Revised Proposal

Attachment 5.20 Non-network property

PUBLIC

January 2019

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1 Executive summary

Our non-network property assets include offices, depots and specialist sites located throughout Ausgrid's distribution area. Capex is required to mitigate the risk of safety hazards causing harm to our workforce and the general community. Each project is based on quantitative analysis identifying the least cost option (including deferral) and an independent appraisal of deliverability within the 2019-24 period.

1.1 Customer benefits

$54 million reduction to our revenues

When viewed as a whole, our capital program for non-network property, inclusive of asset disposals, will lead to a $54 million revenue reduction. This is equal to a cumulative bill saving of $30 per customer over the 2019-24 period.

A decision made by Ausgrid management in the 2014-19 period to consolidate our non-network property portfolio to a more efficient level is driving this bill saving for our customers. This led to the disposal of assets totalling $138 million, the proceeds from which must now be reflected in an adjustment to our opening FY20 asset base.

In our view, this demonstrates that Ausgrid has taken a customer centric approach to our non-network property investment decisions. It also underscores the prudency of our investment strategy.

Land sale options unlocked to our customer's benefit

Our planned investment program in the 2019-24 period is expected to result in further land sales in addition to those already made in the current regulatory period. These disposals are contingent on the completion of a new depot in Alexandria (currently under construction) and our proposed replacement programs for our Hornsby depot and Wallsend administration building going ahead as planned.

Once alternative sites have been developed, we will look to sell land surplus to our needs which will deliver substantial benefits to our customers. Up to 65% of the Hornsby depot and 68% of the Wallsend administration building capex can in effect be "self-funded" through the proceeds from expected land sales. This will deliver benefits to our customers through the construction of modern, cheaper to operate buildings that address the identified health and safety risks, at the lowest possible cost.

Reliability to be maintained by remediating the most dilapidated assets

We use non-network property assets, comprising of 9 offices and 19 depots, to support the delivery of reliable network services to more than 1.7 million customers.

Although our property portfolio includes 3 offices and 14 depots that have exceeded or are approaching the end of their technical life, our capex program over the 2019-24 period only includes the 5 most dilapidated and urgently in need of refurbishment or replacement. By only including the most dilapidated offices and depots, we are also targeting the buildings within our portfolio most at risk of giving rise to a safety incident. These buildings – which are up to 80 years old – also have a layout and general amenity that, in the absence of investment, will restrict the productivity of our workforce.

1.2 Revised Proposal

We propose a revised non-network property capex in the 2019-24 regulatory period of $152 million (real, $FY19).[1]

The AER accepted $135 million in non-network property capex at the Draft Decision stage, amounting to a 28% reduction on our Initial Proposal of $188 million (SCS component only).[2]

The development of our Revised Proposal is grounded in our regulatory obligations (section 2). We have also considered the safety risks at each site and the AER's Draft Decision (section 3).

Key aspects of our Revised Proposal have also been informed by our Investment Governance Committee (IGC) and our engagement with stakeholders and customer representatives. This "review and challenge" embedded in our investment

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[1] All dollar values in this document are in real $FY19 unless otherwise stated.

[2] Our Initial Proposal was represented as $208 million. For the reasons outlined in 3.1.1, it should have been $188 million.

decision making has, among other things, led to Ausgrid adjusting the timing of our planned projects, resulting in the deferral of capex beyond the 2019-24 period (see section 3.2.1).

Figure 1 sets out our revised proposal compared to our historical expenditure and the AER's Draft Decision. The major difference, compared to our Initial Proposal, is a reduction in the scope of our Homebush and Oatley depots and the deferral of capex relating to our Wallsend administration office. The AER's Draft Decision and stakeholders also stated that it would expect a reduction to our general refurbishment program, given the likely efficiencies achieved from depot refurbishments in the current 2014-19 period. We have taken this on board and incorporated a reduction to that component of our forecast in our Revised Proposal. Although this will result in less funding available to address hazards in non-network properties not subject to a major refurbishment or replacement project, we have applied this reduction in recognition that the clear priority of our customers is affordability in the services we offer. Table 1 sets out our Revised Proposal by capex program.

