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# British Waterways

Report to the British Waterways Board  
and the Trustees of the Canal and  
River Trust

28 May 2012





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**Private and confidential**

28 May 2012

The Directors  
British Waterways Board  
64 Clarendon Road  
Watford  
WD17 1DA

The Trustees  
Canal & River Trust  
64 Clarendon Road  
Watford  
WD17 1DA

Dear Sirs

**British Waterways Board – analysis of business plan and financial projection assumptions**

This Report has been prepared on the basis set out in our Engagement Letter addressed to the Directors of British Waterways and the Trustees of the Canal & River Trust (“the Client”) dated 3 May 2011 as varied by the variation letter dated 29 March 2012 (the “Engagement letter”), the scope of which is attached as at Appendix 1.

This report is final and replaces for all purposes and in all respects any and all prior versions and supersedes all previous oral, draft or interim advice, reports and presentations. No reliance should be placed by you on any such oral, draft or interim advice, reports or presentations other than at your own risk. The scope of work set out in our Engagement Letter and subsequently amended in consultation with you is attached as Appendix 1 to the report. You should note that our findings do not constitute recommendations to you as to whether or not you should proceed with becoming a charity. The Important notice on page 2 should be read in conjunction with this letter.

We have not verified the reliability or accuracy of any information obtained in the course of our work.

This Report is for the benefit of the Client only. This Report has not been designed to be of benefit to anyone except the Client. In preparing this Report we have not taken into account the interests, needs or circumstances of anyone apart from the Client, even though we may have been aware that others might read this Report. We have prepared this report for the benefit of the Client alone.

This Report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Client ) for any purpose or in any context. Any party other than the Client that obtains access to this Report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through the Client’s Publication Scheme or otherwise) and chooses to rely on this Report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this Report to any party other than the Client.

In particular, and without limiting the general statement above, since we have prepared this Report for the benefit of the Client alone, this Report has not been prepared for the benefit of any other Government Body nor for any other person or organisation who might have an interest in the matters discussed in this Report, including for those who use the waterways or those who provide goods or services to those who operate in the waterways sector.

Yours faithfully

*KPMG LLP*

Our fieldwork commenced in April 2011 and was completed on 6 March 2012. We have not undertaken to update our work for events or circumstances arising after that date.

In preparing our report, our primary source has been British Waterways internal management information and representations made to us by British Waterways Management during the project. We do not accept responsibility for such information which remains the responsibility of Management. Details of our principal information sources are set out on page 3 and we have satisfied ourselves, so far as possible, that the information presented in our report is consistent with other information which was made available to us in the course of our work in accordance with the terms of our engagement letter. We have not, however, sought to establish the reliability of the sources by reference to other evidence.

This engagement is not an assurance engagement conducted in accordance with any generally accepted assurance standards and consequently no assurance opinion is expressed. Nothing in this report constitutes a valuation or legal advice.

Our report makes reference to 'KPMG Analysis'; this indicates only that we have (where specified) undertaken certain analytical activities on the underlying data to arrive at the information presented; we do not accept responsibility for the underlying data.

The prospective financial information set out within our report has been prepared by British Waterways; we do not accept responsibility for such information. We must emphasise that the realisation of the prospective financial information is dependent on the continuing validity of the assumptions on which it is based. The assumptions will need to be reviewed and revised to reflect any such changes in trading patterns, cost structures or the direction of the business as they emerge. We accept no responsibility for the realisation of the prospective financial information. Actual results are likely to be different from those shown in the prospective financial information because events and circumstances frequently do not occur as expected, and the differences may be material.

We accept no responsibility or liability for the findings or reports of legal and other professional advisers even though we may have referred to their findings and/or reports in our report.

The contents of our report have been reviewed in detail by the directors of British Waterways who have confirmed in writing the factual accuracy of this report.

This Report has not been designed to be of benefit to anyone except the Client. In preparing this Report we have not taken into account the interests, needs or circumstances of anyone apart from the Client, even though we may have been aware that others might read this Report. We have prepared this report for the benefit of the Client alone.

This Report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Client) for any purpose or in any context. Any party other than the Client that obtains access to this Report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this Report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this Report to any party other than the Client.

In particular, and without limiting the general statement above, since we have prepared this Report for the benefit of the Client alone, this Report has not been prepared for the benefit of any other Government Department or Non-departmental Public Body nor for any other person or organisation who might have an interest in the matters discussed in this Report, including for example British Waterways employees, the Trade Unions, customers of British Waterways or those who provide goods or services to British Waterways.

### Focus of our report

- Our work has been performed in accordance with the terms of our engagement letter dated 3 May 2011, as varied by the variation letter dated 29 March 2012. Our report:
  - Focuses on the areas outlined in our agreed scope as set out in Appendix 1. We draw your attention to the limitations in scope set out therein;
  - Utilises tables imported directly from Excel which are rounded to thousands and so may appear to contain small rounding differences as a consequence;
  - Focuses on the review of assumptions underlying the business plan of British Waterways (England and Wales) for the period 2011/12 to 2014/15 ('the business plan period');
  - Comments on sensitivities in respect of the assumptions.

### Sources of information

- The sources of information used in preparing our report included the following:
  - British Waterways long term projections, 8 February 2012
  - British Waterways Property Directorate Business Plan Executive Summary 2012/13 – 2014/15, 17 February 2012
  - British Waterways NWC – Incremental Benefits v3, 12 October 2011
  - British Waterways Steady State Profile four year plan, 14 October 2011
  - British Waterways Steady State Expenditure (exc. Asset Repairs) as % of Model (Final Agreement), 28 February 2012
  - British Waterways Asset Condition Analysis v24 – Final Agreement, 22 February 2012
  - British Waterways Sensitivity Analysis, Asset Condition model v24, 6 March 2012
- Our findings are also based on discussions with the following key directors and management of British Waterways:
  - Philip Ridal – Finance Director
  - Nigel Johnson – Corporate Services Director and Secretary to the Board
  - Jim Stirling – Technical Director
  - Quentin Pickford – Financial Controller, Property and Ventures
  - Daniel Sanders – Financial Controller - Management Information
  - Ian Jarvis – Financial Controller
  - Steve Pullinger – Head of Tax & Accounting

	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property income	16
■ Charitable income	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

Area	Summary
<b>Purpose</b>	<ul style="list-style-type: none"> <li>■ The purpose of this report is to comment upon the Business Plan for British Waterways for England and Wales, which is for the period to 2014/15, as approved by the Board on 18 May 2011, and the related longer term projections for the Canal and River Trust (CRT)</li> <li>■ The report comments on the assumptions included on the business plan. The report also comments on the longer term projections which are for the period to 2026/27, and the key assumptions underpinning the projections</li> <li>■ The report includes a factual representation of information presented to KPMG</li> </ul>
<b>Background</b>	<ul style="list-style-type: none"> <li>■ Government has undertaken a consultation on the proposal to transition British Waterways into a charitable body, followed by a further, shorter, consultation to transfer the assets and funding of British Waterways to CRT and to ensure provision is made for the waterways in Scotland. The transfer to CRT is to secure longer term financial sustainability for the waterways. Under this proposal the assets owned by British Waterways will transfer to CRT as an endowment, supported by a long term funding contract. As part of the creation of CRT, Trustees have been appointed and this report is intended to provide contextual information to them</li> <li>■ The transfer of British Waterways assets is only concerned with those assets located in England &amp; Wales. All assets and waterways located in Scotland would not be transferred into CRT, these will remain in the public sector. This report is only in relation to the England and Wales business plan and does not address any separation issues in respect of the retention of the Scottish waterways in the public sector</li> <li>■ Government's plans are to also transfer into CRT the Environment Agency water navigations and assets. The Environment Agency's assets include 1,000km of river navigation, and are concerned with flooding and pollution. The plan to transfer the Environment Agency assets into CRT is not as advanced as those of British Waterways. This report is concerned with transfer of British Waterways assets only</li> </ul>

Area	Summary
<b>Viability of the Canal and River Trust</b>	<ul style="list-style-type: none"> <li>■ The viability of the new Canal and River Trust (CRT) is dependent on it generating sufficient contribution from income generating activities in combination with grant funding to maintain the waterways at a safe standard over the long term</li> <li>■ Based on the financial projections compiled by British Waterways for CRT for the 15 years to 2026/27, the Trustees and BW management consider that the viability of the new Trust has been secured over this period. Whilst the Trust is forecast to operate at a deficit in 2011/12 and 2012/13, requiring funding from retained earnings, over the rest of the projection period it is projected to breakeven</li> <li>■ The projections reflect the outcome of the Defra funding agreement, the shift in property strategy away from joint ventures towards investment assets providing a regular income stream, and the introduction of further income and savings             <ul style="list-style-type: none"> <li>– Grant funding is projected to be the most significant source of income being £56.4 million in 2026/27, followed by contribution from property investments (£46.8 million in 2026/27) and then from leisure business activities (£34.4 million in 2026/27). Contribution from voluntary income, enabled as a result of the new charitable status, is forecast to increase over the projection period, but remains a small percentage of total investment income and funds generated from business activities</li> <li>– CRT has negotiated a 15 year funding package from Defra which index links the core grant of £39 million per annum to the GDP deflator from 2015/16. A conditional grant of £10 million per annum is also receivable from 2015/16 to 2021/22, dependent on the condition of the waterway. Defra will also contribute a one off payment to the pension fund of £25 million, receivable in 2011/12 and 2012/13</li> <li>– The sale of British Waterways' share in the Wood Wharf Joint Venture to Canary Wharf Group was finalised in January 2012 and generated proceeds of £52 million. These proceeds are being used to acquire income generating investment properties and, under the terms of the transaction, the retention of the freehold to the land has led to an increase in ground rent income of £4.0 million per annum from 2015/16</li> <li>– As part of fulfilling the charitable purpose of CRT the projections include some assumed revenue from fundraising. For CRT, this is a new and untested revenue source. Income from this source (projected to reach £9.7 million by 2026/27 accounting for 8% of total incoming resources) is important but not critical to achieving the viability of the new Trust. This voluntary income figure does not quantify the value contributed towards sustaining and improving the waterways of a projected 80,000 volunteer days pa by 2026/27</li> </ul> </li> <li>■ The condition of the principal assets on the waterways is forecast to decline marginally over the period, with an increasing number of assets categorised as D and E, although remaining within the acceptable range as established by management and Defra             <ul style="list-style-type: none"> <li>– Principal assets are categorised A-E according to condition, where A is the best condition and E is the poorest condition. CRT measures the number of assets which are classified in the D and E categories and has agreed with Defra an upper limit of no greater than 23% of total principal assets to be in these categories, as compared to the actual rate of 17.4% at March 2011. Over the projection period the number of assets in this category is forecast to increase to 21.2%, which remains below the threshold. This increase is due to underfunding in the period up to 2014/15</li> <li>– Historically, spend on principal asset repairs has exceeded steady state levels due to the need to rectify a backlog of under spend and achieve the current level of assets in D&amp;E categories</li> </ul> </li> </ul>

Area	Summary
<b>Viability of the Canal and River Trust</b>	<ul style="list-style-type: none"> <li>■ The level of waterway spend will increase from 82% to approximately 94% of the steady state requirements and lead to an improvement in the standard of waterway maintenance               <ul style="list-style-type: none"> <li>– The standard of maintenance of the waterways has historically been below the steady state condition levels due to the level of funding available. The under spend has historically impacted expenditure levels on general maintenance, dredging, vegetation management and customer service, as management consider these not to be critical to the stability of the waterway structures. Expenditure on these maintenance categories is forecast to increase under CRT's projections as a result of the higher levels of funding receivable</li> </ul> </li> <li>■ Although projected levels of income increase, there are a number of risks to the achievement of the projections, including:               <ul style="list-style-type: none"> <li>– Inflation has been assumed to be broadly 3% across cost and income lines. The effect on the projections if this rate were to increase by 1% would be an £8.0 million (2.6%) reduction in funds available for principal asset repairs over the projection period</li> <li>– A prudence factor of 25% has been applied to charitable income as it is new revenue stream. Assuming that this reduced revenue was not achieved and only 50% of the forecast was met then spend on principal assets would fall by £11.5 million (3.7%) across the whole 15 year projection period</li> <li>– The projections have assumed a contingency of £2 million per annum to meet the cost of an unexpected major event e.g. canal breach, income shortfall, other sensitivities. Whilst this annual contingency has been projected, this could be insufficient to meet the costs of repair of a major incident or shortfall of income, putting pressure on other areas of spend. However, the Trustees believe that the risk of a major breach or asset failure occurring is low</li> <li>– The projections do not take account of market risk factors in relation to returns achievable on the property portfolio</li> </ul> </li> <li>■ Overall, the plans as currently drafted lead to a waterway network in which the general standard of maintenance improves whilst the condition of principal assets declines marginally from the current position. This is achieved by an increase in the overall level of funding projected. This real terms increase in funding serves to reduce the gap between actual spend and steady state requirements, though a small under spend remains</li> <li>■ The Defra funding agreement is critical to achieving projected levels of spend on the waterway. The greater certainty afforded by the 15 year funding package from Defra has given CRT the opportunity to plan its repairs and maintenance in advance, therefore allowing for operating efficiencies to be built into future planning</li> </ul>



	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property	16
■ Charity	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

**British Waterways has a statutory obligation for maintaining its extensive network of canals, rivers and reservoirs across England, Wales and Scotland**

