

22 June 2026

AER Draft Rate of Return Instrument

Presented to the AER Public Forum, June 2026
David Johnston – Head of Client Funding



What did the AER say it would do?

*'Our **Guiding Principle** is that the expected rate of return should be an **unbiased estimate** of the expected efficient return, consistent with the relevant risks involved in providing regulated network services. This principle guides our decision-making across **all parameters** of the Instrument.'*

*'A rate of return that is too high may encourage over-investment, while one that is too low may lead to under investment, and **neither outcome serves the long-term interests of consumers.**'*

What the AER proposed in the Draft RoRI

*'...we acknowledge that a weighted trailing average approach may be considered preferable in certain circumstances, particularly where the debt RAB is changing materially through time and **current interest rates vary materially from the simple trailing average**. By placing greater weight on interest rates in years where firms will finance relatively more debt, it may **better reflect financing costs incurred**.'*

*However, adopting a weighted trailing average approach at this time would **likely increase the allowed return on debt**, relative to maintaining the simple trailing average approach, for a number of years. This reflects that the simple trailing average approach has not yet converged to a level consistent with long run equilibrium/neutral interest rate ...'*

What the AER proposed in the Draft RoRI

' ... the potential benefits of such an approach [QTC WTA] depend on whether regulated businesses are expected to raise debt materially above the 10% per annum financing profile implicitly assumed under the simple trailing average.

While we found that the implicit assumption that businesses raise around 10% debt in each year may not always hold, we also found that only a small number of large businesses with large investment programs are materially impacted.

In these circumstances, the best way to address this issue would be through a targeted mechanism applying a weighted trailing average to these materially impacted businesses rather than a broad change in approach.

QTC's understanding of the AER's reasoning

- The QTC WTA will produce the best estimate of the efficiently incurred cost of debt
- The benefits of the QTC WTA are greater when new borrowings above the 10% annual refinancing are material
- Material debt increases are only expected for some NSPs, so a targeted approach is preferred rather than applying the QTC WTA to all NSPs
- However, a targeted approach is problematic because it requires thresholds, and stakeholders were not supportive of applying thresholds
- The efficiently incurred cost of debt might be higher than the allowed cost of debt under the current STA approach, so moving to the QTC WTA will impose additional costs on consumers (ie, not be 'cost neutral')

The QTC WTA should apply to all NSPs

- The main benefit of the QTC WTA is that it produces an unbiased estimate of the efficiently incurred cost of debt in each year for all NSPs regardless of the size of future RAB changes
- The weighting parameter in QTC's WTA automatically changes each year based on the annual percentage change in benchmark debt
- The implementation costs are negligible and not affected by the size and timing of the changes in benchmark debt
- The current STA is just a special case of the QTC WTA where the weighting parameter equals zero in all years, so it will never produce a better estimate of the efficiently incurred benchmark cost of debt than QTC's WTA

AER views on equilibrium interest rate and cost neutrality

*'We consider the existing simple trailing average is likely below the **long run equilibrium/neutral interest rate**, reflecting a prolonged period of unusually low interest rates, as compared to current interest rates which are higher than those embedded in the simple trailing average.*

*In these circumstances, a move to a weighted trailing average now would be expected to increase the allowed return on debt over the next 10 years and, therefore, **not be cost neutral to consumers.**'*

Cost neutrality

- Cost neutrality was not raised as an issue in the August 2025 Discussion Paper
- Proposed changes to the value of two cost of equity parameters are not cost neutral, but this isn't considered to be a problem in the Draft RoRI
- Moving from STA to QTC WTA involves changing the value of the weighting parameter (W):
 - STA: $W = \text{zero}$ in all years
 - QTC WTA: W automatically changes based on the annual % increase in benchmark debt
- Why is cost neutrality an issue for the QTC WTA but not the cost of equity?

