Powerlink 2027-32 Revenue Proposal

Appendix 5.07

Incenta – Benchmark Debt and Equity Raising Costs Report

Benchmark debt and equity raising costs

Powerlink

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INCENTA
ECONOMIC CONSULTING

Contact us:

Incenta Economic Consulting
Unit 1, 19-35 Gertrude Street
Fitzroy, Victoria, 3065
Telephone: +61 3 8514 5119
Website: www.incenta.com.au

Disclaimer:

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1. Executive Summary

1.1 Our Brief

Powerlink Queensland (Powerlink) is preparing its submission to the Australian Energy Regulator (AER) with respect to its next regulatory determination process for the 2028-32 regulatory period.. Powerlink requested Incenta to undertake a review of relevant information and provide recommendations relating to debt and equity raising transaction costs to inform and support Powerlink's Revenue Proposal. Our brief was to prepare a report:

- having regard to, and in the context of, the National Electricity Rules (NER) and the National Electricity Law (NEL) for electricity transmission network service providers that,
- considers recent Revenue Proposals to and responses from the AER in relation to debt and equity raising transaction costs by other regulated network service providers, and
- bases all analysis and its recommendations on the Australian Energy Regulator's Better Regulation Guidelines and Better resets handbook to provide:
  - Estimates the total debt raising transaction costs that a benchmark efficient energy network service provider would be expected to incur in the upcoming regulatory period;
  - Estimate the total equity raising transaction costs that a benchmark efficient energy network service provider would be expected to incur in the upcoming regulatory period.

In undertaking these tasks Powerlink has requested that we provide information and analysis that clearly demonstrates the basis upon which the estimates were derived.

1.2 Recommendations:

A debt raising cost of 8.61 bppa is recommended

We recommend that Powerlink apply a **8.61 bppa** (basis points per annum) debt raising cost, comprised of:

- An arrangement fee of **6.36 bppa**, which is based on the approach that the Australian Energy Regulator (AER) applied since the SA Power Networks decision and using the WACC as the annualization discount rate for a sample of 10 bonds issued by 3 Australian businesses in the last 5 years; [1] and
- Other debt raising costs of **2.25 bppa**, which is based on applying the approach the AER accepted in the SA Power Networks decision using the Chairmont report's updated other cost parameters adjusted for CPI and Powerlink's number of benchmark bond issues (22 bonds instead of 11). [2]

As a cross-check, we found 100 recent US BBB-rated utility bond issues at a 10-year term, which indicated a benchmark arrangement fee of 9.01 bppa (applying the Powerlink PTRM's 6.493 per cent

[1] AER (June 2020), *Final decision – SA Power Networks 2020-25*, *Attachment 3: Rate of Return,* p.3-14.
[2] Chairmont (29 June, 2019), *Debt Raising Costs*.

WACC as the annualisation discount factor). This suggests a total debt raising cost of 11.26 bppa, which is higher than the 8.61 bppa that is derived using the AER's standard method updated for inflation (CPI).

No equity raising costs are required

Based on its base case PTRM, Powerlink does not require any equity to be raised and therefore would not attract equity raising costs over the forecast period.

2. Arrangement fee

The "arrangement fee" is the first component of direct debt raising costs. This component relates to the fees paid to the organisation (generally an investment bank) that is responsible for preparing and marketing the bond issue. The arrangement fee is expressed as a percentage (or basis points, bp) of the value of the bond issue. PwC (2013) found that the "average arrangement fee [in basis points per annum] … remained relatively constant with respect to term at issuance, issuance size and credit rating."[3]

2.1 The AER's approach

2.1.1 SA Power Networks 2020

Since its Final Decision on SA Power Networks in 2020, when the Australian Energy Regulator (AER) established a methodology for estimating benchmark debt raising costs, it has applied the same approach.[4] The approach is based on the framework determined by the Allen Consulting Group (ACG) that was commissioned by the Australian Competition & Consumer Commission (ACCC) in 2004.[5] In its 2020 decision on SA Power Networks the AER concluded that:[6]

> *Having regard to SA Power Networks' submission, we consider that Bloomberg is likely to be the most suitable source of information for the 'arrangement fee' at this time because it is the only published source of data known to us and was previously used to estimate the 'arrangement fee'. We have updated the 'arrangement fee' using Bloomberg data and the selection criteria consistent with the PwC report. This leads to an annual total debt raising cost of 7.98 bppa which is not materially different to the estimate proposed by SA Power Networks of 8.50 bppa.*