**The net income British Waterways generates is directly linked to the funds available to spend maintaining the waterways; therefore any reduction in net income can lead to a deterioration in asset condition**

**Government has approved in principle the transfer of the assets and operations of British Waterways in England and Wales into the Canal and River Trust, a newly established charity**

**British Waterways is a public corporation that has responsibility for 2,500km of canals, 500km of river navigations, 15km of docks and thousands of associated physical assets such as locks, bridges, embankments and aqueducts**

- The network is comprised of a wide range of assets of varying condition and age, including heritage and listed structures
- British Waterways has a responsibility to keep these physical assets in a reasonable condition through maintenance and repair
- British Waterways also aims to ensure the surrounding environment is managed effectively to provide a positive user experience, for example, through vegetation management and customer service
- These responsibilities and objectives must be undertaken whilst complying with national and EU regulations, including the Water Framework Directive

**British Waterways and the Government have agreed that the future of the waterways lies in a charitable status as the Canal and River Trust (CRT)**

- The Trustees believe that CRT will encourage increased engagement with different communities of users of the waterways in the management and future development of the waterways
- Only the assets located in England and Wales will transfer to CRT. Those navigations located in Scotland will remain in the public sector
- CRT will have the freedom to pursue new commercial income opportunities, as well as income from charitable donations
- For the foreseeable future, however, CRT will require continued Government support in the shape of an annual grant, which will be in the form of a long term funding agreement. Funding has been agreed with Government for the next 15 years
- Over the next decade CRT could be expanded to include the river navigations of the Environment Agency, creating a larger, more extensive network. However, this has not been considered within the scope of this report

**The Trustees consider the charitable model to provide CRT with benefits which are not accessible in the current British Waterways structure**

- Firstly, the Trustees believe that removing the guardianship of the waterways from the public sector will ensure that these assets are protected from the political vagaries of government funding
  - The funding agreement for CRT that has been secured with Government covers a period of 15 years, which is longer than traditional spending review periods, enabling improved business planning for the long term
- Secondly, they expect the charity model to provide access to new funding sources, namely fundraising from individuals including legacies and donations, and greater access to commercial and private income
- Thirdly, they believe that a charitable structure positions the organisation in a better place to form local alliances and funding partnerships with public, private and charitable organisations and to access new grants from other organisations
- Finally, it is understood that a charitable structure will also result in an efficient tax structure where income whose primary purpose is for the charity will not be liable to corporation tax

**The Trustees do not intend that the new ownership model will significantly alter the financial strategy pursued by the entity**

- This will continue to be driven by the principle of costs breaking even against revenue
- Capital will continue to be accumulated and invested in property assets in order to provide a long-term source of recurring income

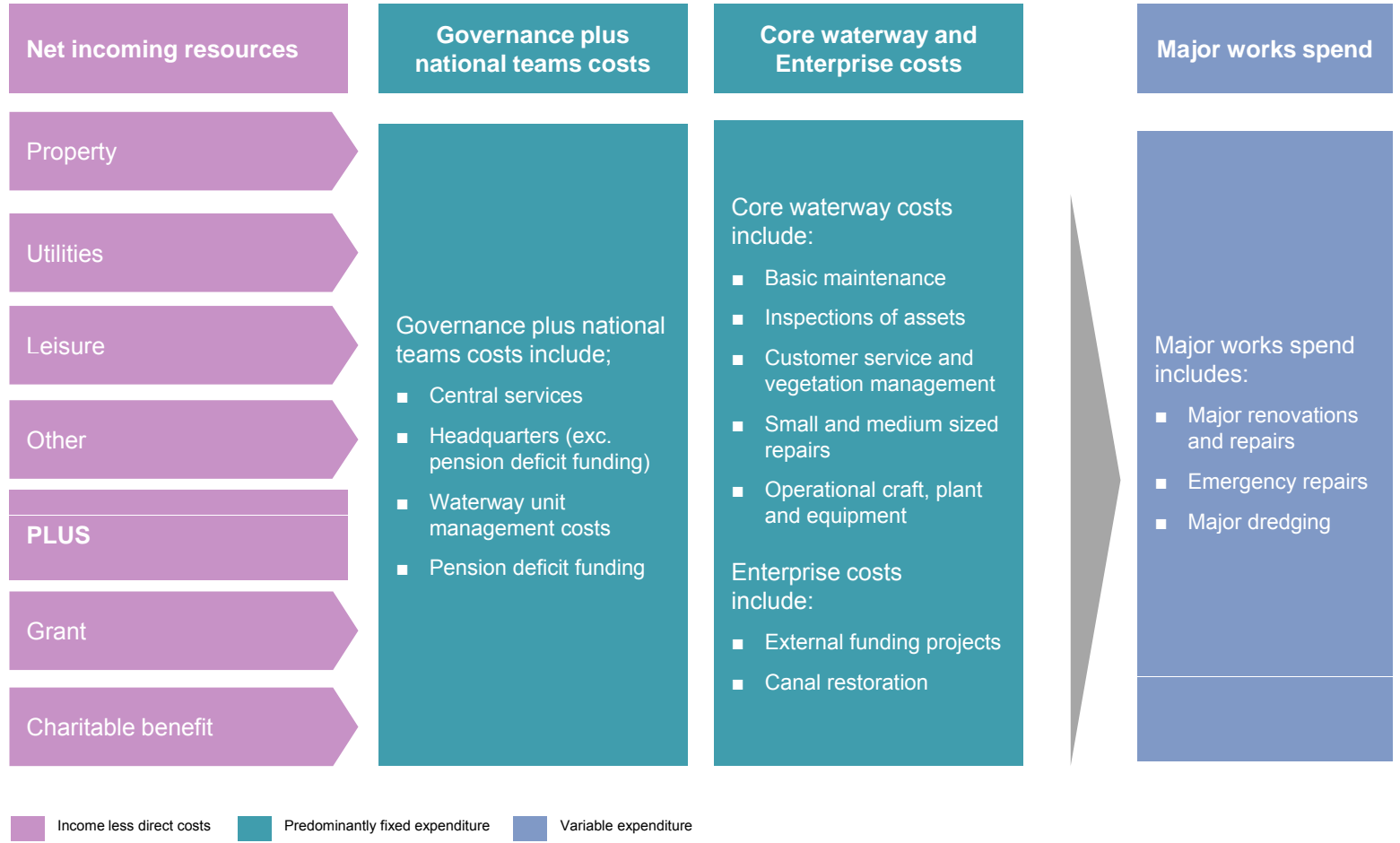
	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property	16
■ Charity	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

The key sources of income arise from investments and commercial activities plus grant income and charitable donations

The main areas of expenditure are governance plus national teams costs and charitable activities such as core waterway and enterprise costs

The spend on major works is calculated once all other expenditure items have been taken into account. The major works expenditure is capped at the amount that reduces the surplus from all other activities to nil

Annual budgets for British Waterways outline six core sources of income, two areas of essentially 'fixed' expenditure for yearly periods, governance plus national teams costs and core waterway costs, and the 'balancing figure' of major works



Financial summary																	
	Actual	Business plan				Projections											
£'000	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Property	19,697	22,245	25,651	27,540	31,489	34,415	35,235	35,695	36,878	38,124	39,601	41,034	42,077	43,152	44,515	45,478	46,828
Leisure	22,631	22,561	23,465	24,040	24,727	25,446	26,235	27,032	27,833	28,583	29,331	30,078	30,863	31,690	32,560	33,476	34,440
Utilities	22,840	21,169	21,765	22,476	23,330	23,862	24,410	24,975	25,556	26,154	26,771	27,406	28,060	28,734	29,428	30,143	30,879
Olympic games	(93)	(324)	415	-	-	-	-	-	-	-	-	-	-	-	-	-	-
British Waterways Marinas	855	1,298	1,492	1,763	2,164	2,229	2,295	2,364	2,435	2,508	2,584	2,661	2,741	2,823	2,908	2,995	3,085
BW share of joint ventures	(2,399)	2,910	54	320	2,700	2,858	1,866	2,274	2,232	3,256	3,674	4,112	4,235	4,362	4,493	4,628	4,767
Charity	-	(2,635)	421	475	364	1,316	2,022	3,060	3,862	4,977	5,794	6,631	7,242	7,898	8,534	9,080	9,682
Net interest	(1,792)	(1,134)	1,384	803	(210)	(1,194)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)	(1,950)
<b>Contribution from generated funds and investment income</b>	<b>61,739</b>	<b>66,090</b>	<b>74,647</b>	<b>77,418</b>	<b>84,564</b>	<b>88,931</b>	<b>90,113</b>	<b>93,449</b>	<b>96,846</b>	<b>101,652</b>	<b>105,804</b>	<b>109,972</b>	<b>113,269</b>	<b>116,709</b>	<b>120,489</b>	<b>123,850</b>	<b>127,731</b>
Management costs <sup>(1)</sup>	(34,827)	(30,118)	(29,953)	(29,666)	(29,932)	(30,829)	(31,754)	(32,707)	(33,688)	(34,699)	(35,740)	(36,812)	(37,916)	(39,054)	(40,225)	(41,432)	(42,675)
Contingency	-	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Pension deficit funding	(1,663)	(4,780)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)	(7,000)
<b>Net incoming resources before grant</b>	<b>25,249</b>	<b>29,193</b>	<b>35,694</b>	<b>38,752</b>	<b>45,632</b>	<b>49,101</b>	<b>49,359</b>	<b>51,742</b>	<b>54,158</b>	<b>57,953</b>	<b>61,064</b>	<b>64,160</b>	<b>66,353</b>	<b>68,655</b>	<b>71,264</b>	<b>73,418</b>	<b>76,056</b>
Grant	47,341	42,332	39,649	39,388	39,198	50,162	51,150	52,108	53,105	54,181	55,284	56,414	56,414	56,414	56,405	56,401	56,389
<b>Total net incoming resources</b>	<b>72,591</b>	<b>71,525</b>	<b>75,343</b>	<b>78,141</b>	<b>84,830</b>	<b>99,263</b>	<b>100,509</b>	<b>103,850</b>	<b>107,262</b>	<b>112,134</b>	<b>116,348</b>	<b>120,574</b>	<b>122,767</b>	<b>125,069</b>	<b>127,669</b>	<b>129,819</b>	<b>132,446</b>
<b>Resources expended on charitable activities</b>																	
Core waterway <sup>(1)</sup>	(54,787)	(54,417)	(55,518)	(55,912)	(57,627)	(64,729)	(66,671)	(68,671)	(70,731)	(72,853)	(75,039)	(77,290)	(79,609)	(81,997)	(84,457)	(86,991)	(89,600)
Major works <sup>(1)</sup>	(22,702)	(17,941)	(19,881)	(20,228)	(25,115)	(32,383)	(31,622)	(32,897)	(34,181)	(36,859)	(38,815)	(40,716)	(40,513)	(40,347)	(40,405)	(39,938)	(39,868)
Enterprise	(2,725)	(2,168)	(1,944)	(2,001)	(2,088)	(2,151)	(2,216)	(2,282)	(2,350)	(2,421)	(2,494)	(2,568)	(2,645)	(2,725)	(2,807)	(2,891)	(2,977)
<b>Surplus/(deficit)</b>	<b>(7,623)</b>	<b>(3,000)</b>	<b>(2,000)</b>	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Note: (1) Net of efficiency savings

Source: British Waterways long term projections, 8 February 2012

### Overview

- The financial projections for CRT are based upon British Waterways' business plan for the Comprehensive Spending Review period from 2011/12 to 2014/15, which is then extrapolated out to 2026/27, including the effects of the Defra funding agreement and projected increased charitable benefits
- British Waterways achieved a net deficit of £7.6 million for the year ended 31 March 2011, and are planning a deficit of £3.0 million in the year ending 31 March 2012 and a deficit of £2.0 million in the year ending 31 March 2013

- The planned deficit in 2011/12 and 2012/13 arises to fund additional expenditure on major works, which is not deemed to be at an appropriate level by the CRT Trustees. Additional funding has been made available to fund major works through utilising retained earnings; however, this is not a long term solution
- In future years a break even position is projected which takes account of the maximum amount which can be spent on the waterways in each period
- Note that the figures shown in the top half of the table above are contribution from generated funds and investment income i.e. income less direct costs

	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property	16
■ Charity	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