Long run equilibrium interest rate

- The long run equilibrium interest rate was not raised in the Discussion Paper
- There is no long run equilibrium 10-year BBB+ yield
 - non-stationary (no stable average value)
 - mean reversion parameter not statistically different from zero
- What matters is the difference between the STA and the prevailing 10-year BBB+ yield, and this is what the AER has considered in the example in Table 7.1
- The example estimates the STA and QTC WTA over nine years based on 4% RAB growth, a starting STA of 4.65%, and the prevailing 10-year BBB+ remaining at 6.00%

Differences between the STA and QTC WTA

	FY26	FY27	FY28	F29	FY30	FY31	FY32	FY33	FY34	FY35
Simple trailing average (%)	4.65	4.75	4.90	5.09	5.44	5.80	6.00	5.97	5.98	6.00
QTC weighted trailing average (%)		4.80	4.98	5.19	5.52	5.84	6.00	5.97	5.99	6.00
Difference (%)		(0.05)	(0.08)	(0.10)	(0.08)	(0.04)	0.00	(0.01)	(0.00)	0.00

Differences between the STA and QTC WTA

- The efficiently incurred benchmark cost of debt (QTC WTA) is higher than the STA because each increase in debt must be funded at the prevailing 6.00% yield
- Increases in debt cannot be funded at the lower yields that prevailed in the past, so the cost of debt allowance under the STA is biased downwards
- Despite this bias, the AER concludes the STA should be used because allowing the efficiently incurred cost of debt will impose additional 'costs' on consumers
- No consideration of the cost to consumers from NSPs under-investing due to the allowed cost of debt being lower than the efficiently incurred cost of debt

Differences between the STA and QTC WTA

- The AER estimates the expected difference to be ~\$200m over nine years
 - the \$200m is part of the efficiently incurred cost of debt, so it cannot be viewed as an 'additional' cost
 - under the STA, the \$200m is an expected transfer of wealth from NSPs to consumers
- Consumers and NSPs should be concerned about the potential range of future wealth transfers if the STA is retained
- The actual wealth transfer under the STA in the AER's example will depend on the actual path of the 10-year BBB+ yield over the next nine years
- The range of wealth transfers can be estimated by using thousands of randomly generated 10-year BBB+ yield paths as inputs in the AER's example

Range of wealth transfers if the STA retained

(negative values are wealth transfers from NSPs to consumers)

Scenario	Lower 2.5% (STA < WTA)	Average	Upper 2.5% (STA > WTA)
4% RAB growth	(\$2,290m)	(\$205m)	\$1,900m

Recommended next steps

- New arguments in the Draft RoRI that were not in the Discussion Paper have denied stakeholders one round of consultation, which is significant given the streamlined nature of the 2026 RoRI review
- More consultation on the AER's modelling of wealth transfers between consumers and NSPs under the STA before submissions to the Draft RoRI are due
- In making the Final RoRI the AER should:
 - follow the Guiding Principle of making an unbiased estimate of the efficiently incurred benchmark cost of debt for all NSPs, and
 - eliminate future wealth transfers between consumers and NSPs by applying the QTC WTA to all NSPs to determine the allowed cost of debt

Disclaimer

The information in this presentation is provided by QTC in good faith in relation to the information available at the time of its preparation and on the basis of information supplied to QTC by third parties. QTC has not independently verified the information supplied to it and accordingly does not represent that the information provided to QTC is accurate or complete and it should not be relied upon as such. QTC is under no obligation or duty to notify anyone if there is any change in any information or any new information or if it forms a different opinion at any time after the date of this presentation.

Neither QTC nor any of its employees or agents accepts any liability for any loss or damage suffered by any person as a result of that person or any other person placing any reliance on, or acting on the basis of, the contents of this presentation. To the extent permitted by law, QTC expressly excludes any representation or warranty in relation to the accuracy, currency and completeness of the presentation. To the extent permitted by law, QTC limits its liability to the amount of any fees paid to QTC for this presentation.

The recipient acknowledges that QTC is not a legal, tax or accounting advisor and that independent expert advice from practitioners in the relevant disciplines should be obtained on those matters before acting upon the information contained in this presentation.

© Queensland Treasury Corporation 2026