



Online forum Rate of return working papers

Debt

Warwick Anderson, GM Network Pricing

9 August 2021, 9.00 am to 11.30 am

Agenda

Time	Duration	Item	Presenter
9:00	5 min	Check in period	
9:05	5 min	Welcome and Introduction	Warwick Anderson (Chair)
9:10	15 min	Overview of working paper	Eric Groom, PSM, AER Board member
9:25	40 min	Stakeholder Presentations	CRG, NSG
10:05	10 min	Break	
10:15	40 min	Stakeholder Presentations	NICE, ENA
10:55	30 min	Other questions	
11:25	5 min	Next steps	Warwick Anderson

Context and background

- Working paper program so far:

	Title	Draft paper	Forum	Subs close	Final paper
<i>2020 working papers</i>					
1	Energy networks debt data	26 Jun	29 Jul	14 Aug	18 Nov
2	International regulatory approaches to rate of return	27 Aug	16 Sep	9 Oct	16 Dec
3	Capital asset pricing model and alternative return on equity models	27 Aug	16 Sep	9 Oct	16 Dec
<i>2021 working papers</i>					
4	Term of the rate of return	21 May	15 Jun	2 Jul	Sep
5	Rate of return and cashflows in a low interest rate environment	21 May	23 Jun	2 Jul	Sep
6	Overall Rate of return	15 July	4 Aug	27 Aug	Nov
7	Debt Omnibus	15 July	9 Aug	27 Aug	Nov
8	Equity Omnibus	15 July	11 Aug	27 Aug	Nov

Overview of the working paper

Eric Groom, PSM, AER Board member

The Debt draft working paper

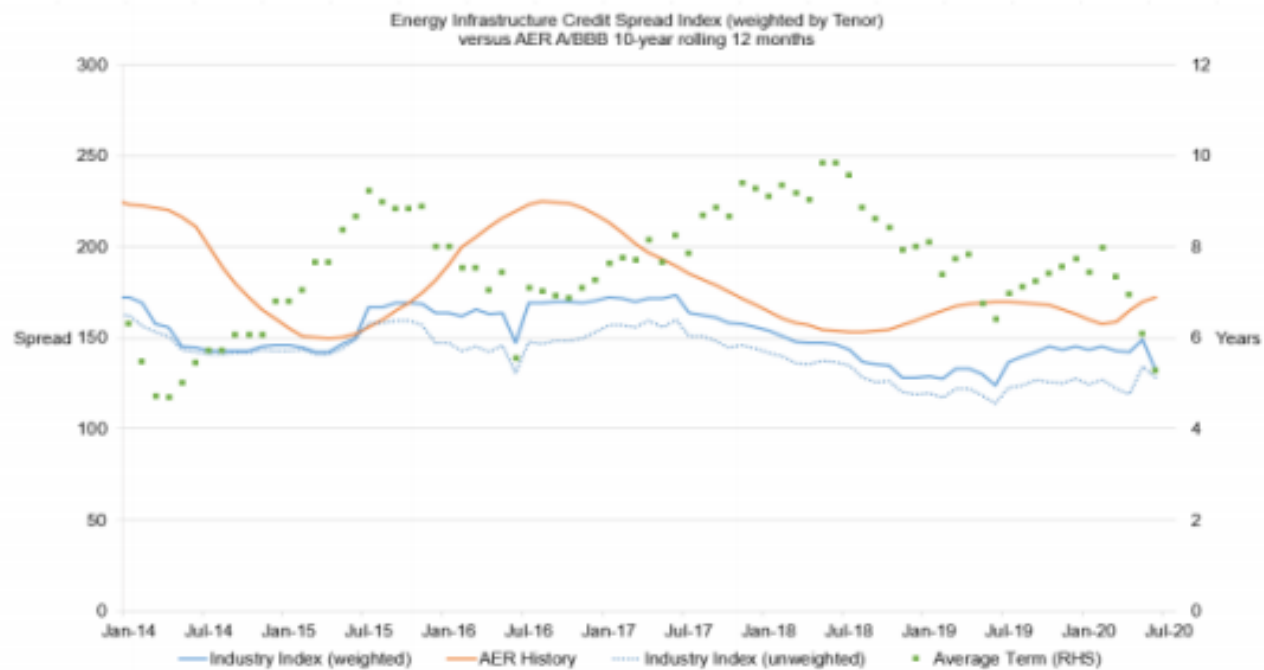
- Released 15 July 2021, briefed on 19 July
- Steps through AER debt estimation process
- Discusses key debt issues with focus on
 - Use of the EICSI
 - Capex weighting of the trailing average
- Hear stakeholders' initial thoughts on key topics in the paper

