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David Withers
Western Power Distribution
Avonbank
Feeder Road
Bristol
BS2 0TB

72 Welbeck Street London W1G 0AY
Tel. 020 7493 3338
www.geraldeve.com

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Your ref:

Dear David

Western Power Distribution – Forecast Rate Liability Report

I refer to our recent telephone conversation and write to set out my thoughts on the future rate liability for the Western Power regulated businesses up to 2023.

Rating Lists

The last revaluation was effective from1 April 2010 with a valuation date of 1 April 2008. Assessments for the Distribution Network Operators (DNO's) were agreed with the Valuation Office Agency (VOA) and are generally not subject to alteration during the life of the Rating List. The Government have announced their intention to postpone the next revaluation, due on 1 April 2015 to a later date of 1 April 2017. This has been included within the Growth and Infrastructure Bill, yet to receive Royal Assent, albeit this decision is very unlikely to be reversed at this stage.

This means that projecting rate liabilities up to 31 March 2017 is relatively straight forward as the Uniform Business Rate (UBR) will increase in line with RPI .

The 2017 Rating list is likely to have a valuation date of 1 April 2015, being two years prior to the List coming into force. This has not been confirmed but is consistent with every revaluation since 1990.

Valuation Methodology

The Valuation Methodology used for the assessment of DNO's is the receipts and expenditure method. This has regard to projected income and operating costs at the valuation date, deducts an allowance for depreciation of the non-rateable assets and after deducting a "tenant's return", calculates a rental value of the rateable assets. Rateable value is effectively a rental value of the rateable assets as at a given valuation date.

This methodology has been used since the industry was returned to conventional assessment in 2005, albeit it also formed the basis of prescribed assessments in the 2000 List. It is a well-established valuation methodology and was fully negotiated with the VOA in respect of the DNO assessments at the time of the 2005 and 2010 Revaluations.

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2017 Rating List

Liability post-2017 Revaluation is far more difficult to project. It depends upon three unknown variables at this stage, namely appropriate Rateable Values for the Networks, the level of UBR post-revaluation and a transitional relief scheme.

With regard to the former, the best guide to potential changes in Rateable Value for the Networks is growth in Regulatory Asset Value (RAV). Earnings for the DNO's are predicated upon the RAV and the return on capital determined by the Regulator. Assuming a consistent return on capital, growth in RAV will therefore, provide the best guide to likely revised Rateable Value's post-revaluation.

Forecast Liabilities post-April 2017

The second assumption that is required is the level of UBR likely to be applied post revaluation. Gerald Eve undertook some research at the time of the postponement announcement as to the likely level of UBR which would have resulted from a 2015 Revaluation. We estimated this to be in the region of 55p, which is higher than the current UBR adjusted for inflation. The reason for this was that given the anticipated valuation date of April 2013 overall levels of rateable value were projected to decline for non-specialised properties and hence a higher UBR would have resulted. Assuming some economic growth by 2015 this is likely to be somewhat mitigated by the time of the 2017 revaluation but any projection at this stage is very subjective.

The other unknown at this stage is the impact of any transitional relief scheme. Transitional relief was a scheme introduced in England to cushion the impact of a revaluation by phasing in large increases in liability. The actual transitional relief scheme will not be known until much nearer the revaluation date but at this stage it may be sensible to assume a repeat of the 2010 scheme in England. However no scheme was applicable in Wales.

Conclusions

In summary, liabilities up to 31 March 2017 can be projected with some degree of certainty. Post-April 2017 there are a number of unknown variables, including levels of Rateable Value, UBR and transitional scheme which mean projections can be subjective estimates only. In our view, growth in RAV provides the best indication of likely changes to Rateable Values assuming a constant return on capital. The level of UBR could increase from current levels unless economic growth in the intervening period drives rental growth for non-specialised properties. The assumption that a transitional relief scheme identical to that introduced in 2010 will apply in England is a significant one. If this was not the case and no transitional relief scheme was introduced, liabilities for the English networks could be significantly higher.

I trust the above is sufficient for your purposes but should you require anything further please do not hesitate to contact me.

Yours sincerely,

Keith Norman
Partner

knorman@geraldeve.com
Direct tel. +44 (0)20 7333 6346
Mobile 07736 549 774