will comprise two elements: being the difference between how the capital allowances are calculated between the PCFM and the CT600; and the difference between actual capital expenditure and expected capital expenditure.

For this RFPR we have not split these out due to the complexity involved and the full difference has been included within the revised regulated tax liability for comparison against allowance.

"Tax impact of financing performance (at actual gearing)" has been calculated by taking the actual financing cost (at actual gearing) less the allowance which is derived from the cost of debt multiplied by 65% of the RAV. The result is multiplied by the appropriate tax rate.

"Tax impact of financing performance (at notional gearing)" has been calculated by adjusting actual financing cost for the ratio of the notional to actual gearing difference. This is compared to the allowance derived from the cost of debt multiplied by 65% of the RAV. The result is multiplied by the appropriate tax rate.

4.8. RAV

12/13 prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m	*Forecast* 2021 £m	*Forecast* 2022 £m	*Forecast* 2023 £m
Opening RAV (before transfers)	1,526.2	1,538.9	1,540.9	1,554.5	1,564.8	1,580.7	1,600.8	1,628.3
Opening RAV (after transfers)	1,526.2	1,538.9	1,540.9	1,554.5	1,564.8	1,580.7	1,600.8	1,628.3
Net additions (after disposals)	159.5	145.3	155.0	157.7	152.0	152.8	158.8	148.8
Net additions (after disposals) - enduring value adjustment	0.9	5.8	(0.5)	(8.1)	0.1	0.9	0.3	0.6
Total Net Additions	160.4	151.1	154.5	149.5	152.1	153.7	159.1	149.5
Depreciation	(147.7)	(149.1)	(140.6)	(138.9)	(136.3)	(133.6)	(131.6)	(129.9)
Total Depreciation	(147.7)	(149.1)	(140.9)	(139.2)	(136.3)	(133.6)	(131.6)	(129.9)
Adjusted Closing RAV	**1,538.9**	**1,540.9**	**1,554.5**	**1,564.8**	**1,580.7**	**1,600.8**	**1,628.3**	**1,647.8**

Regulatory asset value (RAV) effectively reflects the part of totex costs that are not immediately chargeable to the customer via allowed revenue, thereby spreading costs between current and future generations. Our adjusted closing RAV as at 31 March 2020 is £1.6bn in 12/13 prices. This number is expected to increase in comparable price base as we continue to invest in the network. RAV has also been adjusted in table R9 as a result of the adjustment to totex for Enduring value. Please see the enduring value section in Appendix 1 for further details.

4.9. Dividends

Nominal prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m
Dividend paid as per Statutory Accounts	30.0	81.0	75.6	46.3	38.3

During the year ended 31 March 2020, the Company proposed and paid a final dividend for the year ended 31 March 2019 of £16.9m, paid in June 2019, and an interim dividend of £21.4m that was paid in December 2019. In the year ended 31 March 2019 the Company declared a final dividend for the year ended 31 March 2018 of £16m, paid in June 2018, and an interim dividend of £30.3m that was paid in December 2018. The Directors have not proposed a final dividend for the year ended 31 March 2020.

To respond to the financial risk introduced by the coronavirus pandemic through the active management of our cash flows, we have been able to mitigate the impact of reduced income as a result of reduced electricity demand and connections work. We have taken the short-term decision to defer some capital investment into future years of ED1 until the outlook becomes more certain as well as to cancel our year ended March 2020, June dividend payment. These steps have enabled us to play our full part in supporting the industry 'Small Supplier Liquidity Scheme', despite a significant reduction in cashflow from customers.

The dividends are paid from the available cash in each financial year at semi-annual intervals, with reference to the forecast business needs, the Group's treasury policy on liquidity, financing restrictions, applicable law in any given year and the Company's licence obligations. We continue to invest in our network, aiming to deliver optimal performance for our stakeholders. We focus on delivering business performance throughout the RIIO-ED1 period that is both strong and continuously improving.