The Cost of Debt estimation method

- Our estimation methodology is accepted by stakeholders – transparent and replicable
- Transition to trailing average is still underway
- Networks have discretion regarding timing and length of averaging periods
- Benchmark term and/or rating could change with current evidence

The use of the EICSI

Figure 1 EICSI (weighted by tenor) against the AER's benchmark estimate

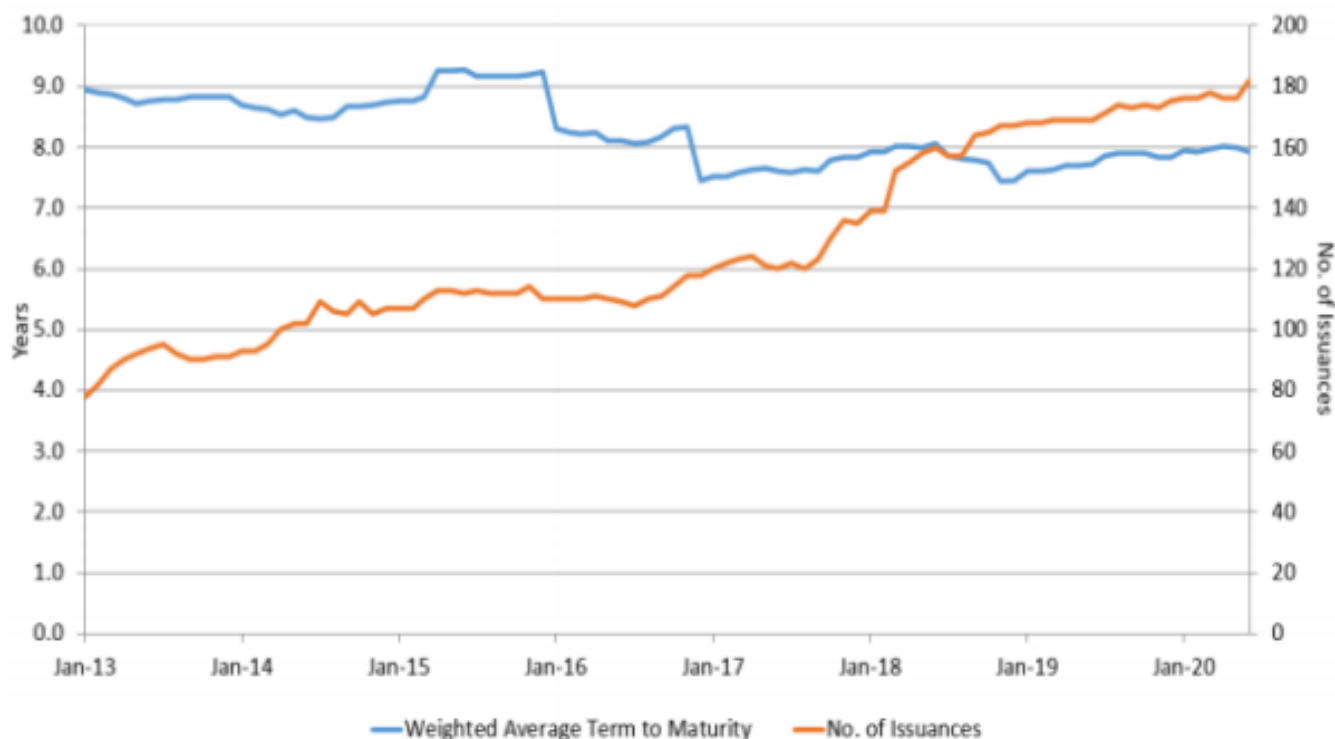


Notes: Spread is reported in basis points above the variable 3-month bank bill swap rate.

Source: AER analysis; Chairmont, *Aggregation of debt data for portfolio term to maturity*, 28 June 2019.

The use of the EICSI – WATMI advice

Figure 2 Weighted Average Term to Maturity at Issuance and number of debt instruments issued



Source: AER analysis; Chairmont, *Aggregation of debt data for portfolio term to maturity*, 28 June 2019.

The use of the EICSI – Working paper options

- Option 1 - The EICSI should not be used at all.
- Option 2 - The EICSI should be given the same use and significance it was in the 2018 Instrument.
- Option 3 - We will use the EICSI to adjust the blend of A and BBB debt data from third party debt providers (Bloomberg, Thomson Reuters and the RBA)
- Option 4 - The gap between the EICSI and the AER's benchmark estimate over a fixed observation window is used to shift the benchmark in the future.
- Option 5 - The EICSI is used as a fourth curve to estimate the benchmark debt (alongside estimates from Bloomberg, Thomson Reuters and the RBA).
- Option 6 - The EICSI is used as the sole input to determine the benchmark debt.