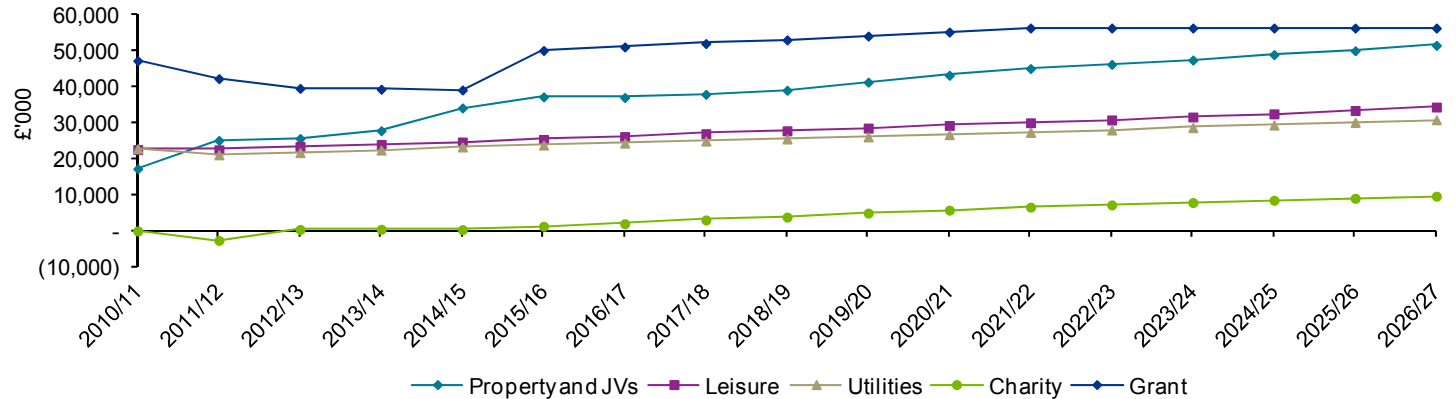
# Income

## Contribution by core income streams

Over the projection period, contribution from property and JVs, leisure and utilities income streams is projected to increase broadly in line with inflation, reaching a total of £116.9 million in 2026/27

In real terms, overall contribution is projected to increase to 2015/16 and then remain stable over the remainder of the period

Historical and projected contribution from core income streams, 2010/11 – 2026/27



Source: British Waterways long term projections, 8 February 2012

### Property and joint venture income arises from rental income and returns on a portfolio of diverse assets (see page 16 for details)

- Contribution from property and JVs is projected to increase rapidly to 2015/16 to £37.3 million, following completion of the disposal of British Waterways' share of the Wood Wharf joint venture and reinvestment of the proceeds from this transaction
- Throughout the remainder of the projection period, contribution is projected to increase by 3% per annum, which is in line with inflation

### Leisure income arises from activities relating to boat licensing, directly managed moorings, leisure property and connection and trading agreements

- Boat licensing is projected to represent the most significant proportion of leisure contribution at 66% in 2011/12, increasing to 71% by 2026/27
- Contribution from the leisure business is projected to increase annually by 2.7% (on average) between 2011/12 and 2026/27, representing a slight decrease in value in real terms, if inflation is at 3%
- Boat licence fees have been forecast to increase by 4% in the first three years of the projections, followed by an annual increase of 2%, being below inflation

- Mooring fees are projected to increase by 2-3% per annum over the projection period due to an increase in demand for residential moorings
- Limited volume growth is projected as a result of the reduction in online mooring (i.e. alongside canal banks) and an increase in moorings in basins and marinas

### The utilities business comprises fees charged for wayleaves used to carry utility services alongside or over the waterways, in addition to supply of water to water utility companies

- This is a high margin portion of British Waterways' business due to the low cost of delivery
- Management consider it to be stable over the long-term as contracts remain in place for long periods of time
- Contribution from utilities is projected to increase annually on average by 2.5% between 2011/12 and 2026/27 from £22.8 million to £30.9 million
  - This growth rate is lower than inflation (assumed at 3%) due to a significant long-term fixed price contract with BSKyB, which accounts for c.25% of the total
  - All other contracts are index-linked

The grant from Defra is projected to fall in the short-term to £39 million, but then increase from 2015/16 as a result of index-linking and the inclusion of an additional conditional grant related to performance

Contribution from charitable activities is projected to increase to £9.7 million by the end of the projection period

**CRT has secured Defra grant funding for 15 years from 2012/13**

- The core grant is set at £39 million in 2012/13 and will be index-linked to the GDP deflator from 2015/16, with an assumed rate of 2.5% per annum
- An additional £10 million per annum grant is receivable between 2015/16 and 2021/22, which is conditional on performance
- See page 20 for details

**Charitable income will be generated from regular donations, appeals, legacies and corporate donations. Additional financial benefits from operating as a charity will also apply**

- Contribution from charitable activities is projected to increase over the projection period to £9.7 million in 2026/27, when it accounts for 8% of commercial contribution
- Year on year growth is forecast for the first 10 years of charitable activity. From 2022/23 to the end of the projection period, the compound annual growth rate slows to 8% per annum
- See page 18 for details



# Property and Joint Venture Income: Overview of Portfolio

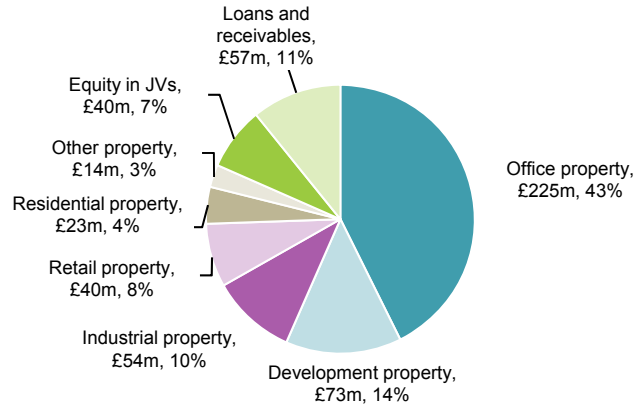
British Waterways has a property portfolio of £527 million net asset value (including Joint Ventures and property related loans and receivables)

The portfolio includes secondary investment assets and sites with future development potential. These have a net asset value of £430 million

The majority of investment sites have a waterside location to remain in keeping with the operations of British Waterways

40% of the value of the investment property portfolio is held in three assets. The majority of the portfolio of over 1,100 assets is low value and management intensive

Forecast property portfolio value as at 1 April 2012 (£m)



Source: British Waterways Property Directorate Business Plan Executive Summary 2012/13 – 2014/15, 17 February 2012

British Waterways' property and JV portfolio has a current value of £527 million. This is split between £430 million of investment property assets, £40 million of capital invested in Joint Ventures and £57m of capital debtors. The portfolio excludes the core waterway assets

- The portfolio has been built from a base of legacy assets surrounding the core waterway infrastructure. The value of the portfolio has been expanded through development activity and the purchase of new assets
- British Waterways cannot borrow to fund its property investments and is restricted to purchasing assets close to the waterways network

### Investment portfolio

- The investment portfolio is diverse in terms of geography and asset class with residential, office and retail investments together with ground rent income streams from development sites sold on long leases
- There are over 1,100 assets in the portfolio, the majority of which the Trustees consider to be low value and management intensive. The top three assets (Wood Wharf freehold interest, Paddington Basin and Interchange Camden) account for 40% of the value

### Joint venture portfolio

- In the early 2000s, British Waterways' strategy shifted toward Joint Venture based developments with conversion of over a quarter of the portfolio by value into equity holdings in JVs. The strategy was designed to provide:
  - Participation in higher level of value enhancement and more rapid expansion of the capital base for future reinvestment;
  - Access to the development expertise of the private sector
  - Retention of control over canal-side development activity; and
  - The opportunity to sell development sites into the vehicles and to purchase completed income producing assets.
- This strategy has subsequently been re-evaluated, with the sale of stakes in certain JVs. In January 2012, British Waterways sold its share of its most significant JV, Wood Wharf, a joint venture with Canary Wharf Group, for £52 million
- ISIS is British Waterways' largest remaining joint venture with Aviva and Muse. ISIS purchases sites with development potential from British Waterways and then either develops or trades the sites with enhanced value planning consents.
  - ISIS accounts for £38 million of the £40 million invested in joint ventures
  - The balance of £2 million is invested in a range of smaller JVs

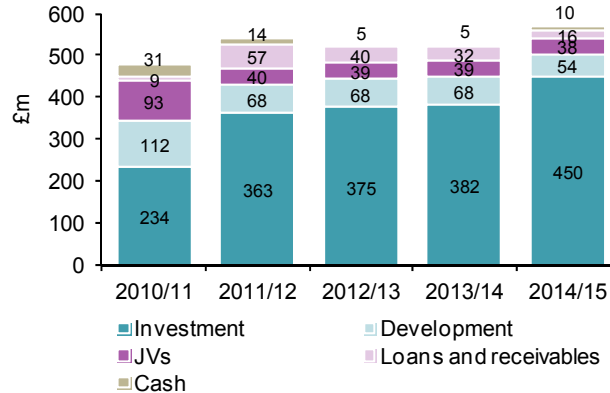
# Property and joint venture income: Future strategy and forecasts

British Waterways is realigning its investment portfolio to reduce exposure in Joint Ventures and to increase investment in assets with a regular rental income stream

This strategy is underpinned by the sale of British Waterways interest in the Wood Wharf Joint Venture in early 2012 and the re-investment of the capital receipt into rental income generating property

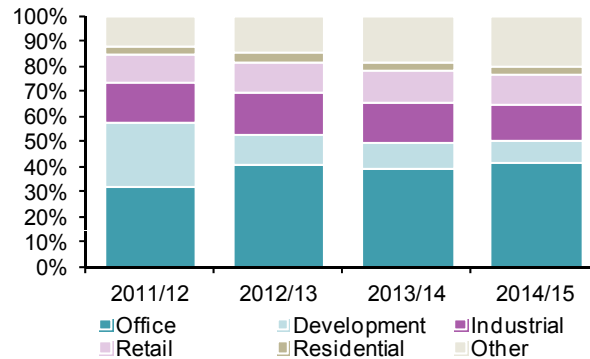
The Trustees believe that initial returns on the revised strategies are likely to be lower. However, the strategy gives security over the longer term, thereby reducing the risk in the portfolio

**British Waterways projected commercial capital investment, 2011/12 – 2014/15**



Source: British Waterways Property Directorate Business Plan Executive Summary 2012/13–2014/15, 17 February 2012

**Projected percentage of property income forecast from each investment type, 2011/12 – 2014/15**



Note: Other includes income from other property and ancillary and planning activities  
 Source: British Waterways Property Directorate Business Plan Executive Summary 2012/13–2014/15, 17 February 2012

## Future strategy

- British Waterways intends to rebalance its portfolio towards a greater number of investment assets which have a regular income stream
- British Waterways plans to retain an interest in Joint Ventures to maintain a balance of higher returns in the portfolio and to leverage its ability to maximise value from and control of canal side developments
- British Waterways also intends to dispose of lower value, multi-tenanted properties in favour of properties with fewer tenants, which require less management. This is illustrated by the increasing percentage of income from prime office property by 2014/15
- The Trustees consider that implementation of this strategy will be facilitated by the removal of the restriction to invest only in assets close to the waterways network

## Income from property and JVs is projected to be generated as follows:

- Consistent returns from a broad portfolio of assets, targeting an income rate of return of 6.75% pa on new investment property
  - Rental income is forecast to grow at 1%, 2% and 3% in 2011/12, 2013/14 and 2014/15 respectively and remain at 3% pa over the rest of the projection period
- The sale of British Waterways' interest in the Wood Wharf JV in January 2012 for £52 million, of which £4 million will be received in cash and £48 million in loan notes with a coupon of 6.3%
  - The loan notes will be paid down in annual instalments to 2015/16, with funds reinvested as released at a rate of 6.75%. This is projected to provide £3.7 million per annum of additional income from 2016/17
  - British Waterways' right to any future capital payments from the Wood Wharf JV has been converted into additional ground rent of £4 million per annum by 2016/17, increasing rental income from the freehold of the site to a minimum of £6 million from 2016/17
- An extension to the Heron Quays option agreement in 2012, increasing the option fee from £250,000 to £1.2 million, followed by exercise of the option itself in 2014, resulting in ground rent of £1.7 million per annum
- A return to profit of the ISIS JV in 2013/14, which is dependent on asset sales on completed developments, the repayment of existing debt facilities and the future redevelopment of land adjacent to Brentford Lock, West London

## Other Key Factors

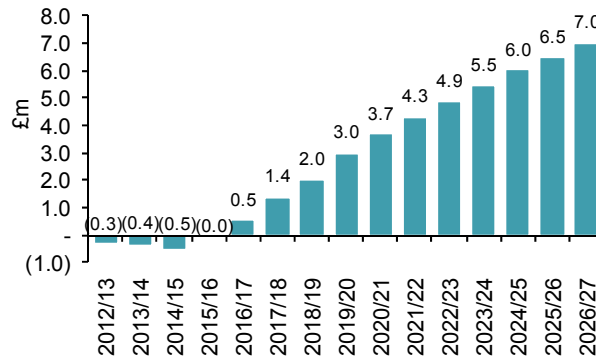
- The Port Of London Properties loan of £12.9 million is planned to be repaid in 2014/15 and has been included in cash flow forecasts

The Trustees believe that conversion to charitable status will give British Waterways access to new funding sources from individuals and other public, private and charitable organisations

The primary fundraising approach that will be used in the first decade of the charity will be face-to-face fundraising, projected to result in a donor file of 88,000 individuals by the end of year 10

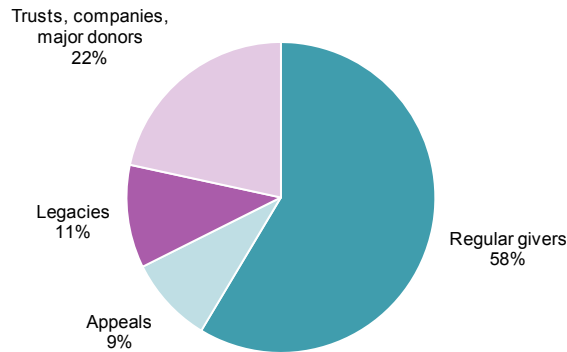
This approach is particularly well-suited to the new CRT because it will operate at waterway locations which visitors will come to, providing a self-selecting population of potential donors to recruit from