4.10. Pensions

12/13 prices	*Actuals* 2016 £m	*Actuals* 2017 £m	*Actuals* 2018 £m	*Actuals* 2019 £m	*Actuals* 2020 £m
Established deficit element funded via specific allowances	10.4	10.3	15.1	15.0	15.1
Established deficit (EDE) allowance as per PCFM	15.8	15.8	15.8	11.6	11.6

Latest pension scheme valuation (as advised to be used by Ofgem)	***31/03/2016***
Price base	***2015/16***
	£m
Total Liabilities attributable to post cut-off date notional sub fund	116.4
Total Liabilities attributable to pre cut-off date notional sub fund	1,232.6
Total Assets attributable to post cut-off date notional sub fund	113.7
Total Assets attributable to pre cut-off date notional sub fund	1,092.7
Deficit in the post Cut-Off Date Notional Sub-Fund	2.7
Deficit in the pre Cut-Off Date Notional Sub-Fund	139.9
Licensee element of established deficit	2.7
Licensee element of incremental deficit	139.9

As per the guidance received from Ofgem on 23rd July we have reported the pension deficit payments as per the reasonableness review submission in August 2017 as part of the 2016 pension deficit valuation review which takes place every three years. The updated triennial review based on a 31 March 2019 valuation was concluded in March 2020 and will be used for our next submission.

We continue to monitor the performance of the pension funds with the funding rate at 31 March 2019 being approximately 94.5%.

Formal pension funding documents can be requested from the ENW Pensions Department.

5. Data assurance statement

While we have applied the principles of Ofgem's data assurance guidance we also note the element of judgement required in preparing the forecasts until the end of the RIIO-ED1 period. We have also used certain assumptions regarding the RIIO-ED1 close out methodology in arriving at the Enduring Value adjustment, thus having an impact on our RoRE forecast. The submission has been subject to expert and second person review and signed off by the Chief Financial Officer.

6. Appendices

6.1. Appendix 1 - Enduring Value Methodology

Overview

Enduring value (EV) is an adjustment made to totex performance by licensees to reflect the true value of the performance over the course of the price control. The adjustment reflects the estimated value of the impact of decisions that impact future value. Adjustments are made for the known or estimated value of close out mechanisms and to reflect timing differences in delivery for example, expenditure in advance or lagged from the timing of the allowance received.

For ENWL, the two most material items impacting the enduring value are:

1. The timing of load related expenditure which is profiled more heavily in the second half of ED1, particularly the last 3 years, in the latest approved Business Plan.

2. Over delivery of risk points at the end of year 5, 72% of outputs delivered for a lower unit rate than provided in allowances, resulting in both the recognition of accelerated delivery and efficiencies against allowances

Enduring Value Methodology

The approach to Enduring value by core category is outlined below:

Totex category	Expenditure Type	Basis of EV calculation
Non Load	Asset replacement and refurbishment	Enduring value adjustment created on basis of progress against risk point targets. If risk point delivery is on track, no adjustment is made. Adjustments are made to reflect over or under delivery of risk points using the actual and forecast unit rate.
	Expenditure related to a Business Plan commitment	Any expenditure behind planned delivery will be included in the EV calculation e.g. Delayed delivery of pinch points
	Other Network Investment (e.g. Flood mitigation, legal and safety, Rising & lateral mains etc.)	Current under / over spends vs. allowances fall into the EV calculation to the extent they unwind over ED1. Adjustments in FY19 included: timing of delivery of RLM, flooding delays due to storms Desmond / Eva
Load Related expenditure	Reinforcement expenditure (Distribution and connections) less customer contributions	Three elements of calculation:

Totex category	Expenditure Type	Basis of EV calculation
		• Impact of higher / lower customer contributions recognised in the year they occur • Proportional recognition of overall forecast ED1 efficiency i.e. 5/8 of forecast ED1 efficiency was recognised at March '20 • The balance of expenditure variance, relating to timing, falls into EV being the variance to date we expect to unwind during ED1.
Network Operating Costs	Troublecall / I&M / cut outs (non smart)	Adjustments only in exceptional circumstances – out/underperformance in year taken to RoRE. Adjustment applied dependent on separate scrutiny of individual components in light of events affecting the network – storm-related repairs, etc. Separate consideration for Business Plan commitments and other internal programmes such as annual tree cutting profiles
Business Support / Closely associated Indirects		Adjustments only in exceptional circumstances – out/underperformance in year taken to RoRE. Under / over spend recognised in year with adjustments only for exceptional events. In ENWL's case, the element of the insurance claim receipt from the December 2015 storms which relates to future expenditure to improve flood defences has been treated as an enduring value adjustment in the past.
Non Operational Capex	Non Operational IT / Fleet / Logistics / accommodation	Adjustments only in exceptional circumstances – out/underperformance in year taken to RoRE. General principle is that under or overspend is recognised in the year it arises. Adjustments limited to specific large projects where acceleration or deferral has occurred.
IT&T Capex	Operational IT	Adjustments only in exceptional circumstances – out/underperformance in year taken to RoRE. General principle is that under or overspend is recognised in the year it arises. Adjustments limited to specific large projects where acceleration or deferral has occurred, in our case acceleration of an operational IT system (NMS).