The PwC report relied on "bond arrangement fee data for [33] Australian firms issuing bonds in the US" over a "5 year window" (2008 to 2013) after eliminating "bonds that were not corporate issuers, not investment grade, or did not provide arrangement fee data."[7] In September 2024, in the context of Energex's draft determination for the 2025 to 2030 period, the AER's reiterated its method in the following terms:[8]

> *… we have applied the approach from our 2020-25 final decision for SA Power Networks.[9] That is, we use updated Bloomberg data to inform the 'arrangement fee' component of debt raising costs and Chairmont's updated estimates for the remaining components. We use this method because regulated businesses have previously raised concerns with Chairmont's 2019*

3 PwC (June, 2013), *Energy Networks Association: Debt financing costs,* pp.16-17.
4 AER (June, 2020), *FINAL DECISION, SA Power Networks Distribution Determination 2020 to 2025, Attachment 3, Rate of return*, pp.3-12 to 3-14.
5 ACG (2004*), Debt and Equity Raising Transaction Costs, Final Report*, Report to The Australian Competition and Consumer Commission.
6 AER (June, 2020), *FINAL DECISION, SA Power Networks Distribution Determination 2020 to 2025, Attachment 3, Rate of return*, p.3-14.
7 PwC (June, 2013), *Energy Networks Association: Debt financing costs,* p.ii.
8 AER, (September, 2024), *DRAFT DECISION, Energex Electricity Distribution Determination 2025 to 2030 (1 July 2025 to 30 June 2030)*, p.6.
9 AER, Final Decision SA Power Networks Distribution Determinations 2020–2025 — Attachment 3 Rate of Return, June 2020.

update, with the key focus being on Chairmont's estimate of 'arrangement fee'.[10] After assessing submissions, we recognised that Bloomberg is likely to be the most suitable source of information for the 'arrangement fee' at this time because it is the only published source of data known to us and was previously used to estimate the 'arrangement fee'.

In its SA Power Networks decision the AER accepted the company's proposed total debt raising cost estimate of 8.50 basis points per annum (bppa), which was comprised of an arrangement fee component of 6.75 bppa and "other debt raising costs" of 1.75 bppa.[11] While the AER separately calculated an estimated arrangement fee of 6.23 bppa (assuming it applied the same 1.75 bppa for other debt raising costs) it accepted SA Powerlink's 6.75 bppa submission "because it is not materially different from [the AER's] estimate."[12]

2.1.2 Regulatory precedent

Table 1 below displays the total debt raising cost outcomes of the SA Power Networks determination and subsequent determinations in the regulated energy sector. In its determinations the AER has not been transparent in breaking down the total debt raising cost into the arrangement fee and "other direct costs" components. On average, since the SA Power Networks decision the debt raising fee applied by the AER has been 8.43 bppa, in the range of 8.10 bppa to 8.79 bppa excluding Marinus Link Stage 1. The 9.74 bppa applied to Marinus Link Stage 1 may be an aberration.

Table 1: Total debt raising cost – regulatory precedents

Company	Activity	Date	Period	Debt raising fee AER applied
SA Power Networks	Electricity Distribution	June 2020	2020-25	8.50
APA Victorian Transmission S	Gas Transmission	June 2022	2023-27	8.10
AusNet Gas Services	Gas Distribution	Dec 2022	2023-28	8.60
Multinet Gas Networks	Gas Distribution	Dec 2022	2023-28	8.10
Ausgrid	Electricity Distribution	Sept 2023	2024-29	8.27
Essential Energy	Electricity Distribution	Sept 2023	2024-29	8.66
Evoenergy	Electricity Distribution	Sept 2023	2024-29	8.79
TasNetworks	Electricity T&D	Sept 2023	2024-29	8.10
Energex	Electricity Distribution	Sept 2024	2025-30	8.35
Marinus Link Stage 1	Electricity Transmission	May 2025	2025-30	9.74
Jemena	Electricity Distribution	Sept 2025	2026-31	8.64
AusNet Services	Electricity Distribution	Sept 2025	2026-31	8.43
Powercor	Electricity Distribution	Sept 2025	2026-31	8.38
United Energy	Electricity Distribution	Sept 2025	2026-31	8.51
AGN (SA)	Gas Distribution	Nov-25	2026-31	8.56
Average (2021-2025 excl. Marinus Link)				**8.43**

Source: AER

[10] SA Power Networks, (10 December 2019), *Revised Regulatory Proposal 2020–25: Attachment 3 Rate of Return*, pp. 20–21; CEG, (November, 2019), *The cost of arranging debt issues*, p. 3

[11] SA Power Networks (10 December, 2019), *2020-25 Revised Regulatory Proposal, Attachment 3 Rate of Return*, p.21.