**Projected total net voluntary income, after prudence factor, 2012/13–2026/27<sup>(b)</sup>**



Source: British Waterways NWC – Incremental Benefits v3, 12 October 2011

**Projected breakdown of voluntary income and donations, 2021/22**



Source: British Waterways NWC – Incremental Benefits v3, 12 October 2011

### Charitable income

- Face-to-face fundraising has been selected as the primary approach for recruiting donors. According to THINK Consulting Solutions<sup>(a)</sup>, it is currently the only viable approach for recruiting regular givers
- The Trustees believe the new CRT will be particularly well-suited to this form of fundraising because it will be operating at waterway locations which visitors will come to. Therefore, rather than approaching people at random in the street, with no knowledge of their interest in a cause, the professional fundraisers will have a self-selecting population of potential donors to draw from
- After 10 years of operation, these management forecasts assume that CRT has a donor file of c. 88,000 individuals
- CRT will also pursue other forms of giving, namely appeals, legacies and trusts and companies
- In projecting net voluntary income, British Waterways has applied a prudence factor of 75% to projected figures in order to account for the uncertainty of this new income stream
- British Waterways' management has made some high level assumptions about other income and savings which could result from charitable status. These include rates relief, other operating savings and the extra return on capital from debt gearing
  - Within the projections, this income and savings accounts for £1.0 million in 2012/13, rising to £2.7 million by 2026/27, when it represents 28% of charitable contribution

Note: (a) The fundraising assumptions have been produced by THINK Consulting Solutions ('THINK') and are based on three data points:

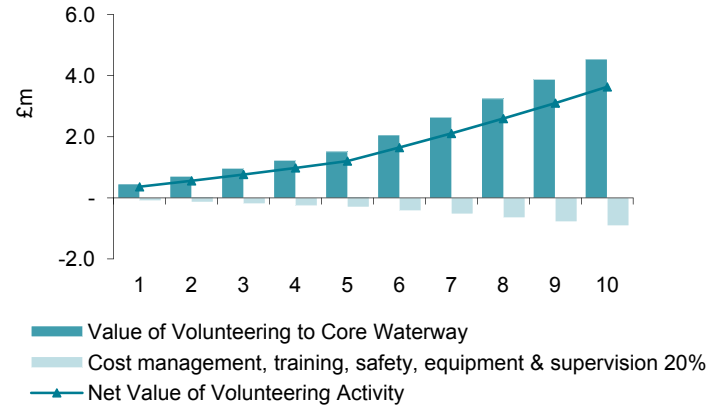
- Canalside research – conducted in January and July/August 2010
- Broad benchmarking against The Woodland Trust
- Discussions with Clive Mattock Fundraising

(b) Net voluntary income includes income from regular givers, appeals, legacies and corporate donors, less applicable direct costs. It does not include other income benefits from operating as a charity

The value of volunteer time that could contribute to the maintenance of the waterway has been projected by management to be £3.7 million per annum by year 10

Charities do not include the value of volunteer time in income. However, the effect of volunteer activities on CRT will be to increase outputs, thereby helping to close the funding gap to steady state levels

Projected net value of volunteering activity over time (years)



Source: British Waterways NWC – Incremental Benefits v3, 12 October 2011

## Volunteers

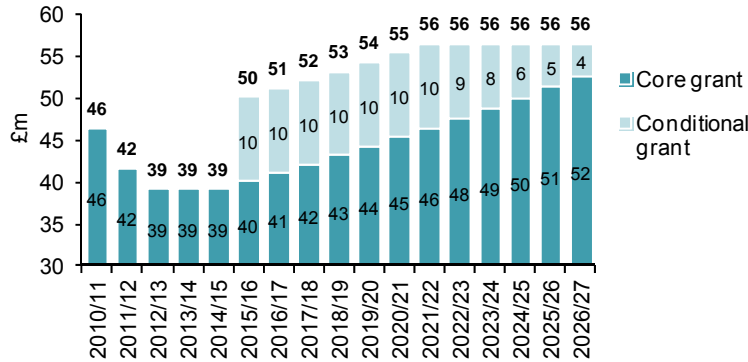
- The waterways and their associated assets require significant maintenance activity from year to year, in addition to the operational customer service activities. There are a number of tasks for which it should be possible to train volunteers to perform
- An estimate has been made of the amount of volunteering time which may be available to the charity as well as the value of that time
  - Volunteer days are projected to grow from 10,000 in year 1 of the charity to 80,000 in 2021/22. No increase in volunteering numbers is projected from years 10 to 15
  - The volunteer time has been valued on the basis of the equivalent annual salary that would be paid to a full time employee to carry out the same activities and meet similar outputs
- The net value of volunteering is estimated to be around £365,000 in year one, rising tenfold to around £3.7 million by year 10
- British Waterways already has a volunteering programme in place. In 2008/09, volunteer days were approximately 15,000, in 2009/10 this increased to 24,000 days and in 2011/12 management forecast that this will increase again to 32,000 days. Therefore, the Trustees consider that estimates of volunteer days made for CRT are conservative
- The infrastructure to manage a volunteer programme is already in place, which includes stimulating and recruiting volunteers and handling their activities
- The Trustees do not envisage that volunteers displace any existing staff but will instead contribute to closing the funding gap to steady state levels
- Charities are not permitted to include the contribution from volunteers in their Statement of Financial Activities due to the difficulties in quantifying the value. However, the role and contribution of volunteers will be reflected in the Trustees' Annual Report

British Waterways partially relies upon grant income from Defra to fund the costs of maintaining the waterways

A funding agreement with Defra has been reached which guarantees this income until 2026/27 and is index-linked

Grant funding is projected to account for 43% of net income by 2026/27

Projected Defra grant income, 2010/11 – 2026/27



Source: British Waterways long term projections, 8 February 2012

Performance measures				
Standard	Measurement	Thresholds		BW current KPI
		Warning	Breach	
Safe waterways	Asset Management to be in accordance with PAS-55 Percentage of assets in classes D&E shall not rise to or above the thresholds	23% in classes D&E	25% in classes D&E	17% in classes D&E
Towpath condition	Percentage of towpath at condition A, B or C shall not fall to or below the thresholds	60% in classes A-C	50% in classes A-C	75% in classes A-C
Flood mgmt	Percentage of principal culverts & embankments in class D & E, breach of which would cause more than £2m in damages, shall not rise to or above the thresholds	4% in Classes D&E	7% in classes D&E	2.3% in Classes D&E

**CRT will remain highly dependent on grant funding from Defra over the projection period. This income source has been guaranteed until 2026/27**

The grant settlement is comprised of two key elements

- The core grant is set at £39 million from 2012/13 and will be index-linked to the GDP deflator from 2015/16
  - This is intended to ensure that the grant retains its real terms value over time
  - Management have modelled this using a 2.5% per annum rate of inflation, which results in the core grant reaching £52.5 million by 2026/27
- An additional conditional grant of £10 million per annum is receivable each year from 2015/16 to 2021/22, providing CRT meets three specific performance targets as detailed in the table to the left
  - If CRT reaches warning threshold, it must produce an action plan for Defra showing how to remedy the situation
  - If CRT reaches the breach threshold, Defra may (after due process) withhold payment of some or all of the conditional grant
  - These KPIs are already monitored by British Waterways and are met based on current performance
- From 2021/22 to 2026/27, the total grant funding receivable is capped at the value of the 2021/22 payment. As the core grant increases with inflation, the conditional grant falls by the same amount
- Under the terms of the grant, CRT has committed to implementing a transparent reporting strategy and adherence to specific policy provisions

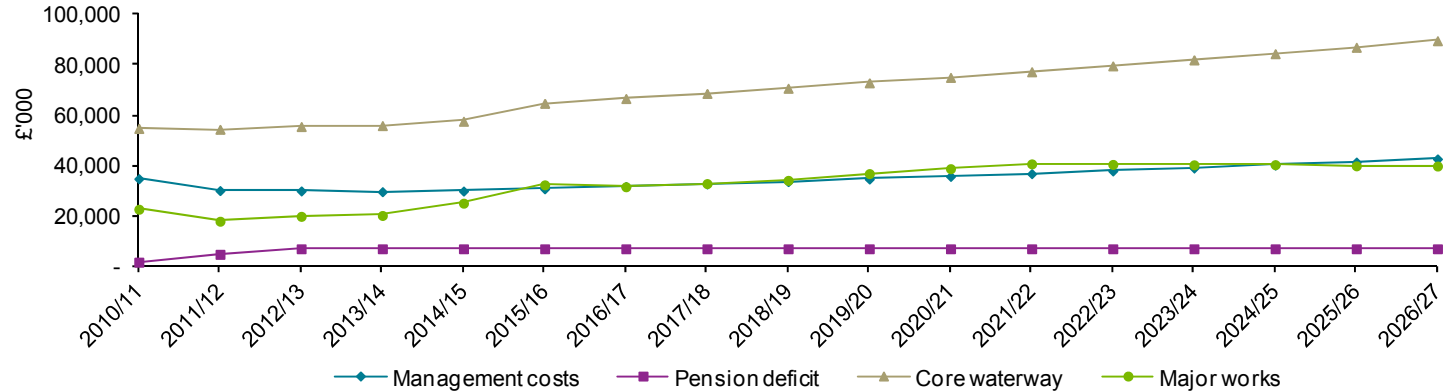
	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property	16
■ Charity	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

Core waterway and management costs are projected to increase broadly in line with inflation over the projection period, reaching a total of £89.6 million and £42.7 million respectively, by 2026/27

Pension deficit funding is projected to be £7 million per annum over the projection period

Major works costs are projected to fluctuate over the period as this spend is driven by the surplus achieved from all other activities

Significant costs projections, 2010/11 – 2026/27



Source: British Waterways long term projections, 8 February 2012

**Management costs are relatively fixed and include office costs, professional fees, IT, marketing and other overhead costs, less planned efficiency savings**

- They are projected to remain relatively constant at £30 million per annum between 2011/12 and 2014/15 due to the impact of planned efficiencies offsetting inflation
- Over this period, payroll and staff related expenses represent the majority of the projected cost at 56%. Projected premises and office costs and professional fees account for 17% each
- Management costs are then projected to increase by 3% for the remainder of the projection period, reaching £42.7 million by 2026/27
- Contingency spend of £2 million per annum is also projected every year from 2011/12. This is for use in an emergency situation e.g. breach of a canal bank

**Pension deficit funding**

- British Waterways currently has a deficit on its pension scheme. Under the funding agreement with Defra, it will receive a one-off payment of £25 million to reduce this deficit
- However, a deficit of c. £100 million will remain, which CRT intends to fund via a 19 year asset-backed contribution scheme. This is projected to require property income of £5 million per annum to be paid to the pension fund

- In addition, CRT plans to set aside £2 million per annum to a sinking fund in order to create the funds that are projected to be required to unwind the asset-backed contribution scheme at its maturity in 2031

**Core waterway spend represents the largest single item of current expenditure, and is projected to increase**

- Core waterway spend accounts for £54.8 million of the total in 2010/11, and is projected to increase to £64.7 million in 2015/16 and to £89.6 million by 2026/27
- Over the period core waterway spend as a proportion of total waterway spend and administrative costs is projected to rise from 47% in 2014/15 to 49% in 2026/27. See page 28 for further details

**Spend on major works is the balancing figure in the annual income and expenditure plan**

- Expenditure below £15.0 million per annum is deemed a risk by British Waterways and is also uneconomical. For this reason additional spend has been planned in 2011/12 and 2012/13, resulting in a deficit in both years
- Over the projection period, major works spend is projected to increase from £17.9 million in 2011/12 to £39.9 million in 2026/27
- It represents 16% of total projected waterway spend and administrative costs in 2011/12, rising to 24% in 2019/20 and falling marginally to 22% by 2026/27. See page 29 for further details

## British Waterways is responsible for a diverse distributed network of heritage assets

British Waterways has a statutory obligation for maintaining its extensive network of waterways across England, Wales and Scotland

The money British Waterways spends on the waterways is directly linked to its net income levels, meaning falls in income lead to deterioration of asset condition

### British Waterways has a statutory obligation to maintain over 3,000km of waterways in England & Wales

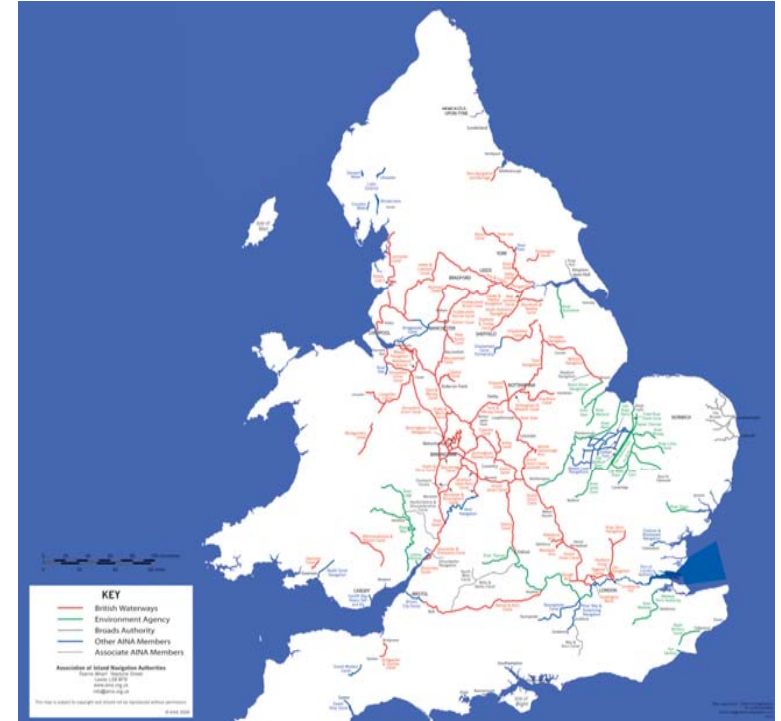
- The network is comprised of a wide range of assets of varying condition and age, including heritage and listed structures
- There are eleven waterways in the England and Wales network: North West, North East, Manchester & Pennine, North Wales & Border, Central Shires, East Midlands, South Wales & Severn, West Midlands, South East, Kennet & Avon, and London