Figure 1

Historical and forecast non-network property capex ($m, FY19)

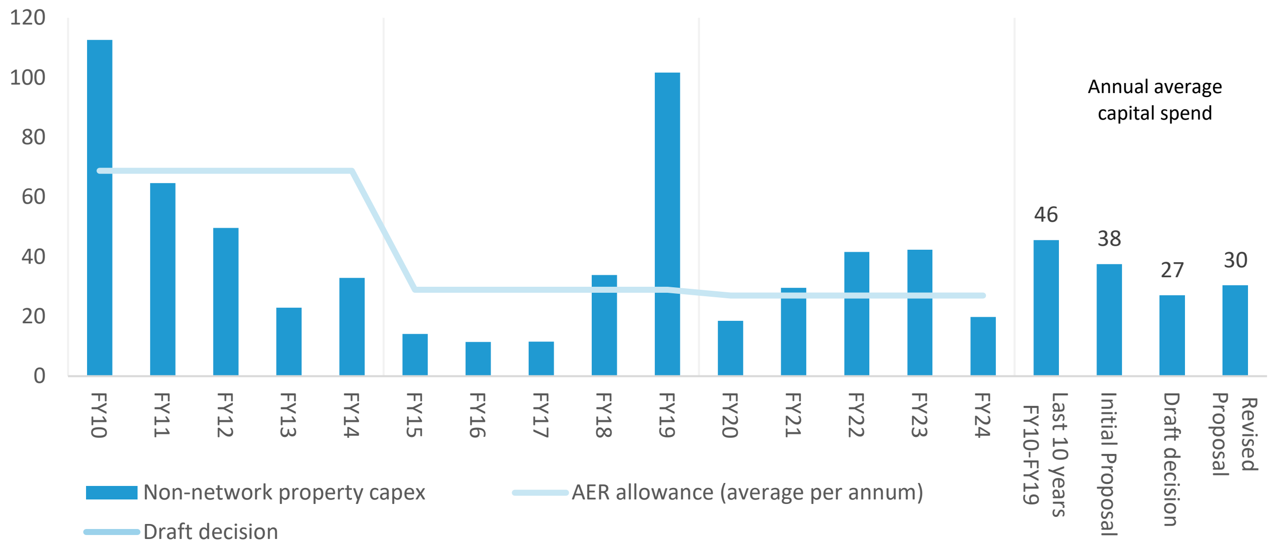


Table 1

Proposed non-network property capex ($m, FY19)

	INITIAL PROPOSAL	REVISED PROPOSAL	DIFFERENCE
Homebush	[redacted]	[redacted]	[redacted]
Oatley	[redacted]	[redacted]	[redacted]
Hornsby	[redacted]	[redacted]	[redacted]
Wallsend Depot	[redacted]	[redacted]	[redacted]
Wallsend Office	[redacted]	[redacted]	[redacted]
Alexandria	[redacted]	[redacted]	[redacted]
General Refurbishment	[redacted]	[redacted]	[redacted]
Future Workplace Program	[redacted]	[redacted]	[redacted]
Total	187.9	151.8	-36.0

Note: Numbers may not add due to rounding

2 Regulatory obligations

Ausgrid is subject to regulatory obligations which inform the investment decisions we make in relation to our portfolio of non-network properties. We have taken these regulatory requirements into account when developing our Revised Proposal for the 2019-24 period.

2.1 Overview

Ausgrid plans to continue replacing our ageing buildings and network support infrastructure over the 2019-24 period. We plan to complete replacement of our Zetland depot with a new depot at Alexandria, and replace four depots at Homebush, Hornsby, Oatley and Wallsend. We also plan to commence the replacement of an office at Wallsend and undertake general refurbishment and modernisation of our other non-network properties.

Our plan to replace selected assets from our non-network property portfolio represents the most prudent and efficient means of maintaining the safety of our network and complying with our regulatory obligations to ensure the health and safety of our customers, employees and the general public. It will also promote the efficient operation and use of our distribution system, which is in the long-term interests of our customers. Replacing aging depots that have passed their technical life with modern, fit-for-purpose buildings is also likely to have benefits in terms our response times to outages, thereby enhancing our ability to maintain reliability.