[12] AER (June, 2020), *FINAL DECISION, SA Power Networks Distribution Determination 2020 to 2025, Attachment 3, Rate of Return*, p.3-14.

2.2 Current sample of bonds

Australian bond issuers in the US

In its recent determination for Energex, the AER stated that the method it applies to estimate the benchmark arrangement fee is as follows:[13]

> *… uses a 5-year window of bond data to reflect the market conditions at that time. Our estimates were updated in 2013, based on a report by PricewaterhouseCoopers (PwC) which used data over 2008–2013, and most recently in 2019 by Chairmont.[14] … Our standard approach is to amortise the upfront costs that are incurred in raising the bonds using the service provider's nominal vanilla weighted average cost of capital (WACC) over a 10-year amortisation period. This is then expressed in basis points per annum (bppa) as an input to the PTRM.*

The PwC (2013) report recommended that the benchmark arrangement fee be estimated based on the last 5 years of bond data for Australian firms issuing debt in the US, which we have assembled in Table 2 below. The sample, which has been assembled consistent with the PwC (2013) report's recommendations is comprised of 10 bonds issued by three corporates between 1 October 2020 and 30 September 2025. When Powerlink's 6.395 per cent average WACC (drawn from Powerlink's PTRM model) is applied as the discounting factor an average annualised fee of 6.33 bppa is calculated.[15]

The **6.36 bppa** we calculate using the WACC method of amortisation that is applied by the AER is lower than the 6.75 bppa applied in the SA Power Networks case because it relied on a different sample of bonds and the nominal vanilla WACC estimated by Powerlink (6.493 per cent) is higher than that applied to SA Power Networks (4.75 per cent).

Table 2: Arrangement fee derived from bonds issued by Australian businesses, 2021-25

Issuer Name	Ticker	S&P rating	Issue Date	Maturity	Term	Upfront Fee	bppa
BHP Billiton Finance USA Ltd	BHP	A-	8-Sep-23	8-Sep-30	7.0	0.40%	7.29
BHP Billiton Finance USA Ltd	BHP	A-	28-Feb-23	28-Feb-33	10.0	0.45%	6.25
BHP Billiton Finance USA Ltd	BHP	A-	8-Sep-23	8-Sep-33	10.0	0.45%	6.25
BHP Billiton Finance USA Ltd	BHP	A	21-Feb-25	21-Feb-35	10.0	0.45%	6.26
BHP Billiton Finance USA Ltd	BHP	A	21-Feb-25	21-Feb-32	7.0	0.40%	7.29
BHP Billiton Finance USA Ltd	BHP	A	5-Sep-25	5-Sep-36	11.0	0.45%	5.85
Wesfarmers Ltd	WESAU	A-	21-Oct-21	21-Oct-33	12.0	0.38%	4.59
Woodside Finance Ltd	WDSAU	BBB+	12-Sep-24	12-Sep-34	10.0	0.45%	6.26
Woodside Finance Ltd	WDSAU	BBB+	19-May-25	19-May-32	7.0	0.40%	7.29
Woodside Finance Ltd	WDSAU	BBB+	19-May-25	19-May-35	10.0	0.45%	6.26
Average arrangement fee (bppa) (7-13 year term)							**6.36**

Source: Bloomberg and Incenta analysis Note: the bppa values are calculated using the nominal vanilla WACC in Powerlink's PTRM.

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13 AER (September, 2024), *Draft Decision, Energex Electricity Distribution Determination 2025 to 2030 (1 July 2025 to 30 June 2030)*, p.5.

14 PricewaterhouseCoopers, (30 June 2019), *Energy Networks Association: Debt financing costs, June 2013*; Chairmont, Debt Raising Costs., p.5.

15 Applying the cost of debt as the amortising discount rate would result in a benchmark arrangement fee estimate of 7.06.

Bonds issued by US utilities

As a cross-check we also examined arrangement fees for US bond issues by US utilities rated BBB- to BBB+. We found 100 10-year term US bonds issued by BBB-rated US utilities between 1 October 2020 and 30 September, 2025.[16] For this sample that accurately matches the benchmark profile of a utility issuing 10-year term bonds the average annualised arrangement fee was **9.01 bppa** using Powerlink's current PTRM average WACC of 6.493 per cent. Given the great depth, liquidity and highly competitive nature of the US bond market this finding suggests that the results obtained above using a small sample of bonds for four A-rated and one BBB-rated issuer may (slightly) underestimate the benchmark arrangement cost.

