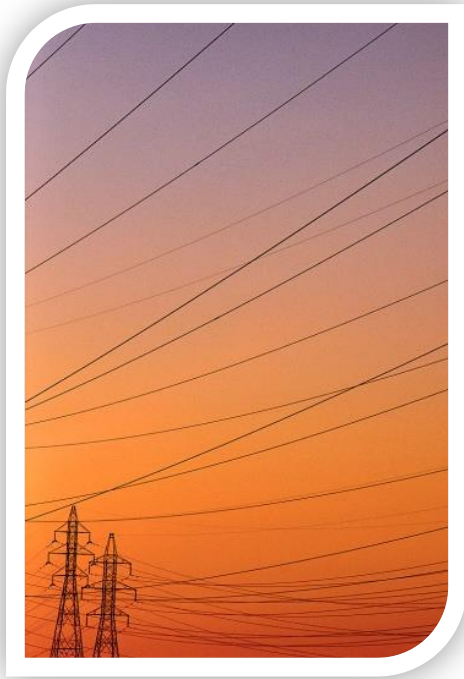


# How we assess opex: an introduction



22 March 2018

## What do the Rules say?

A distributor must include in its proposal a forecast of opex which it considers is required to achieve the *opex objectives*.

In turn, we must accept the forecast if we are satisfied it reasonable reflects the *opex criteria*.

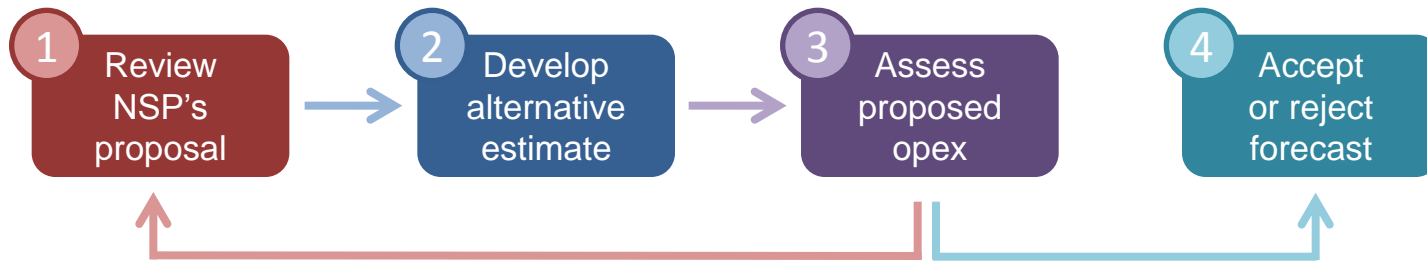
In deciding whether or not we are satisfied we must have regard to the *opex factors*.

# Our expenditure forecast assessment guideline

We are required to develop and publish an *Expenditure forecast assessment guideline* that specifies the approach we will use to assess opex and capex forecasts.

We can depart from it, but we must specify our reasons if we do so.

# How we assess opex



# Our alternative estimate

We use a 'base step trend' approach to forecast opex:

$$Opex_t = \prod_{i=1}^t (1 + \text{rate of change}_i) \times (A_f^* - \text{efficiency adjustment}) \pm \text{step changes}_t$$

where:

- *rate of change<sub>i</sub>* is the annual percentage rate of change in year *i*
- *A<sub>f</sub><sup>\*</sup>* is the estimated opex in the final year of the preceding period
- *efficiency adjustment* is the difference between efficient opex and estimated final year opex
- *step changes<sub>t</sub>* are the determined step changes in year *t*.

# Base opex

$$A_f^* = F_f - (F_b - A_b) + \text{non-recurrent efficiency gain}_b$$

Where:

- $A_f^*$  is the best estimate of actual opex for the final year of the preceding period
- $F_f$  is the opex allowance for the final year of the preceding period
- $F_b$  is the determined opex allowance for the base year
- $A_b$  is the reported opex in the base year
- $\text{non-recurrent efficiency gain}_b$  is the non-recurrent efficiency gain in the base year.

# Rate of change

$$\text{Rate of change}_t = \text{output growth}_t + \text{real price growth}_t - \text{productivity growth}_t$$

**Output growth:** a weighted average of customer numbers, circuit length and ratcheted maximum demand

**Price growth:** a weighted average of WPI growth for the EGWWS sector and CPI

**Productivity growth:** ???

# Step changes

‘Step changes may be added (or subtracted) for any other costs not captured in base opex or the rate of change that are required for forecast opex to meet the opex criteria’ (EFA guideline)

Most commonly provided for the costs of new regulatory obligations



# Category specific forecasts

In certain, limited, circumstances we may remove a specific cost category from base opex and forecast it separately

Examples:

- debt raising costs
- GSL costs
- costs subject to a pass through