Each of the buildings that Ausgrid plans to replace present risks to the health and safety of our employees and visitors to Ausgrid sites. Ausgrid faces regulatory obligations under the *Work Health and Safety Act 2011 (NSW)* (**WHS Act**) to eliminate hazards and risks to the health and safety in our workplaces, so far as is reasonably practicable.

Ausgrid has two options for addressing the health and safety risks at these sites and thereby two options for complying with our regulatory obligations:

- continuing to operate a building while undertaking significant remedial works that allows us to comply with our regulatory obligations and keep our employees and the public safe in the short term until a major rebuild can occur. Any remediation will still need to consider a replacement in the medium to long term given the advanced age of the targeted buildings (**remediate option**); or
- replacing a building with one that complies with workplace health and safety laws by either rebuilding the properties at the existing sites or moving to a new site (**replace option**).

The costs and benefits of these two options have been carefully analysed, with advice from commercial property experts Jones Lang Lasalle (JLL) in relation to the long-term cost under each option. Our analysis demonstrates that the second of these options represents the most prudent and efficient course for addressing health and safety risks at each of the selected sites (see section 3).

Ausgrid has therefore proposed to replace certain buildings that present a range of work health and safety risks to employees and visitors over the 2019-24 period. We have determined that this is the most efficient, prudent and reasonable means of maintaining the safety of the distribution system and complying with our regulatory obligations under the WHS Act.

2.2 Ausgrid's regulatory obligations and commitment to safety

2.2.1 Key regulatory obligations

As a 'person conducting a business or undertaking' in NSW, Ausgrid has a duty of care under section 19 of the WHS Act to eliminate, so far as is reasonably practicable, the risks to the health and safety of workers[3] and visitors to our

[3] Under s 7 of the *Work Health and Safety Act 2011* (NSW), 'workers' is defined broadly to include an employee, a contractor or subcontractor (or an employee of a contractor or a subcontractor), an employee of a labour hire company who has been assigned to work in Ausgrid's business or undertaking, an outworker, an apprentice or trainee, a student gaining work experience or a volunteer. NB: a 'worker' also includes 'a person of a prescribed class', however none of the classes of persons under s 7 apply to Ausgrid's workers and no regulations appear to have been created that define persons of a prescribed class that may apply to Ausgrid.

workplaces. This obligation to eliminate or minimise risks to health and safety at our workplaces clearly falls within the definition of a ‘regulatory obligation or requirement’ under the National Electricity Law.[4]

The obligations faced by Ausgrid under the WHS Act shape the manner in which we operate our depots, offices and other workplaces which form part of our distribution system, and thereby directly and materially affect how we provide network services. As such, Ausgrid’s duty of care to workers and visitors under the WHS Act to eliminate risks to health and safety so far as is reasonably practicable is an obligation which Ausgrid must comply with in providing electricity network services.

2.2.2 Maintaining the safety of the distribution system

More generally, Ausgrid is committed to maintaining the safety of our distribution system. This includes safety at our depots and other sites which form part of the distribution system.[5]

Ausgrid endeavours to always protect the safety of our employees and visitors to workplaces. Without a safe workplace, employees at these sites may not only be at risk of injury or harm, but could also be prevented from performing their respective functions at these sites that enable Ausgrid to provide electricity network services to our customers. Where risks or hazards have been identified, as is the case at the sites identified in our proposal, Ausgrid seeks to eliminate such risks so far as is reasonably practicable, in line with our obligations under the WHS Act.

[4] In accordance with s 2D(b)(v) of the National Electricity Law, our duties under the WHS Act are obligations under an Act of a participating jurisdiction (NSW) and these obligations materially affect Ausgrid’s ability to provide electricity network services.

[5] The NER definition of ‘distribution network’ (which is a part of the ‘distribution system’) includes the apparatus, equipment, plant and buildings used to convey, and control the conveyance of, electricity to customers.

