

1 Q. With reference to all of the Capital Projects, what policies or guidelines does Hydro  
2 follow as to (a) when an “Interest and Escalation” cost component should be  
3 included in the Budget Estimate and (b) how it should be calculated? Have any of  
4 those policies or guidelines changed within the last five (5) years? If yes, also  
5 provide the previously followed policies or guidelines.  
6

7 A. (a) Interest is applied to the majority of projects but not applied to direct purchases,  
8 Information Systems projects, Service Extensions, Distribution Upgrading and  
9 the Wood Pole Line Management Program. Generally interest would be  
10 included on projects of a longer duration where the interest amount would be  
11 considered a material cost.  
12

13 Escalation is applied to all projects and it is based on the type of work as  
14 determined by the project estimator when preparing the budget estimate. It is  
15 based on the Electric Utility Construction Price Escalation and the Canadian  
16 Price Index (CPI) as of January 2012 for this budget application and it is updated  
17 annually for budgeting purposes. The type of work and the annual percentage  
18 change are shown in the following table for 2013.

Inflation and Escalation Forecast	
Type of Work	Annual Percentage Change 2013
Hydraulic Plant Construction	2.4%
Transmission Line Construction	2.3%
Transformer Station Construction	2.4%
Distribution Line Construction	2.6%
More Material Less labour	2.2%
More Labour Less Material	2.8%
Labor Only	3.0%
Same Material Same Labour	2.5%

(b) Interest is calculated on the previous month's accumulated cash flow plus half of the current month's cash flow. The interest rate used in preparation of the 2013 capital budget was based on the forecasted weighted interest rate on Hydro's 2012 borrowing costs which was 7.91 percent or 0.64 percent compounded monthly. There has been a change from using the Weighted Average Cost of Capital (WACC) to using the forecast weighted interest rate to be IFRS compliant. However, the application of this interest remains unchanged.

Escalation is applied using a monthly escalation rate multiplied by the monthly expenditures. The method of applying escalation has not changed within the last five years.

Please see the response to IC-NLH-11 Attachment 1 for specific examples of how interest and escalation are applied.