### A large proportion of British Waterways' income is spent on maintaining this network

- Waterway expenditure is split into three component parts being core waterway, enterprise and major works. (These costs are disclosed net of income)
- Broadly, core waterway spending supports the maintenance of assets at the same condition and provision of customer service and amenities, whilst major works spending is focused on improving the condition of assets in need of specific repair
- Movements in net income received by British Waterways have a direct impact on the condition of the waterway

### To understand British Waterways' approach to its obligations and to review the business planning assumptions, it is essential to look at three areas:

- British Waterways' concept of 'Steady State', the total amount required by the waterways, and the amount British Waterways spends
- Budgeting for repairs of assets
- Prioritisation of assets for repair





# The condition of the waterways is determined by the state of the physical assets and surrounding vegetation and environment

Activities undertaken by British Waterways range from specific maintenance on physical assets, such as locks, through to vegetation management which maintains the surrounding environment and improves the user experience

Activities are divided into maintenance and repair of principal and non-principal assets, customer service and vegetation management

Principal assets are further categorised according to condition and graded A-E

British Waterways has a statutory obligation to ensure that the waterways are kept in operational condition. In addition, British Waterways aims to maintain the wider waterway environment to ensure a positive experience for users

- Across the eleven waterways in the network, there is a total of 26,000 assets, together with extensive vegetation requiring management

British Waterway's responsibility of maintaining the condition of the waterways can be categorised into three broad areas:

Condition categorisation		
	Characteristics	Examples
<b>Principal assets</b>	<ul style="list-style-type: none"> <li>Most important assets</li> <li>Key to navigation of the waterways</li> <li>More heavily regulated and monitored</li> <li>Tend to have a higher consequence of failure than non-principal assets</li> </ul>	<ul style="list-style-type: none"> <li>All Locks</li> <li>Accommodation bridges</li> <li>Reservoirs</li> <li>Culverts</li> <li>Aqueducts</li> <li>Major cuttings</li> <li>Principal embankments (&gt;3m)</li> </ul>
<b>Non-principal assets</b>	<ul style="list-style-type: none"> <li>All other physical assets</li> <li>Failure or condition will not severely impact navigation of waterways</li> <li>Less regulated and monitored</li> </ul>	<ul style="list-style-type: none"> <li>Bank protection</li> <li>Non-principal embankments (&lt;3m)</li> <li>Winding holes</li> <li>Piers / Jetties</li> <li>Visitor moorings</li> </ul>
<b>Customer service and vegetation management</b>	<ul style="list-style-type: none"> <li>Activities carried out to allow customers to use the waterways and for amenity benefit</li> <li>These typically relate to customer services that are provided (such as toilets, car parks etc.), and also the management of the vegetation surrounding the waterways</li> </ul>	<ul style="list-style-type: none"> <li>Customer facilities (toilets, car parks etc.)</li> <li>Soft / Hard towpath management</li> <li>Tree management</li> <li>Dry stone walling / fencing</li> <li>Vegetation management</li> <li>Grass cutting</li> </ul>

Maintenance of principal and non-principal assets is crucial to ensure the waterways remain operational. To support this, British Waterways monitors the condition of its principal assets

- Assets are graded by their condition on a scale of A-E (see below)
- For those assets receiving grades D&E, their 'consequence of failure' grading is identified
- Assets are then prioritised on a basis of their condition how severe the consequence of failure is

Non-principal assets are not monitored in the same way

- Non-principal assets are not graded A-E due to the high costs which would result from regular inspection and the perception that these assets are less central to waterways operations
- However, due to major breaches and high cost of repairs from failing non-principal assets, British Waterways is now undertaking assessments of non-principal embankments

Asset condition grade	Description
A - Very good	Construction sound, well maintained
B - Good	Superficial wear and tear/minor deterioration of surfaces, some perishing, non structurally significant cracking
C - Fair	Sound but affected by minor, structurally insignificant degradation or leakage
D - Poor	Functional but significant spalling, perishing, leakage, structural cracking, deformation, potential loss of stability
E - Bad	About to stop functioning, strong possibility of failure, structure unstable, potential risk to users

## To understand the total cost of maintaining the network, British Waterways develops a view of the total spend required through the 'steady state' model

British Waterways uses a model called the 'steady state' to understand and estimate the expenditure required to maintain the waterways in a stable condition

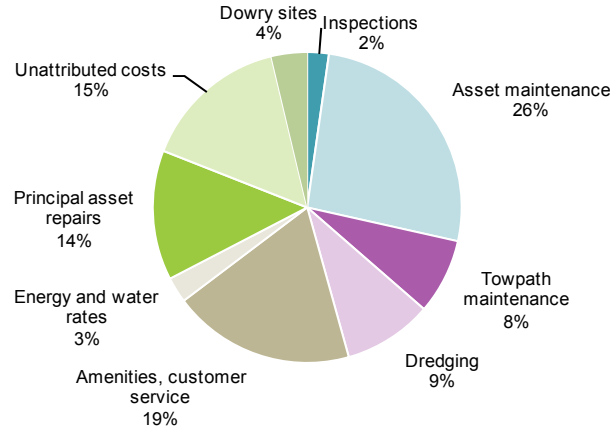
The steady state model is comprised of direct activities required to maintain physical assets, activities required for customer services and vegetation management together with unattributed costs

Steady state expenditure figures assume that the waterways are already in steady state condition

Steady state model - total cost	
	£m
Inspections	2.3
Asset maintenance	27.3
Towpath maintenance	8.2
Dredging	9.6
Amenities, customer service	19.7
Energy and water rates	2.8
Principal asset repairs	14.1
<b>Total direct costs (excluding dowries)</b>	<b>84.1</b>
Unattributed costs	15.9
Steady state expenditure before dowries	100.0
Dowry sites	3.8
<b>Steady state expenditure</b>	<b>103.9</b>

Source: British Waterways Steady State Profile four year plan, 14 October 2011

### Composition of steady state model 2011/12



Source: British Waterways Steady State Profile four year plan

### The steady state model provides a guide for expenditure required to maintain the waterways in a stable condition

- The model seeks to estimate the annual cost of performing activities to physical assets and other aspects of the waterways to ensure a stable state is maintained. British Waterways first develops the cost of the activity. This figure is then 'annualised' to give the yearly requirement. A description of the methodology behind the model is provided in Appendix 2.
- The model specifies required spend by category, type of activity, type of asset / vegetation and by geography, allowing operational application of steady state budgeting
- However, it should be noted that British Waterways does not currently use the model to allocate funds between waterway units because they are not at steady state levels and the shortfall in condition varies between units. Instead, funding is allocated according to the current level of defects that require rectification

### British Waterways reviews the steady state model every few years to reflect changes in the cost base

- The model was first developed in 2004, with most recent reviews conducted in 2009/10 and during summer 2011
- The underlying cost drivers of the steady state are constantly changing, for example increased cost inflation, labour rates or productivity improvements. Reviewing the model allows British Waterways to understand changes in the cost base
- Between full steady state reviews, British Waterways aims to undertake annual refreshes, updating for any significant known changes in costs

### The current steady state estimation as created in 2011 estimates a direct total steady state spend of £84.1 million for England and Wales

- This number is an 8% decrease on the figure derived in 2009/10 of £91.4 million. This is due to a reduction in the number of units managed, the removal of duplication in the model and the redefinition of steady state activities, partially offset by increases to unit costs

### There are also indirect costs included in the full steady state model for 2011 of £15.9 million (2009: £20.5 million)

- Unattributed costs are costs which cannot be attributed to a direct activity. This could include training, travelling time and supervisory and works management costs

## Whilst the majority of spending on the waterways has historically lagged steady state requirements, that specifically focused on principal asset repair has exceeded targets

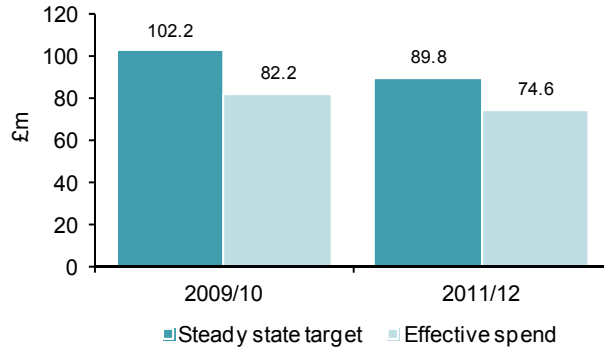
To date, the overall condition of the waterways has not met steady state requirements. Spend in arrears has been required to reduce this gap

Since 2004 British Waterways has not met the steady state levels of spend on maintenance, dredging and customer service

The under spend on physical assets appears to be less acute than for that on customer service and vegetation management

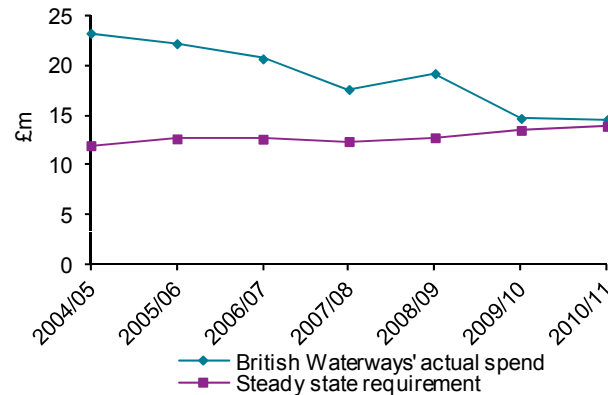
Since 2004 spend on principal asset repairs has exceeded steady state requirements as a result of the need to improve overall asset condition by meeting some of the historical funding deficit

### Steady state versus effective spend (excluding principal asset repairs), 2009/10 and 2011/12<sup>(a)(b)(c)</sup>



Source: British Waterways Steady State Expenditure (exc. Asset Repairs) as % of Model (Final Agreement), 28 February 2012

### Spend on principal asset repairs, steady state vs. actual (including spend on arrears), 2004/5 – 2010/11<sup>(a)</sup>



Source: British Waterways Steady State Expenditure (exc. Asset Repairs) as % of Model (Final Agreement), 28 February 2012

### Spend on the waterways is benchmarked by management against steady state requirements

- However, it should be noted that the overall condition of the waterways has not reached the steady state levels
- Additional spend in arrears has been required to reduce this gap

### Effective spend<sup>(c)</sup> by British Waterways on maintenance, dredging and customer service has been below steady state requirements every year since 2004 when the model was developed

- Effective spend on in these areas (i.e. excluding asset repairs<sup>(a)(b)</sup>) was below steady state in 2009/10 at £82.2 million. The 2011/12 planned effective spend is also less than target at £74.6 million
- However, the gap between steady state and actual effective spend has fallen over this period from 20% to 17% of target spend
  - This is due to efficiencies achieved by British Waterways (e.g. through outsourcing some activities), as well as the changes made to the steady state model in 2011 as discussed on page 25

### Although in aggregate spending has lagged the steady state target, spend on principal and non-principal assets has been closer to steady state requirements

- Maintaining the condition of principal assets has been prioritised above spending on the less critical aspects of network functionality, in the areas of customer service and vegetation management

### Also in contrast, spend on principal asset repairs has been at a significantly higher level than that required by the steady state model

- This has been driven by a requirement to meet government targets for improving asset condition by clearing the arrears of repair that had accumulated
- As shown left, in 2004/5 actual spend on asset repairs was 1.9 times the steady state requirement. By 2010/11, this had fallen to 1.05 times, but still remained higher

Note: (a) Principal asset repair costs represent the portion of major works spend that is directly spent on improving asset condition. Dredging, whilst categorised as part of major works, is not included in asset repairs  
 (b) Both the steady state target and effective spend have been shown excluding principal asset repair costs. This provides more comparable figures because actuals include amounts spent on arrears whereas the steady state model assumes that there are no outstanding arrears on principal assets  
 (c) Effective spend represents total waterway costs, plus contributions to steady state from the Enterprise business

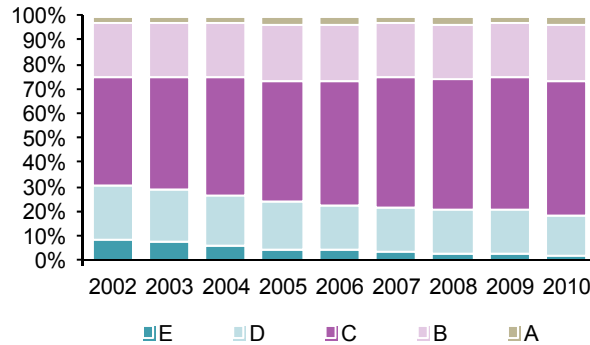
# The well funded principal asset repair programme has contributed to an improvement in asset condition

The spend above steady state on asset repairs and the preferential treatment of maintenance spend on principal assets have, in combination, contributed to improving asset condition over time

The percentage of assets in D&E condition has fallen from 30% in 2002 to 19% in 2010, which is below the threshold agreed with Defra of 23%

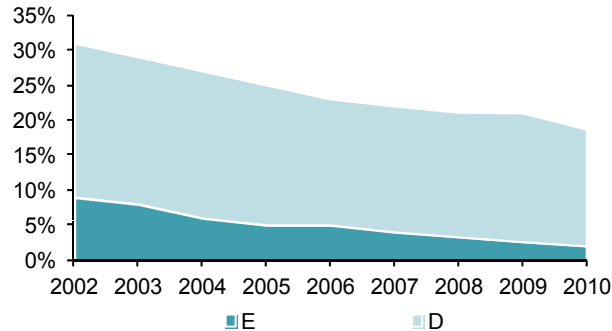
However, a gap still exists between the current percentage of D&E assets and the 15% assumed by the steady state model

British Waterways Group (including Scotland) distribution of principal assets between Grades A-E, 2002-2010



Source: BW analysis pack 26 October 2007 & Defra report p12 2009-10.