3 Response to Draft Decision

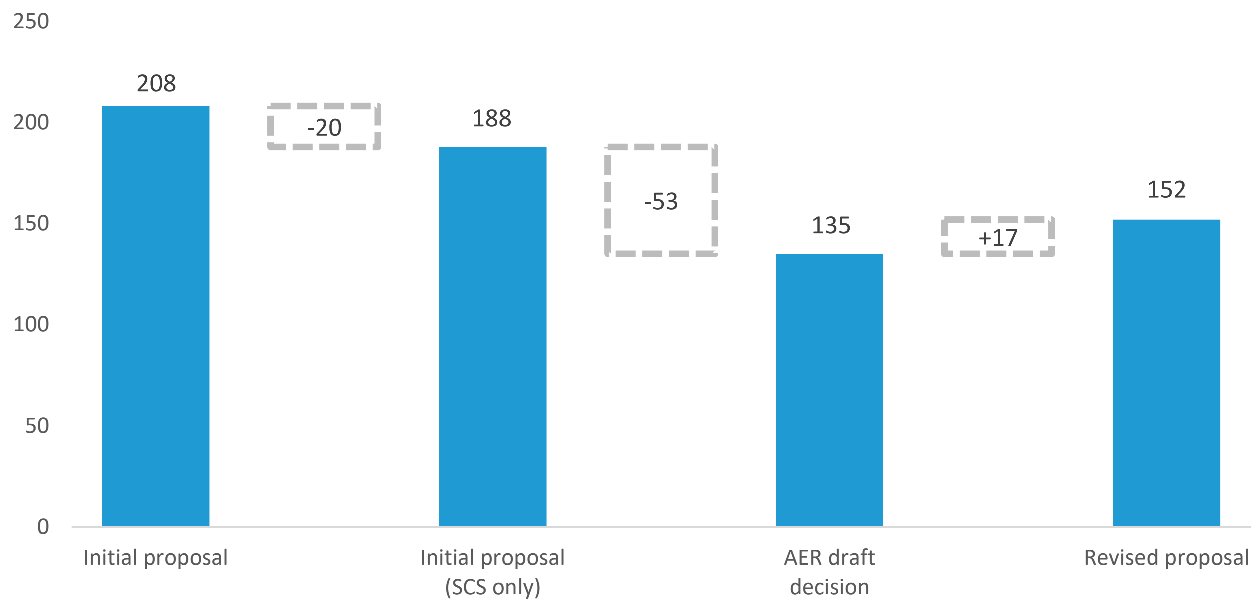
We have taken into account the AER's Draft Decision in the development of our Revised Proposal. This has led to us putting forward a submission which, in our view, more clearly communicates the benefits customers will receive from our planned non-network property investment program (see sections 3.2.4 and 3.2.5). Our Revised Proposal also seeks to clarify the extent to which we have considered alternative options.

3.1 Initial and Revised Proposal compared to the Draft Decision

Our Initial Proposal compared to the AER's Draft Decision and our Revised Proposal is set out in Figure 2. It shows that we put forward an Initial Proposal of $208 million. This amount, for reasons outlined below, should have in fact been presented as $188 million (see section 3.1.1). We are submitting a revised forecast of $152 million.

Figure 2

Initial and Revised Proposal compared to the Draft Decision ($m, FY19)



3.1.1 Clarification about our Initial Proposal

In preparing our Revised Proposal, Ausgrid observed an issue with the presentation of our initial forecast.

Our non-network property assets support the delivery of standard control services (SCS), alternative control services (ACS), and unregulated services.[6] To reflect this, our approved cost allocation methodology (CAM) sets out an approach to allocate our forecast non-network property capex across each of these service categories. Broadly, our CAM allocates approximately 90% of our non-network property capex to SCS, 8% to ACS, and 2% to unregulated services.

In developing our Initial Proposal for non-network property, we applied our CAM but made an error in the presentation of our forecast. This led to us representing our total non-network property forecast of $208 million as our CAM adjusted SCS component. As set out in Figure 2 above, Ausgrid put forward an SCS forecast for non-network property of $208 million when we intended to put forward $188 million.

[6] SCS involves the provision of general network services. ACS includes public lighting, metering and ancillary network services. Unregulated services relate to activities that are incidental to our distribution network, but which are not subject to economic regulation.

3.1.2 AER Draft Decision

In its Draft Decision the AER accepted $135 million in non-network property capex. In making this Draft Decision, we understand that the AER had concerns about the options analysis informing our investment decisions. It also raised concerns about the level at which we had factored in customer benefits into our Initial Proposal as well as the 'deliverability' of our planned program.