2.3 Recommended arrangement fee

Based on the most recent sample of bonds for which fee data is available, and given Powerlink's WACC value of 6.493 per cent, we recommend that a benchmark arrangement fee of **6.36 bppa** be applied to Powerlink. We note, however, that our cross-check using 100 10-year term US BBB-rated utility bond issues indicated a benchmark arrangement fee of 9.01 bppa, suggesting that the smaller sample dominated by A-rated bonds issued by non-utilities may be deriving an under-estimate.

16 These were bonds with terms at issuance in a range of 9.5 years to 10.5 years. Every one of these bonds had a standard total arrangement fee of 0.65 per cent.

3. Other direct debt raising costs

3.1 The SA Power Networks precedent

In its September 2024 draft determination for Energex for the 2025 to 2030 period, the AER's method to estimate benchmark "other direct debt raising fees" was described as follows:[17]

> *The ACG method involves calculating the benchmark bond size and the number of bond issues required to rollover the benchmark debt share (60%) of the capital base. This approach looks at how many bonds a regulated service provider may need to issue to refinance its debt over a 10-year period.*

The "other direct debt raising costs" parameter values estimated by PwC (2013) are shown in Table 3 below. These were updated by Chairmont (2019).[18] However, 6 years have passed since the other cost parameters were estimated by Chairmont which included the Covid-19 pandemic, which included some years of rapid inflation that followed material fluctuations in GDP. In our view, in order to provide a valid benchmark, the cost parameters estimated by Chairmont need to be brought up-to-date by grossing up the June 2019 values by the change in CPI to June 2025.[19]

Given the parameter values estimated by Chairmont (2019), and the assessment made by the AER in the case of SA Power Networks based on the firm's submission, and grossing up for CPI, the key input into this calculation is the average end of year RAB during the regulatory period and the number of standard $250 million bonds that would be required to refinance the debt component (60 per cent of the RAB). In the case of SA Power Networks (2019) a total of 11 standard bonds was required, while Powerlink would require 22 bonds given the RAB values in its PTRM . Using the updated Chairmont (2019) parameters and applying Powerlink's nominal vanilla WACC of 6.493 per cent (drawn from its PTRM) results in an estimated benchmark other direct debt raising costs value of 2.25 bppa.

Table 3: Other direct debt raising costs – Powerlink 2025 vs SA Power Networks, 2019

Value / bppa	parameter values ($)	basis for calculation	SAPN 11 bonds	parameter values CPI adjusted ($)	issuing 22 bonds
Bond master program (per program)	110,000.0	Declines with bonds	0.05	135,684.3	0.03
Issuers Legal counsel	30,000.0	Per bond	0.16	37,004.8	0.21
Company credit rating	85,000.0	Declines with bonds	0.04	104,846.9	0.03
Annual surveilance fee	15,000.0	Per bond	0.05	18,502.4	0.10
Up-front issue fee (bp)	7.5	Per bond	0.99	9.3	1.31
Registration up-front (per program)	13,000.0	Declines with bonds	0.01	16,035.4	0.00
Registration annual	6,500.0	Per bond	0.26	8,017.7	0.32
Agents Out of pockets	35,000.0	Per bond	0.19	43,172.3	0.24
Total			**1.75**		**2.25**

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17 AER, (September, 2024), Draft Decision, Energex Electricity Distribution Determination 2025 to 2030 (1 July 2025 to 30 June 2030), Attachment 3 Rate of return, p.

18 Chairmont, (29 June, 2019), *Debt Raising Costs*.

19 Using Bloomberg, we find the rise in CPI over that period was 23.7 per cent.

Source: Bloomberg, PwC (June, 2013), Chairmont (30 June, 2019) and SA Power Networks (10 December, 2019).

3.2 Recommended other direct debt raising costs

Updating the direct debt raising cost parameters estimated by Chairmont (2019) for inflation, and given Powerlink's notional requirement to issue 22 benchmark "standard" bonds, we recommend that a benchmark arrangement cost of **2.25 bppa** be applied to Powerlink. This is higher than 1.75 bppa that was applied to SA Power Networks, which is due to a higher nominal vanilla WACC (6.493 per cent vs 4.40 per cent) and our CPI adjustment of 23.7 per cent to bring Chairmont's estimated cost parameters relating to 2019 up-to-date.