FINAL DECISION

Power and Water Corporation Distribution Determination 2019 to 2024

Attachment 4 Regulatory depreciation

April 2019

AUSTRALIAN ENERGY REGULATOR

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Note

This attachment forms part of the AER's final decision on the distribution determination that will apply to Power and Water Corporation for the 2019–2024 regulatory control period. It should be read with all other parts of the final decision.

The final decision includes the following attachments:

Overview

Attachment 1 – Annual revenue requirement

Attachment 2 – Regulatory asset base

Attachment 3 – Return on debt transition

Attachment 4 – Regulatory depreciation

Attachment 5 – Capital expenditure

Attachment 6 – Operating expenditure

Attachment 7 – Corporate income tax

Attachment 13 – Control mechanisms

Attachment 15 – Alternative control services

Attachment 18 – Tariff structure statement

Attachment A – Negotiating framework

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Shortened forms

Shortened form	Extended form
AER	Australian Energy Regulator
capex	capital expenditure
CPI	consumer price index
disposal	asset disposal
NT NER or the rules	National Electricity Rules As in force in the Northern Territory
PTRM	post-tax revenue model
RAB	regulatory asset base
RFM	roll forward model
RIN	regulatory information notice
WACC	weighted average cost of capital

4 Regulatory depreciation

Depreciation is the allowance provided so capital investors recover their investment over the economic life of the asset (return of capital). In deciding whether to approve the depreciation schedules submitted by Power and Water, we make determinations on the indexation of the regulatory asset base (RAB) and depreciation building blocks for Power and Water's 2019–24 regulatory control period.[1] The regulatory depreciation allowance is the net total of the straight-line depreciation less the indexation of the RAB.

This attachment sets out our final decision on Power and Water's regulatory depreciation allowance, including an assessment of the proposed asset lives used for forecasting depreciation.

4.1 Final decision

Our final decision is to determine a regulatory depreciation allowance of $133.8 million ($nominal) for Power and Water over the 2019–24 regulatory control period. This amount represents a reduction of $0.7 million (or 0.5 per cent) on the $134.6 million ($nominal) in Power and Water's revised proposal. It is $2.0 million (or 1.5 per cent) higher than the regulatory depreciation allowance determined in the draft decision. In coming to this decision:

- we accept Power and Water's revised proposed straight-line method to calculate the regulatory depreciation, which is consistent with our draft decision.
- we accept Power and Water's revised proposed asset classes and standard asset lives, which were consistent with our draft decision, subject to some changes arising from the tax review (attachment 7). Further, we have changed the standard asset life for the 'Equity raising costs' asset class.
- we accept Power and Water's revised proposal to apply the year-by-year tracking approach for depreciating its existing assets, consistent with our draft decision. In accepting this approach, we have updated the year-by-year tracking calculations with actual CPI for 2018–19.
- we made determinations on other components of Power and Water's revised proposal, which affects the RAB and in turn impacts the forecast regulatory depreciation allowance. The decrease to the regulatory depreciation allowance from the revised proposal reflects our adjustments to the opening RAB as at 1 July 2019 and projected RAB over the 2019–24 regulatory control period (attachment 2).[2]

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1 NT NER, cll. 6.12.1, 6.4.3.

2 Capex enters the RAB net of forecast disposals and capital contributions. It includes equity raising costs (where relevant) and the half-year WACC to account for the timing assumptions in the PTRM. We have accepted Power and Water's revised proposed forecast capex for the 2019–24 regulatory control period (attachment 5). However

Table 4-1 sets out our final decision on the forecast regulatory depreciation allowance for Power and Water over the 2019–24 regulatory control period.

Table 4-1 AER's final decision on Power and Water's forecast regulatory depreciation for the 2019–24 regulatory control period ($million, nominal)

	2019–20	2020–21	2021–22	2022–23	2023–24	Total
Straight-line depreciation	41.8	48.6	52.9	58.7	62.6	264.5
Less: inflation indexation on opening RAB	23.3	25.1	26.3	27.7	28.4	130.7
Regulatory depreciation	**18.5**	**23.5**	**26.6**	**31.0**	**34.2**	**133.8**

Source: AER analysis.

Year-by-year tracking approach

For this final decision, we accept Power and Water's revised proposal to use the year-by-year tracking approach to calculate the forecast straight-line depreciation amounts for its asset values as at 1 July 2019. This is consistent with Power and Water's initial proposal and our draft decision.

Our draft decision did not accept Power and Water's use of forecast capex to implement the year-by-year tracking depreciation model for the 2014–19 regulatory period. Instead we adjusted this model so that depreciation for this period reflected actual incurred capex. Power and Water's revised proposal adopted all our draft decision changes on the year-by-year tracking calculations, and made updates to inputs to 2017–18 and 2018–19 capex.[3]

In accepting this approach, we have updated the year-by-year tracking depreciation calculations with actual CPI for 2018–19, which became available after Power and Water submitted its revised proposal (attachment 2). We have also updated the year-by-year tracking depreciation calculations to reflect Power and Water's revised actual capex for 2017–18 (attachment 2).