Historical proportion of assets in D&E condition, 2002-2010



Source: BW analysis pack 26 October 2007 & Defra report p12 2009-10

Principal asset repair spend directly contributes to the number of D&E grade assets

- This can be identified in the graph to the left which illustrates the number of D&E grade assets declining from 2002 to 2010. During which time the principal asset repair budget increased
- Assets in poorer condition require more maintenance to keep them at that condition. In addition, the poorer the asset condition, the more expensive asset repairs are to return it to acceptable condition (grade C or above)
- A deteriorating asset base will lead to an increased 'intermediate repair' and other maintenance as part of core waterway costs, which in turn will have a corresponding reduction in the amounts available to be spent on major works

The 2010 total of 19% principal assets in D&E condition is a marked improvement since 2002 and is below the threshold agreed with Defra of 23%; however, the number remains above the 15% assumed by the steady state model

- There has been a reduction in the total number of D&E condition assets from around 30% in 2002 to 19% in 2010
  - The reduction in E grade assets has been even more striking, falling from 9% to 2%
- The steady state model assumes that assets are repaired on a fully cyclical basis (i.e. with no arrears spend required), based on only 15% of principal assets being in D&E condition
- However, management assess that a level of 23% represents a more appropriate reflection of risk in relation to asset condition
  - Management also notes that 23% is an average across all principal assets. In reality, key asset types (e.g. reservoirs) are maintained in a better condition than this

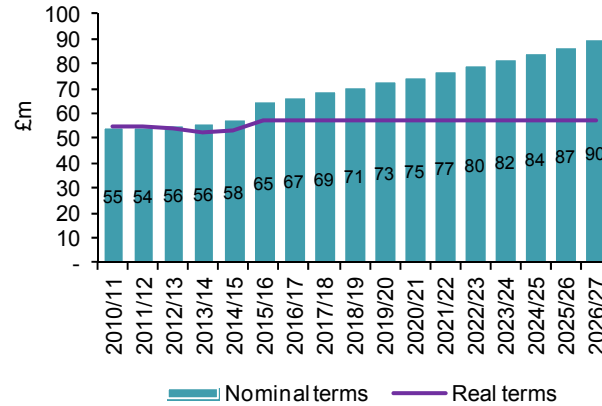
Note that major works spend includes both principal asset repair spend and also spend on minimum safety standards, emergency repairs, major dredging and non-principal asset major works

- British Waterways does not have a detailed asset register for non-principal assets, therefore the condition of these assets is not measured
- The condition grades of some principal assets have been reassessed by the Head of Asset Management over the past few years. This has partially contributed to the improving picture of the principal asset base

Core waterway costs are projected to grow from £54.4 million in 2011/12 to £89.6 million by 2026/27

This increase is driven by inflation at 3% and the inclusion of additional spend to narrow the gap on critical functionality spend (elements of customer service and vegetation management which lead to deterioration if not undertaken)

Projected core waterway costs, 2010/11-2026/27



Note: Real terms assumes an annual rate of inflation of 3%  
 Source: British Waterways long term projections, 8 February 2012

### Core waterway costs are targeted at maintaining asset condition and providing a level of customer service and amenities

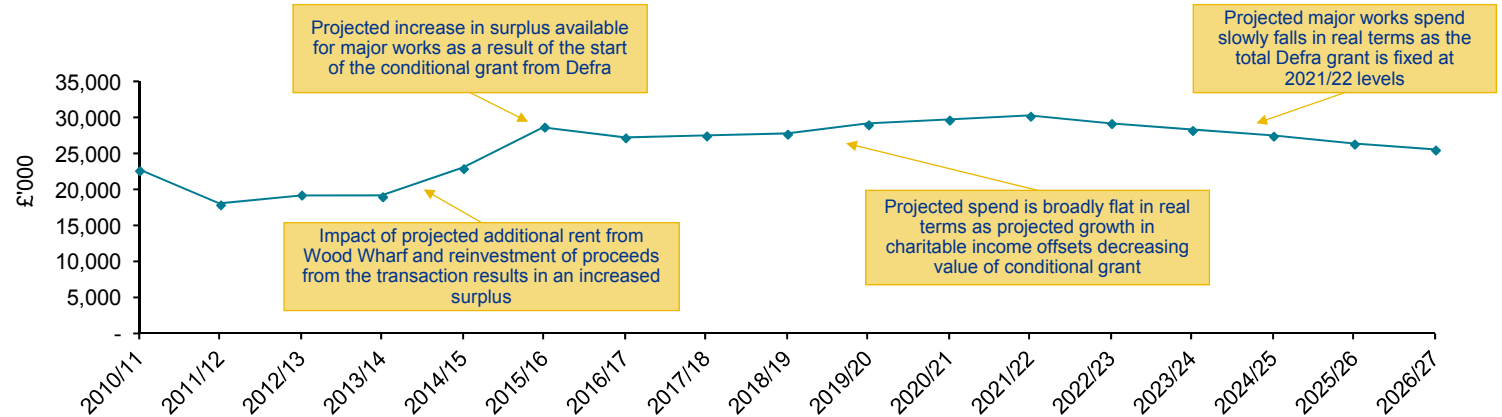
- British Waterways identifies priorities as being:
  - Inspection of principal assets on the waterways to understand condition and potential consequence of failure
  - Planned preventative maintenance – all waterways are required to deliver consistent levels of planned preventative maintenance on priority assets
  - Intermediate repair – medium sized repairs to assets on the waterway
- Costs are projected to inflate annually by 3% over the projection period and are offset by an assumption of efficiency savings being achieved through specific initiatives
- The conditional grant from Defra has enabled budgeting for additional spend on tree, vegetation and towpath management, as well as boundary, car park and mooring maintenance from 2015/16
  - These works have historically been de-prioritised given funding constraints and the importance of maintaining principal assets

Spend on major works is broadly determined as the balancing figure for British Waterways, though specific allocations between core waterway spend and major works will be for the Trustees and management to determine

Spending on major works is projected to grow over the projection period. In real terms, its value is projected to be broadly flat from 2015/16, although begins to decline slowly from 2020/21

This projected decline at the end of the period is due to the real terms decrease in the Defra grant once it is fixed at £56 million. This is in comparison to a continued inflating cost base

Projected annual spend on major works (in real terms<sup>(a)</sup>), 2010/11 – 2026/27



Note: (a) Projected spend on Major Works has been discounted to real terms using an assumed inflation rate of 3%  
 Source: British Waterways long term projections, 8 February 2012, KPMG analysis

### Major works projects are prioritised based on risk, from which a three year rolling programme is developed

- British Waterways plans an element of flexibility within its budget to allow any emergency works to be undertaken. The key works categories are reservoir safety; embankments and culverts; water supplies; large moving structures; and dredging. In addition, assets which have a high consequence of failure are prioritised

### Funding available for major works is calculated as the surplus arising from all other activities

#### In the near term, the surplus available for major works is projected to increase in real terms to 2015/16, as a result of:

- Projected additional property income generated from the Wood Wharf transaction, namely increased ground rent and the reinvestment of cash proceeds
- The start of the £10 million p.a. conditional grant from Defra

### From 2015/16 to 2021/22, major works spend is projected to be relatively flat in real terms

- Both the core Defra grant and contribution from property and leisure business activities are projected to grow in line with inflation
- Whilst charitable contribution is projected to grow strongly at a compound annual growth rate of 31%, this is offset by the falling value of the Defra conditional grant, which is fixed at £10 million

### From 2021/22, funding for major works is projected to fall slowly in real terms to the end of the projection period

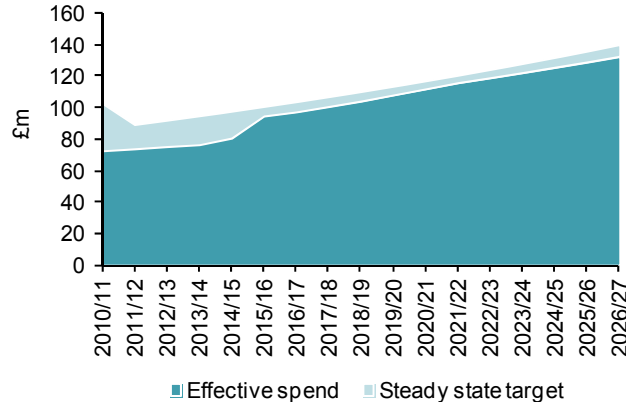
- This is as a result of the total Defra grant being fixed at the 2021/22 level of £56 million per annum

# Comparison of projected spending levels to steady state

From 2015/16, the gap between actual spend on maintenance, dredging, inspections and customer service and steady state requirements is projected to narrow as a result of the introduction of the conditional grant from Defra

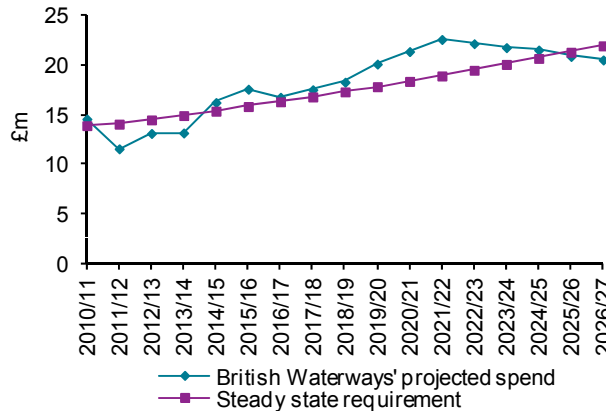
Spend on principal asset repairs is projected to dip below steady state levels in the short-term to 2014/15, but then exceed steady state requirements in order to recover the earlier deficit

**Steady state versus projected effective spend (excluding principal asset repairs), nominal terms, 2010/11-2026/27<sup>(a)(b)(c)</sup>**



Source: British Waterways Steady State Expenditure (exc. Asset Repairs) as % of Model (Final Agreement), 28 February 2012

**Spend on principal asset repairs, steady state vs. projections, nominal terms, 2010/11 – 2026/27<sup>(a)</sup>**



Source: British Waterways Steady State Expenditure (exc. Asset Repairs) as % of Model (Final Agreement), 28 February 2012

**British Waterways' projections indicate that the gap between steady state requirements and effective spend (excluding principal asset repairs)<sup>(a)(b)(c)</sup> on maintenance, dredging and customer service will narrow from 2015/16**

- Over the business plan period to 2014/15, effective spend (excluding principal asset repairs) is projected to equate to an average of 82% of steady state requirements
- From 2015/16, this is projected to increase to 94%, a level which is then maintained over the remainder of the period
- This up turn in spending against steady state arises as a result of the introduction of the conditional grant from Defra in 2015/16

**Spend directly on principal asset repairs is projected to fall below steady state requirements in the business plan period, resulting in a backlog of required spending. From 2015/16, this backlog will begin to be rectified as spend again increases above steady state levels**

- On average, between 2011/12 and 2013/14, spend on principal asset repairs is projected to be 87% of steady state requirements
- This metric increases to 106% in 2015/16, with the introduction of the conditional grant from Defra, and peaks at 119% in 2021/22
  - Additional spend has been projected by management in this period in order to mitigate the deficit in earlier years
- Spend on principal asset repairs then falls to the end of the projection period, falling below steady state levels in 2025/26

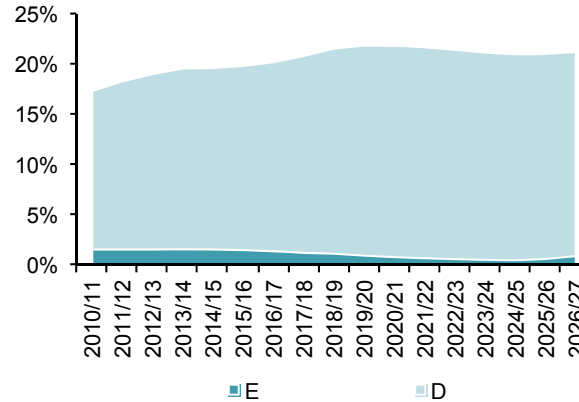
Note: (a) Principal asset repair costs represent the portion of major works spend that is directly spent on improving asset condition. Dredging, whilst categorised as part of major works, is not included in principal asset repairs  
 (b) Both the steady state target and effective spend have been shown excluding principal asset repair costs. This provides more comparable figures because actuals include amounts spent on arrears whereas the steady state model assumes that there are no outstanding arrears on principal assets  
 (c) Effective spend represents total waterways costs, plus contributions to steady state from the Enterprise business, plus a value attributable to volunteering

