Q. Consumer Question: In CA#126 (c) Nalcor states, " The in service capital cost for MF assuming an AFUDC rate of 8.4% is $3.6 B " For DG 2 purposes Nalcor has assumed 100% equity with no IDC or AFUDC with an in service cost $2.9 B or $700 m. Can Nalcor advise If the extra $700m for AFUDC in the $ 3.6B in service MF cost was reviewed in the sensitivity analysis - similar to the impact of a $700 cost overrun on the in service capital costs? If not can Nalcor provide a sensitivity analysis of the impact of an extra $700 m included in 2017 in service capital costs for the MF site?

A. Please note the “$700m for AFUDC” is not an additional expense in the same form as a cost overrun. This is a financing cost that is already fully reflected in Nalcor’s Internal Rate of Return (IRR) calculations.

Given the same capital expenditures before financing, both approaches are essentially the same on a cumulative present worth basis. The COS methodology explicitly capitalizes the cost of capital during construction, which is subsequently recovered through higher depreciation charges and return on rate base once the asset is placed in service. With 100% equity financing and the PPA approach, the cost of capital is recovered by establishing revenues to provide a defined IRR over the full analysis period, including the construction period. Therefore the recovery of the cost of capital during the construction period is implicitly accounted for.[1]

[1] Once the Muskrat Falls investment is leveraged with a sustaining amount of debt (for example, in order to avail of the Federal Loan Guarantee), interest during construction will be capitalized to the project and included in the project’s in-service cost, similar to capitalized interest charges under a COS approach. As indicated in CA/KPL-Nalcor-188, with the cost of debt less than the cost of equity, the overall cost of capital will be lower.

Where capital expenditures before financing are different; i.e, a $700 million capital cost overrun, a PPA approach will require higher revenues to provide the same internal rate of return. This is not the same as $700 million of capitalized financing charges.

No sensitivity analysis is required as Nalcor's analyses include the cost of capital either explicitly in the case of AFUDC or implicitly in the IRR methodology used in the 100% equity analysis.