Totex category	Expenditure Type	Basis of EV calculation
Uncertainty mechanisms		Adjustments made to include expected impact of close out mechanisms requires definition of close out mechanism. ENWL impact: NOMS – no adjustment as risk points delivery expected to be in line with target Street-works – Adjustments to allowances made as per 2019 reopener assessment. Smart meters – allowed revenue adjusted with volume driver mechanisms Load reopener/ net to gross: Innovation offset identified at the time of reporting to Ofgem is considered in assessing the impact of close out mechanisms No other close out or uncertainty mechanisms impact is expected

Other assumptions

1. Close out mechanisms are reflected on the basis of information available at the time and clarity of close out mechanisms
2. Non-totex costs are excluded from the enduring value calculation.

Summary of position at 31 March 2020

Enduring value summary £m (2012/13 prices)	Cumulative 2020	Cumulative 2019
Load related costs	**22.3**	23.7
Non load – risk point assessment	**(30.3)**	(33.2)
Non load – other	**1.5**	1.7
Business support – Insurance recovery	**-**	1.0
Total	**(6.5)**	(6.8)

6.2. Appendix 2 - Net Debt Forecasting Assumptions

Our Net Debt forecast is based on a retained gearing position of 62-63% RAV, allowing for 2-3% headroom against the regulatory assumption of an efficient DNO.

In the eight years to 31st March 2028, ENWL has the following debt maturities requiring refinancing:

- £77.4m of various intercompany loans at differing fixed nominal rates issued maturing in 2023. £200m 6.125% fixed rate back to back bond from ENW Finance plc maturing in 2021 (ENW Finance plc being a special purpose vehicle set up with the sole purpose of raising public issued bond finance for ENWL).
- £75m 1.656% + RPI index linked loan from EIB maturing in 2024.
- £60m 1.51% + RPI index linked loan from EIB maturing in 2024.
- £450m 8.875% fixed rate bond maturing in 2026

In addition, there is capacity for incremental borrowings, which have been forecast based on business need and with reference to expected RAV growth, with a gearing target gradually reducing from 62.4% down to 60% between the start and end of ED2.

The key assumptions used in modelling the debt and financing costs are as follows:

- **Refinancing rate and issuance costs.** For all refinances and forecast incremental borrowings, the interest rate nominal costs have been calculated by deriving a 10 year gilt curve (using spot rate forecasts at 31 October 2019) and adding a spread of 180bps to arrive at a proxy to forecast blended iBoXX A/BBB nominal rates. In addition, a cost of carry rate of 26bps has been added to derive the overall nominal rate. This results in an average nominal debt cost of 2.71% for the remainder of ED1 and 3.13% for ED2. Obviously actual performance will be dependent upon the markets at the time of refinance.

  We have derived the index-linked interest costs (applicable only to ED2 refinancing assumptions) by taking the nominal rate pre cost of carry and applying a RPI rate of 3.0% and a CPI rate of 2.0%. We have then added on the 26bps cost of carry.

- **Debt issuance timing.** All external debt is assumed to be refinanced 12-18 months before the existing maturity date to reflect our treasury policy and manage liquidity risk in order to maintain our investment grade rating. This inherently includes either 'double-handling' costs for this period necessary to minimise our liquidity risk exposure. The 12 months is set to manage liquidity concerns against debt investors. At the time of refinance we would look to implement a forward starting debt product to mitigate these double handling costs whilst managing liquidity concerns.

  The £77.4m inter-company loan has been borrowed in instalments from the parent company, North West Electricity Networks plc. This is not directly linked to external debt and, as such, is forecast to be refinanced on maturity in March 2023, without double-handling, at the same amount. All intercompany borrowings are made on an arms' length basis, reflecting market rates at time of drawing,

- **Issuance size.** In order to access the debt markets efficiently, we base our figures on a minimum issuance size of debt of £250m. We also take into consideration our incremental debt requirements at the time to maintain our RAV gearing targets:

- £300m of new nominal debt is assumed to be raised in Q3 2020 with the refinance of our £200m 6.125% 2021 bond, resulting in £100m of incremental debt.

- £300m of index-linked new debt is assumed to be raised in 2023/24 to refinance our £135m EIB index-linked debt, and to provide c.£110m of incremental debt. This is assumed to be refinanced at the very start of ED2 and is not included in the RFPR data tables.

- £580m of new nominal debt is assumed to be raised in 2025/26 to refinance our £450m 8.875% 2026 bonds, and to provide £130m incremental debt. As this would occur during ED2, this refinancing has not been included in the RFPR data tables.