Based on the projected levels of spending, the percentage of assets in condition E is projected to fall from 1.7% to 1.1% over the projection period

However, the percentage of assets in condition D is projected to increase from 17% to 20% over the same period

The increase in assets in D&E condition is driven by continued under spend on maintenance activities compared to steady state and lower than steady state levels of principal asset repairs spend in the first three years. This is coupled with an existing asset base that does not meet steady state assumptions

Projection of assets in D&E condition, 2011/12 – 2026/27<sup>(a)</sup>



Note: (a) A description of the process used to build the asset condition projections is included in Appendix 3

Source: British Waterways Asset Condition Analysis v24 – Final Agreement, 22 February 2012

The impact of the levels of projected spend on the waterways from 2010/11 to 2026/27 is to further decrease the projected percentage of assets in condition E, whilst increasing the proportion of assets in condition D

- The projected percentage of assets in condition E falls from 1.7% to 1.1% (2011/12 to 2026/27) with a low of 0.7% forecast for 2023/24
- Meanwhile, the projected percentage of assets in condition D increases from 16% to 20% (2011/12 to 2026/27) with a high of 21% forecast for 2020/21
- The divergent trend between D and E assets is driven by management’s modelling assumption that expenditure is focused first on E-grade assets, which are considered to be at greatest risk of failure

The total percentage of assets in D&E condition is projected to increase to 21% by 2026/27, although remaining below the threshold agreed with Defra of 23%. This increase is as a result of a combination of factors:

- Core spend on the waterways is below steady state levels throughout the projection period, resulting in assets deteriorating in condition
- In addition, spend on principal asset repairs falls below steady state requirements in the period to 2014/15
- Whilst spend on principal asset repairs then increases above steady state levels, there remains a deficit to be met, which arises both from the early projection period and also from insufficient historical spend
- As noted on page 27, the percentage of assets in D&E condition currently exceeds that assumed by the steady state model. Therefore, steady state spend does not reflect the spend required to maintain the actual asset base and exceeding steady state levels of spend does not directly equate to improving overall asset condition



	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property income	16
■ Charitable income	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

## Forecast assumptions

# Summary of projection assumptions

Projections to 2026/27 have been developed from a detailed four year business plan to 2014/15, followed by high level assumptions

Key costs and contribution from certain income streams have been inflated at 3%

This appears reasonable given the long term target of the Bank of England of 2% inflation rate and the GDP deflator of 2.5%

However if inflation were to be higher or lower than 3% during the projection this would significantly impact the results

Projection	Comment
Property contribution	<ul style="list-style-type: none"> <li>Property income from specific, large properties has been projected on an asset by asset basis based on known contractual terms. The remainder (approximately 65% in 2014/15) has been inflated by 3% each year to 2026/27</li> <li>This results in a projected combined compound annual growth rate of 3.4% from 2014/15 to 2026/27 or 2.8% from 2015/16 to 2026/27. The higher rate arises as a result of significant increase relating to Wood Wharf income specifically in 2015/16</li> </ul>
Leisure contribution	<ul style="list-style-type: none"> <li>Leisure contribution includes several different income streams, which have been projected individually.</li> <li>In aggregate, from 2014/15 contribution from leisure increases by a projected compound annual growth rate of 2.8%</li> </ul>
Utilities contribution	<ul style="list-style-type: none"> <li>Contribution from utilities is projected to inflate annually from 2014/15 by 3% for all contracts except that with BSKyB</li> <li>The BSKyB contract is fixed price, with periodic reviews but no inflationary increase permissible. The projected compound annual growth rate from 2014/15 to 2026/27 of utilities contribution in aggregate is therefore lower than inflation at 2.4%</li> </ul>
Charity contribution	<ul style="list-style-type: none"> <li>Year on year growth has been assumed for charitable contribution to £5.8 million in 2020/21. From 2020/21 to the end of the period the projected compound annual growth rate slows to 8% per annum</li> </ul>
Grant	<ul style="list-style-type: none"> <li>The grant has been modelled based on the terms agreed with Defra, as detailed on page 20</li> <li>The core grant has been inflated annually from 2015/16 by 2.5% to reflect the GDP deflator</li> <li>The conditional grant is also included from 2015/16, but this is fixed at a flat rate of £10 million per annum each year to 2021/22</li> <li>From 2021/22, the grant is fixed, resulting in a projected real terms decrease in value over time</li> </ul>
Management costs	<ul style="list-style-type: none"> <li>From 2014/15, management costs are projected to inflate annually by 3%, thereby remaining at a constant level in real terms</li> <li>These costs would be specifically impacted by wage inflation rates which may differ from the 3% assumption</li> </ul>
Pension deficit	<ul style="list-style-type: none"> <li>Pension deficit funding is projected to remain constant at £7 million per annum over the projection period</li> </ul>
Core waterway cost	<ul style="list-style-type: none"> <li>From 2014/15, core waterway costs are projected to inflate annually by 3%, thereby remaining at a constant level in real terms</li> </ul>
Major works	<ul style="list-style-type: none"> <li>The annual spend on major works is projected as the balancing figure required to eliminate any surplus from operations. Whilst it will be impacted by inflation rates across other income and cost lines, it is not projected in this manner</li> </ul>

Inflation is a key driver of British Waterways' 15 year projections

Inflation has been projected at 3% throughout

Comparison against current levels of inflation suggest that this is too low; however medium term trends and targets are to reduce the official rate of inflation (the CPI) to around 2%

A risk for the Canal and River Trust lies in differential rates of inflation impacting its income and expenditure in different ways

**A core cost assumption British Waterways has made is an assumed constant rate of inflation of 3%, as compared to the GDP deflator of 2.5%, for the duration of the projection period**

- A constant rate of inflation of 3% has been applied to the projections after the business plan period
- This is an important assumption in understanding the likely growth of income and expenditure
- If the actual rate of inflation diverges from this projection of 3% it would have impact on British Waterways' income and cost base

**To understand the appropriateness of the 3% figure, comparisons to other rates of inflation are required**

- Since 2003, the official rate of inflation is the Consumer Price Index (CPI). Prior to 2003 the Retail Prices Index (the RPI) was used
- During 2011, CPI inflation peaked at 5.2% in September, with an annual average of 4.5%. This is above the published target of 2.0%, which the Bank of England forecasts will be met in 2013
  - The current rate of 3.6% (January 2012) remains higher than target, but lower than the 2011 average reflecting the fact that past increases in VAT and petrol prices have fallen out of the twelve-month comparison
- The Office for Budgetary Responsibility in line with the Bank of England's projections, with a rise above 4% in mid 2011, driven higher by VAT increases and commodity prices, before falling back sharply in the final quarter of 2011 and reaching 2% in early 2013

**The 3% inflation rate assumed by British Waterways is considered to be broadly in line with external long-term forecasts**

**However, it should be noted that differential rates of inflation are likely to affect different types of costs. Application of one rate of inflation may not appropriately reflect how different income and cost lines will actually inflate**

- For example, construction inflation has a history of being more erratic than CPI and also has for long periods been substantially higher than CPI
- This could have the effect of increasing British Waterways cost base more rapidly than its income streams growth
  - A high level analysis of the types of cost that comprise core waterway costs and major works costs indicates that over the business plan period only 13% of total costs will be spent on materials
  - This suggests that exposure to construction inflation is not likely to be significant

	Page
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property income	16
■ Charitable income	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

KPMG, together with British Waterways, has identified a number of sensitivities have been applied to the base case projections

These sensitivities are both upside and downside scenarios

The effect of all the sensitivities has been referenced in terms of spend on principal asset repairs<sup>(a)</sup>. The results are detailed in the next pages

To identify the impact of various internal and external events on British Waterways' projections, a range of sensitivities have been applied to British Waterways' base case

- Any variations in income or expenditure will flow through directly to asset repairs as this is the key 'flex' within the model. Therefore the impact of these events is analysed in terms of 'spend on principal asset repairs'<sup>(a)</sup> over the modelled period (2011/12 – 2026/27)
- Sensitivities have been run on the 'Base Case' which assumes 75% of the charitable income estimated by Think Consulting and inflation of 3%

A range of upside and downside scenarios have been identified:

		Base Case assumption	Sensitivity applied
Upside	U1	Inflation is forecast to be 3% during the projection period	<ul style="list-style-type: none"> <li>Inflation is one percent lower than assumed, at 2% across relevant business areas<sup>(b)</sup> and 1.5% on the Defra funding</li> </ul>
	U2	Charitable benefits will generate 75% of the benefit estimated by Think consultancy	<ul style="list-style-type: none"> <li>Assume the prudence factor of 25% is not required and 100% of income is earned</li> </ul>
Downside	D1	Standard inflation will be 3% during the planned period	<ul style="list-style-type: none"> <li>Inflation is 1% higher than assumed, at 4% across relevant business areas<sup>(b)</sup> and 3.5% on the Defra funding</li> </ul>
	D2	Charitable benefits will generate 75% of the benefit estimated by Think consultancy	<ul style="list-style-type: none"> <li>The prudence factor is increased to 50% to reflect reduction in benefits achieved</li> </ul>

Note: (a) Spend on principal asset repairs is defined as major works spend excluding spend on major dredging, minimum safety standards and other major works

(b) The following contribution and cost lines have been projected based on assumed inflation rates, and have therefore been affected by a change to the inflation assumption under sensitivities U1 and D1: property contribution, leisure contribution, utilities contribution, British Waterways Marinas, BW share of joint ventures, grant funding, management costs, core waterway costs, Enterprise costs.

## Quantification of upside and downside

The critical sensitivities relate to potential changes in the rate of inflation over time

If inflation increases by one percentage point over the rate modelled, the impact on CRT would be £8.0 million less to spend on principal asset repairs during the projection period

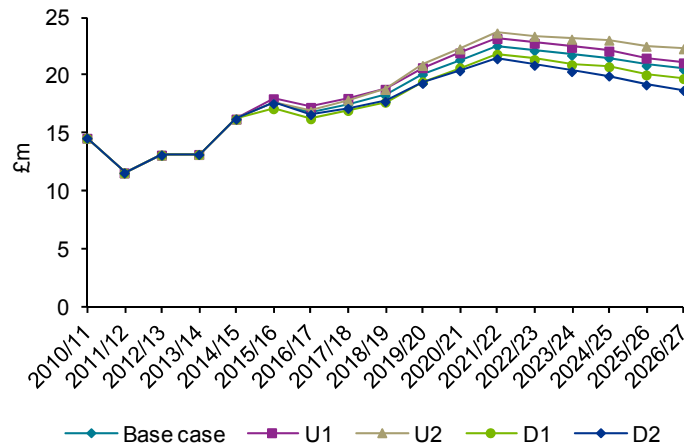
A similar level of upside would result from a fall in inflation rates by one percent

Flexing the level of voluntary income generated has a lesser impact, equating to a £1 million per annum upside or downside

### A range of 'upside' and 'downside' sensitivities have been run against British Waterways' base case scenario

- The key sensitivities are the scenarios where inflation is flexed either upwards or downwards by 1% per annum. In total over the period, this would lead to a downside of £8.0 million less funding for asset repairs and a comparable upside of £7.0 million increase in funds for spending on principal asset repairs
- Flexing the prudence factor applied to voluntary income has a lesser, though not insignificant, impact on funds available for spending on principal asset repairs. Reducing the factor to nil, results in an upside of £11.5 million over the projection period, whilst increasing the prudence factor to 50% creates an equivalent £11.5 million downside

Spend on principal asset repairs – upside and downside scenarios, 2010/11 – 2026/27



Source: British Waterways Sensitivity Analysis, Asset Condition model v24, 6 March 2012

			Principal asset repair spend (£m)	
			2010/11-2026/27	Variance to BC
Base Case	<b>BC</b>	Assumes 75% of the voluntary income estimated by Think Consulting and inflation of 3%	309.7	
Upside	<b>U1</b>	Inflation is one percent lower than assumed, at 2% across relevant business areas <sup>(a)</sup> and 1.5% on the Defra funding	316.7	7.0
	<b>U2</b>	Assume the prudence factor of 25% is not required and 100% of voluntary income is earned	321.2	11.5
Downside	<b>D1</b>	Inflation is 1% higher than assumed, at 4% across relevant business areas <sup>(a)</sup> and 3.5% on the Defra funding	301.7	(8.0)
	<b>D2</b>	The prudence factor on voluntary income is increased to 50% to reflect a reduction in benefits achieved	298.2	(11.5)

Note: (a) The following contribution and cost lines have been projected based on assumed inflation rates, and have therefore been affected by a change to the inflation assumption under sensitivities U1 and D1: property contribution, leisure contribution, utilities contribution, British Waterways Marinas, BW share of joint ventures, grant funding, management costs, core waterway costs, Enterprise costs