Standard asset lives for 2019–24

For this final decision, we accept Power and Water's revised proposed standard asset lives for its asset classes in respect of forecast capex for the 2019–24 regulatory control period subject to some changes arising from the tax review (attachment 7). Further, we have changed the standard asset life for the 'Equity raising costs' asset class to 35.3 years from 48.1 years.

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we have amended the revised proposed rate of return (section 2.2 of the overview). Therefore, our final decision on the forecast RAB also reflects our amendments to the rate of return for the 2019–24 regulatory control period (attachment 2).

3 Power and Water, *Revised regulatory proposal 1 July 2019 to 30 June 2024*, November 2018, p. 45

Implementation of the tax review

The tax review changes relate to different methods of calculation of tax depreciation for different asset classes, which resulted in the addition of two new asset classes to the PTRMs and a reallocation of forecast capex.

The two new asset classes are:

- 'In-house software' – where the forecast capex were originally allocated to the 'IT and communications' asset class
- 'Buildings' – where the forecast capex were originally allocated to the 'Property' asset class.

We have assigned a standard asset life of 40 years to the 'Buildings' asset class which is consistent with the existing 'Property' asset class. In response to an information request, Power and Water stated that it has no concerns with this approach.[4]

For the 'In-house software' asset class, Power and Water proposed a standard asset life of 5 years consistent with the standard tax asset life for this asset class. We consider that this standard asset life is consistent with the economic life of the in-house software capex allocated to this asset class. Therefore, we accept Power and Water's proposed standard asset life of 5 years for this new asset class.

Standard asset life for the 'Equity raising costs' asset class

In the draft decision, we did not accept Power and Water's proposed standard asset life of 5 years for the 'Equity raising costs' asset class and instead determined a standard asset life of 48.1 years. We considered the standard asset life for equity raising costs for regulatory depreciation purposes should be the weighted average (by opening RAB) of the standard asset lives for all depreciable assets in the PTRM. Power and Water's revised proposal adopted our draft decision standard asset life for the 'Equity raising costs' asset class.

However, for our final decision we have further reviewed this weighted average approach to calculate the standard asset life for equity raising costs. We consider the equity raising cost asset life should reflect the lives of the mix of assets making up the approved forecast net capex, because the equity raising cost benchmark is associated with that forecast.[5] This results in the standard asset life for this asset class applying for Power and Water's 2019–24 regulatory control period being revised to 35.3 years. In response to an information request from us, Power and Water agreed with the change to the standard asset life for equity raising costs.[6] We note the standard asset

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4 Power and Water, *Email to AER: PWC - updated 2019–24 capex forecast model*, dated 14 March 2019.

5 For this reason, we used forecast net capex instead of the opening RAB as the weights to establish the weighted average standard asset life for amortising equity raising costs. See AER, *Draft Decision: Essential Energy Determination 2019-24, Attachment 4 - regulatory depreciation,* September 2018, p. 12.

6 Power and Water, *Response to information request #045 - Revised proposal minor modelling issues,* 22 January 2019.

life for the 'Equity raising costs' asset class needs to be reviewed for each regulatory control period and updated where appropriate. Our final decision modelling shows that no benchmark equity raising costs is required for Power and Water's 2019–24 regulatory control period. However, we have kept the standard asset life for this asset class in the PTRM as the threshold for the benchmark equity raising costs may be reached due to the annual return on debt updates over the 2019–24 regulatory control period.

Table 4-2 sets out our final decision on the standard asset lives for Power and Water over the 2019–24 regulatory control period. We are satisfied the approved standard asset lives would lead to a depreciation schedule that reflects the nature of the assets over the economic lives of the asset classes. Further, the sum of the real value of the depreciation attributable to the assets would be equivalent to the value at which the assets were first included in the RAB for Power and Water.[7]

Table 4-2 AER's final decision on Power and Water's standard asset lives for the 2019–24 regulatory control period (years)

Asset class	Standard asset life
Substations	42.0
Distribution lines	55.5
Transmission lines	56.5
LV services	55.8
Distribution substations	45.0
Distribution switchgear	52.4
Protection	42.0
SCADA	23.0
Communications	13.4
Land and easements	n/a
Property	40.0
IT and communications	11.9
Motor vehicles	14.3
Plant and equipment	13.6
Property leases	15.8
Fleet leases	5.7
Buildings	40.0

[7] NT NER, cll. 6.5.5(b)(1)-(2).

In-house software	5.0
Equity raising costs	35.3

Source: AER analysis.

n/a not applicable. We have not assigned a standard asset life to this asset class because the assets allocated to it are not subject to depreciation.

4.2 Assessment approach

We did not change our assessment approach for regulatory depreciation from our draft decision. Attachment 4 section 4.3 of our draft decision details that approach.[8]

[8] AER, *Power and Water Corporation 2019–24 – Draft decision – Attachment 4 – Regulatory depreciation, September 2018*, pp. 10–12.