Term or Rating

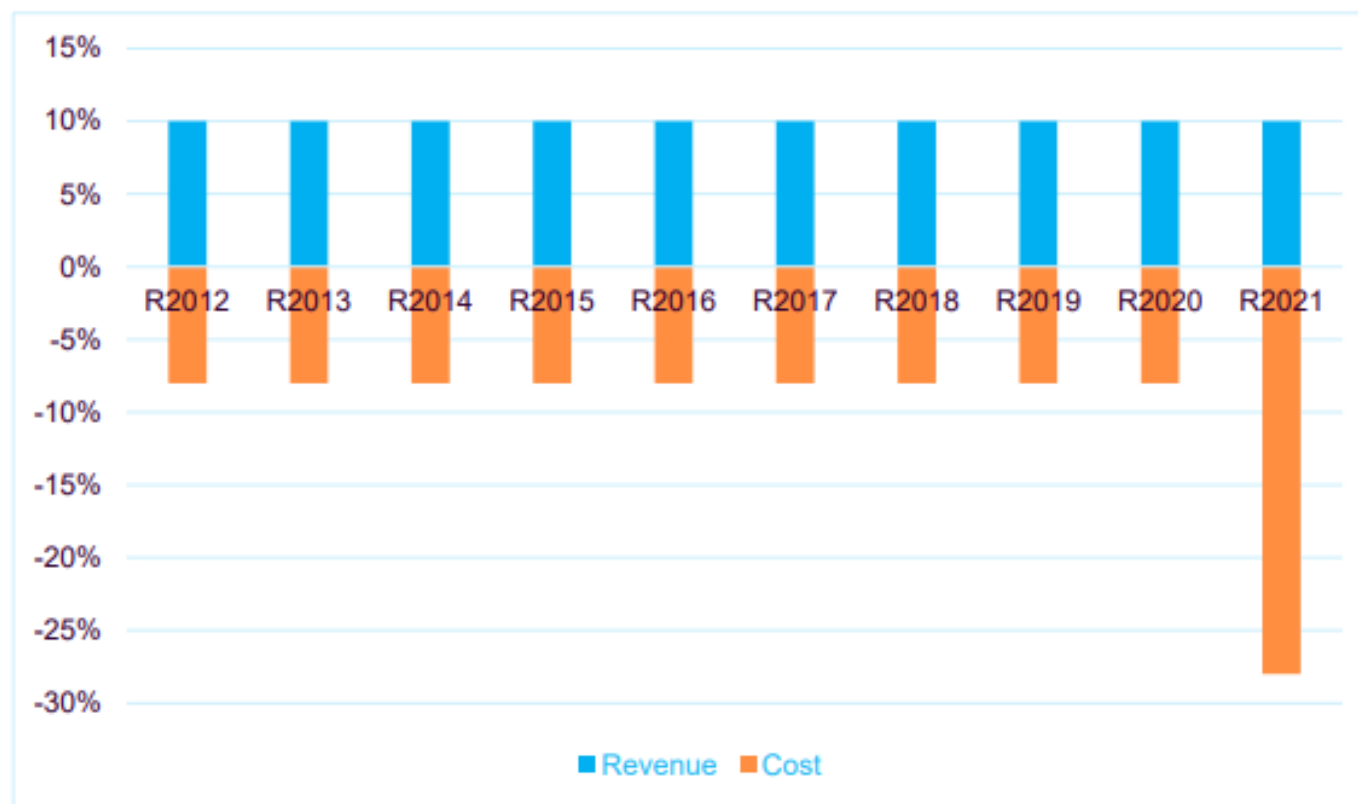
- There has been some discussion about how best to alter the return on debt estimate – through term or rating
- Term is more reflective of network practices
- Rating is easier to put in place and would not require a change in trailing average approach
- Both would reflect the past 4 years of data

Weighting of the trailing average

- Currently we place equal weight on each year of the trailing average
- Upcoming investment projects for networks means that approach may not reflect network costs
- Weighting the trailing average by capex spending could better reflect that

Weighting of the trailing average

Figure 4 Return on debt weighting misalignment during large capex spend under a simple trailing average approach



Other concerns

- $NPV = 0$
- Actual vs Forecast weight
- Transitional issues

Other debt issues

- Averaging Periods
 - Timing
 - Length
- Data providers
 - Extra inclusions or exclusions
- Instrument selection for EICSI
 - Definitive list/definitions

Key questions

1. How should the AER use the EICSI in the 2022 instrument?
2. Should the AER adopt a weighted trailing average approach?
3. Are the proposed changes to averaging periods appropriate?
4. Are there any further inclusions or exclusions the AER should make to the inclusion/exclusions of the EICSI?
5. Are there any other changes the AER should make on their debt approach?

Stakeholder presentations