	<b>Page</b>
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property income	16
■ Charitable income	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

**The charity will have a different tax position to that of British Waterways and a new tax efficient corporate structure will be used to avoid unnecessary payment of corporation tax**

**The asset transfer to CRT is to be done at tax neutrality therefore removing potential tax liabilities of up to £80 million**

### Corporation tax

- British Waterways is subject to corporation tax generally and has paid tax historically on capital gains arising on the disposal of assets. As part of the transfer of assets from British Waterways to CRT, Defra has an outline agreement from HMRC that the transfer will be tax neutral. If this were not the case corporation tax payable could be in the region of up to £80 million on the realisation of gains
- Tax neutrality should apply whether the assets are transferred to CRT or the CIC, and should extend to investments in joint ventures and subsidiaries. Operational assets will also be transferred to CRT, being the heritage waterway assets which have a nil value, plus the offices and workshops
- As at 31 March 2010, British Waterways had £14.3 million of tax losses to be carried forward to future years and it is assumed that these will be transferred to CRT to offset any taxable profits arising in future years
- The “primary purpose” income activities and activities ancillary to “primary purpose” are exempt from corporation tax in CRT. This will apply to the commercial income to be generated by CRT. Any expenditure relating to these activities is therefore not allowable for tax purposes. Rental income, investment income and realised gains are exempt if applied to a charitable purpose i.e. maintenance of the core waterways. All other income is taxable and where possible will be carried on in the wholly owned CIC subsidiary
- Profit before tax earned in the CIC will be gift aided up to the charity. Gift aid is allowable against the taxable profits of the donor and the gift aid received in the charity is exempt for tax purposes

### VAT

- It is assumed that prior to the date of transfer CRT will be registered for VAT and that the trade of British Waterways will be transferred as a going concern from the public sector to CRT ensuring there is no VAT leakage
- British Waterways is partially exempt for VAT and recovers approximately 99% of input VAT. British Waterways elected to waive the exemption to VAT (effectively opted to tax) on the operational land and buildings and waterways infrastructure together with the investment property. It is intended that these elections will remain in place for CRT to retain the benefits of ‘opting to tax’ in input tax recovery
- The current funding received from Defra is treated as grant in aid which is not subject to VAT and it is assumed that this will continue, as the funding agreement is outside the scope of VAT

### Stamp duty and stamp duty land taxes

- The transfer assets from BW to CRT will also be neutral for the purposes of stamp duty and stamp duty land taxes without risk of future clawback
- Under the rules that apply to charities CRT will be exempt from SDLT arising on the sale of investment property provided the assets are held for charitable purposes and must not be subject to any development or trading activity

### Gift Aid

- Gift Aid is a scheme for gifts of money by individuals who pay UK tax. If a donor pays the basic tax rate (20%) and signs a Gift Aid declaration in favour of the charity, then the charity can reclaim the basic rate tax from HM Revenue & Customs (HMRC) on the amount of the donation before basic rate tax was deducted
- For purposes of the voluntary income projections, it has been assumed that 70% of the income received from regular donors will be supplemented by reclaiming Gift Aid from HMRC. Over the first 10 years of fundraising, this amounts to a total of approximately £6 million reclaimed before the application of the prudence factor



	<b>Page</b>
<b>Executive summary</b>	<b>4</b>
<b>Background</b>	<b>8</b>
<b>Financial overview</b>	<b>10</b>
<b>Income</b>	<b>13</b>
■ Property income	16
■ Charitable income	18
■ Grant funding	20
<b>Expenditure</b>	<b>21</b>
■ Expenditure on waterways	23
– Steady state	25
– Core waterway costs	28
– Major works costs	29
– Asset condition	30
<b>Forecast assumptions</b>	<b>32</b>
<b>Key sensitivities</b>	<b>35</b>
<b>Tax</b>	<b>38</b>
<b>Appendices</b>	<b>40</b>

Comment on the core business and financial planning documents provided by the British Waterways team which outline the context and financial position of the Canal and River Trust ('CRT'). This commentary will give an overview of the core assumptions that underpin the case for the CRT:

- Comment on the funding settlement received from DEFRA and its potential effect on the overall financial stability of the CRT;
- Comment on the overall financial setting, strategic context and assumptions which underpin the financial projections for the CRT;
- Suggest sensitivities to be run against the most critical assumptions, to seek to identify the potential impact on the overall financial position of CRT from variance in these assumptions;
- Summarise the outcome of these sensitivities;
- Comment on the income derived from charitable giving and the assumptions underpinning this income stream;
- Comment on the major property assumptions regarding income streams and investment opportunities;
- Comment on the approach taken to model the maintenance and asset repair spend for CRT and analyse the base assumptions. Comment will not be made on the assets themselves or the integrity of the grading status.

We must emphasise that the realisation of the forecasts prepared by BW is dependent on the continuing validity of the assumptions on which they are based. The assumptions will need to be reviewed and revised to reflect any changes in trading patterns, cost structures or the direction of the business as they emerge. We accept no responsibility for the realisation of the forecasts.

Since the forecasts relate to the future, actual results are likely to be different from the projected results because events and circumstances frequently do not occur as expected, and the differences may be material.

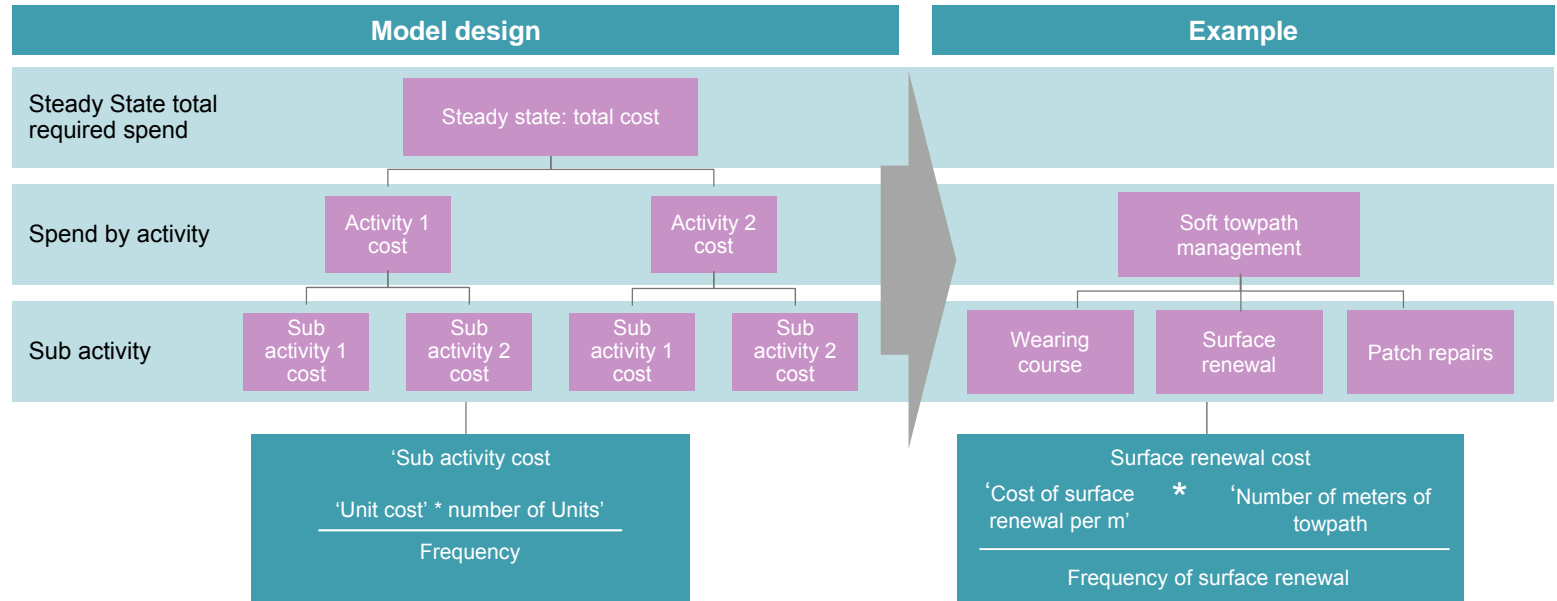
The steady state model builds up the annual cost of the waterways through a bottom up approach, aggregating the activities associated with waterways maintenance and operations

Cost estimations are made on the life-time cost of sub-activities, which is then divided by the frequency of the sub-activity to find the annual required spend

These estimations are multiplied by the number of assets across the network to define the total national cost of the sub activity

When all these costs are combined, the total direct costs of steady state condition are calculated

The direct costs of the steady state model are built 'bottom up' by understanding the cost and frequency of all activities associated with maintaining the condition of the waterways.



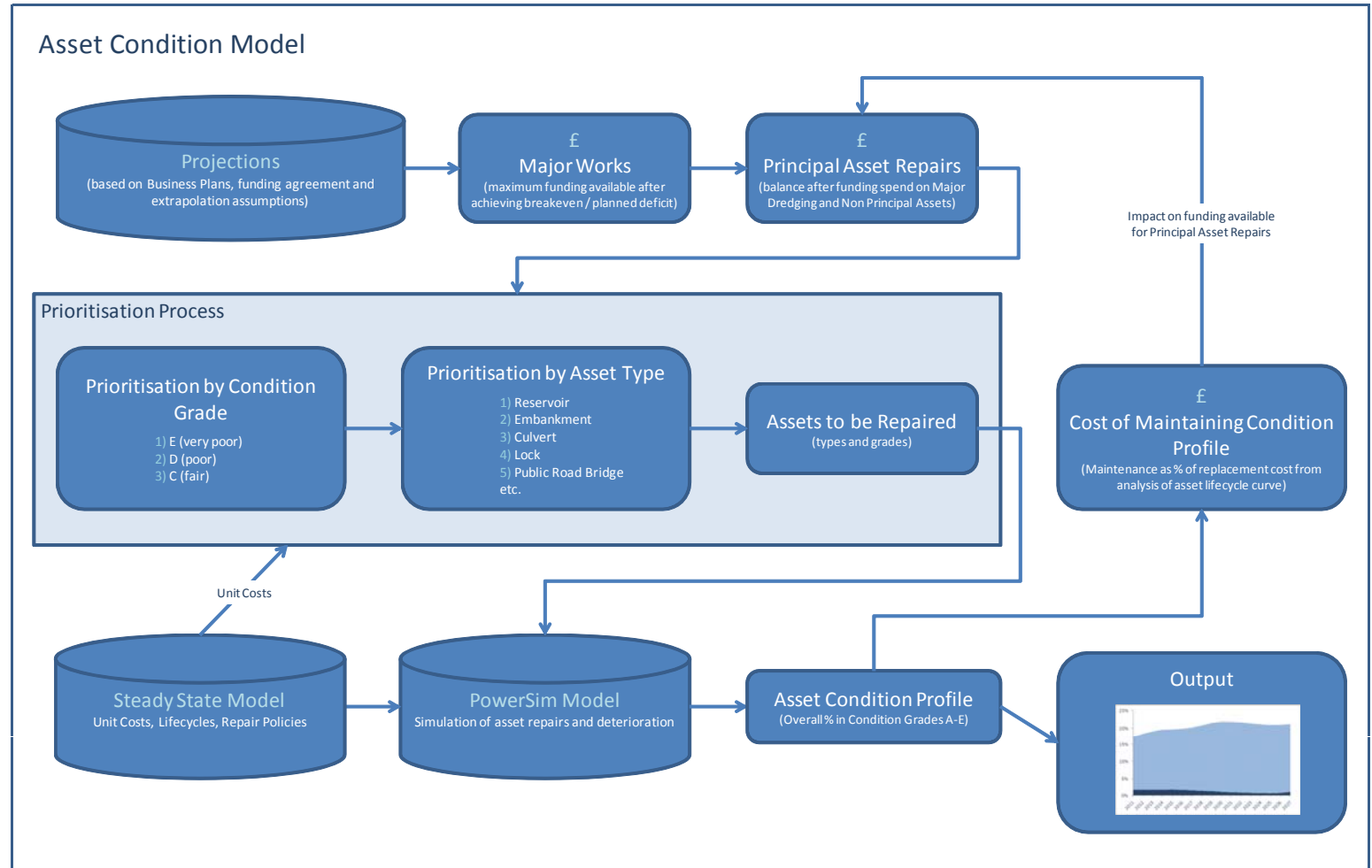
The model takes the following steps to identify appropriate expenditure

- Activities for waterway management are broken down into their sub-activities, as detailed above.
- The annual cost of each sub-activity is developed. To calculate this, the lifetime costs of the sub-activity is multiplied by the number of units in the waterways. This total number is then divided by the frequency with which the activity is required, giving the annual cost.
- The annual cost for sub-activity is now bundled up into 'Activity' and finally the 'Activities' are aggregated to give the total steady state cost.
- The model is designed to take account of the actual number of assets held by each waterway, therefore expenditure can be understood on a regional and an activity basis.
- The terminology used in the model is designed for ease of use when developing the steady state and may not apply exactly in operations. For example, 'sub-activities' are often large complex jobs in their own right, although they may fit within a wider 'activity'.

The asset condition model process allocates funding available for principal asset repairs (as per the financial projections) against assets according to priority

The prioritisation process produces an asset repair profile which is input into the PowerSim model

This then simulates asset repairs and deterioration over time, based on input data, to produce a projected asset condition profile (as shown on page 31)





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