- **Nominal and index-linked debt.** Any refinancing of existing debt is assumed on a like-for-like interest mix basis – i.e. fixed rate debt is replaced by fixed rate debt. The refinancing of the £135m EIB loans and incremental debt to £300m is assumed to be index-linked on a CPI basis.

6.3. Appendix 3 - Methodology notes for completion of Net Debt and Financing tables

In completing the tables, we have made the following assumptions:

- A forecast of 'New/refinanced debt issuance expenses' has been included as a cash cost in the year incurred. Accounting treatment will be to capitalise the cost and amortise it over the life of the financing.
- Following the adoption of the IFRS9, the ENWL £250m bonds maturing 2026 are now held at amortised cost rather than fair value. This change took effect for the 2019 RFPR. The bonds were issued in three tranches across 2001-2002, at a premium to principal. This accounting change impacts the RFPR and the RoRE calculation in two areas.
    - Firstly, the regulatory debt has increased reflecting the unamortised premium on issuance.
    - Secondly, the annual amortisation of the remaining premium reduces ENWL financing costs.
- The reporting approach and standards are being developed over time for this new regulatory reporting pack. As a result of recent developments, the resultant financing charge is more reflective of the effective financing rate on issuance. While IFRS9 is only effective for the year ending 31st March 2019 onwards, we have chosen to include a retrospective adjustment for the first three years of ED1 to ensure performance is consistent across the regulatory reporting period. These changes have had the impact of increasing the reported return and debt performance in the RFPR.
- The Net Debt per Regulatory definition excludes debt fair value adjustments and the fair value of the derivative. It also excludes any restricted cash balances. Movements in future fair values or restricted cash balances have not been forecast, therefore, the actual 2019/20 figures have been held flat in the forecast.
- The cash balance in ED1 is forecast to be maintained at, or above, a minimum acceptable level for working capital requirements. In some years it could be significantly higher due to liquidity requirements and maturing debt instruments being pre-funded (see above).

- Table E shows trading and rechargeable balances between ENWL and other Group companies, including interest accrued balances on the £200m 2021 6.125% bonds. Apart from these accrued interest balances, which are reduced to nil in 2021/22 and accrued interest on the £77.4m intercompany loans, other balances are all held flat for forecasting purposes. These are reversed out on row 329 of R8a before arriving at 'Total Net Debt Per Regulatory Definition'.
- To calculate proportions of debt which are fixed / floating / index-linked on a pre and post-hedging basis, we have excluded the retained cash balances from the Total Net Debt subtotal in order to provide a meaningful split. If these balances are included (presumably on a floating basis), then during periods of 'double-handling' when the cash balances are significant, the resultant proportions calculated can be negative and misleading. We therefore believe that the proportions shown are more helpful and reflective of our underlying interest rate exposures.
- The interest receive legs under some of our swaps are linked to 6 month LIBOR. For forecasting purposes, the LIBOR rates assumed reflect those rates calculated to arrive at the 10 year gilt curves as detailed above in Appendix 2.

7. Glossary

BEIS	Department for Business, Energy and Industrial Strategy
CI	Customer Interruptions
CLASS	Customer Load Active System Services
CML	Customer Minutes Lost
CNAIM	Common Network Asset Indices Methodology
CSAT	Customer Satisfaction
DNO	Distribution Network Operator
DSO	Distribution System Operator
ENWL	Electricity North West Limited
EV	Enduring Value
GEMA	Gas and Electricity Markets Authority
GRESB	Global Real Estate Sustainability Benchmark
GSoP	Guaranteed Standard of Performance
IFRS	International Financial Reporting Standard
NMS	Network Management System
Ofgem	Office of Gas and Electricity Markets
PSR	Priority Services Register
PCFM	Price Control Financial Model
RAV	Regulatory Asset Value
RFPR	Regulatory Financial Performance Reporting
RIIO	Revenue using Incentives to deliver Innovation and Outputs
RIIO - ED1	Revenue using Incentives to deliver Innovation and Outputs – Electricity Distribution 1
RIIO – ED2	Revenue using Incentives to deliver Innovation and Outputs – Electricity Distribution 2
RoRE	Return on Regulated Equity
RPI	Retail Prices Index - a UK general index of retail prices (for all items) as published by the Office for National Statistics (January 1987 = 100).
SECV	Stakeholder Engagement and Customer Vulnerability
tco_2e	Tonnes of Carbon Dioxide Equivalent
Totex	Total expenditure