The AER engaged a technical consultant, EMCa, to assist it in assessing our Initial Proposal. EMCa raised similar concerns to the AER in its Draft Decision. These were, principally, that our Initial Proposal had:

- not factored into its forecast the likely savings and investment deferrals that would be expected to be identified through rigorous options analysis;
- not factored into its forecast investment deferrals due to project delays and business reprioritisation, including from further accommodation rationalisation;
- not factored into its forecast the likely savings and investment deferrals that would be expected to be identified as individual projects are subjected to rigorous review and challenge through the Investment Governance Framework gate review process; and
- not justified the general depot refurbishment capex forecast, including how this money will be spent efficiently.[7]

Based on these findings, EMCa recommended that our Initial Proposal should be reduced by between 15% to 35%. The AER took into account this advice by reducing our forecast by the upper end of EMCa's recommended reduction. This resulted in the AER applying a 35% adjustment to our Initial Proposal of $208 million, giving rise to a substitute forecast in its Draft Decision of $135 million.

3.2 Response to AER Draft Decision

We have considered the AER's Draft Decision and the findings made by EMCa when preparing our Revised Proposal for non-network property capex. Ausgrid also engaged independent experts to inform key aspects of our forecast. This included Colliers International Project Management, JLL and Napier & Blakeley.

3.2.1 Timing of projects

In its report to the AER, EMCa stated:

> It seems more likely than not that Ausgrid will find opportunities and reasons to defer or perhaps stage some of what it has proposed during the next RCP [regulatory control period]. On balance, therefore, we would expect deferrals and reconsiderations at subsequent Gates of its IGF [Investment Governance Framework], to result in Ausgrid spending less than it has currently forecast.[8]

We have considered this observation made by EMCa and the conclusions drawn by the AER in its Draft Decision. In response, we sought independent advice about whether the capital programs included in our Initial Proposal are deliverable within the 2019-24 period. This advice is provided at attachment 5.20.7 and described in greater detail in section 3.2.6 below. No issues regarding deliverability were identified.

Ausgrid has, furthermore, subjected each non-network property program included in our Initial Proposal to an internal review and challenge process. In the lead up to submitting our Revised Proposal, the IGC met twice to consider the five-year plan for remediating the identified health and safety issues at our non-network properties. The IGC is the peak investment body within Ausgrid. Under its charter, it is responsible for reviewing all major investment proposals put forward by management.

7 EMCa, Ausgrid Revenue Proposal 2019-24, Review of aspects of Ausgrid's forecast capital expenditure, August 2018, p. 110.

8 EMCa, Ausgrid Revenue Proposal 2019-24, Review of aspects of Ausgrid's forecast capital expenditure, August 2018, p. 108.

During this review and challenge process, management recommended that all five building replacement programs included in our Initial Proposal should be completed within the 2019-24 period. The IGC acknowledged that there were significant merits to taking this approach. This is particularly given:

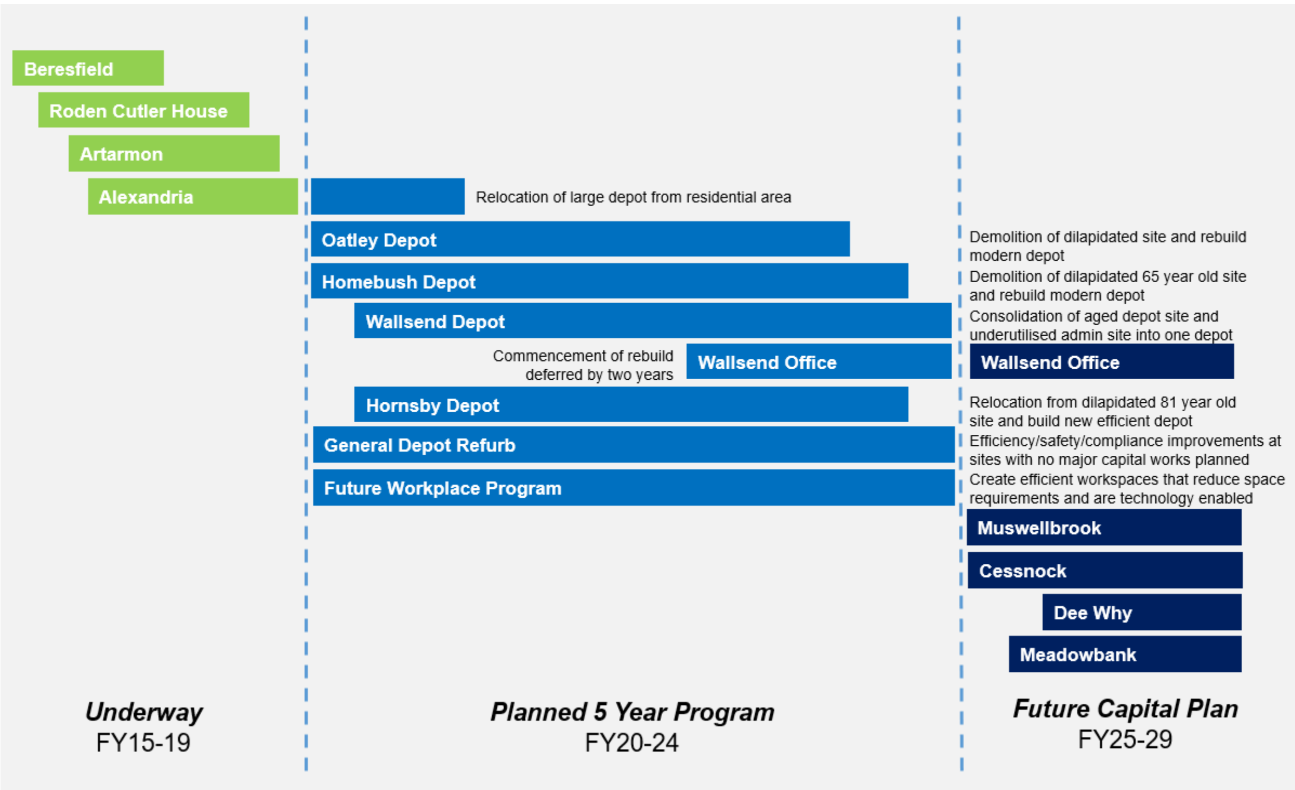
- options analysis identifying the least cost solution within the next five years (section 3.2.3);
- the opex savings which are unlocked to the benefit of our customers when a building passed its technical life is replaced with a modern equivalent (section 3.2.4); and
- independent advice supporting, as noted above, the deliverability of all five programs within the 2019-24 period (see section 3.2.6).

Taking into consideration these benefits, the IGC nonetheless required management to review whether there was scope to modify the timing of any of the planned projects, without significantly increasing Ausgrid's risk profile. To assist in making this determination, the IGC requested that management circulate additional information about the potential to defer a property replacement program.

In considering the range of factors presented before it, the IGC ultimately determined that management's original plan to complete all five non-network property programs within the next five years should be modified. This resulted in a decision to defer the Wallsend administration office building so that that only a single year of its construction will now fall within the upcoming 2019-24 period. This will result in a deferral of [redacted] million in SCS capex, which has been factored into our revised forecast of $152 million. Figure 3 sets out our updated project timetable feeding into our accommodation strategy.

Figure 3

Accommodation strategy following Wallsend deferral ($m, FY19)



Our decision to defer the commencement of the Wallsend administration office project will delay the productivity benefits which we expect from the redevelopment. We have nonetheless reached the view that our re-scoped investment program over the next five years results in a more optimal timing of our capital investment program. This is because, by staging the Wallsend depot and administration offices projects, we will be able to:

- further enhance our ability to deliver our planned investment program within the 2019-24 period; and
- provide our employees at both Wallsend sites with a relocation and temporary accommodation option while each project is underway, reducing workplace disruptions during construction.

In addition to this, the deferral of [redacted] million in SCS capex will promote affordability over the 2019-24 period, which customers have told us is their main priority.

3.2.2 Scope reductions: Homebush and Oatley Depots

We have narrowed the scope of two planned depot replacement programs. This has led to a [redacted] million reduction in capex for the development of our Homebush site and an [redacted] million reduction in the cost of undertaking capital works at our Oatley depot. In narrowing the scope of these programs, we have carefully considered the trade-offs between the capex reductions we are making and the resultant losses to other potential benefits, such as risk reduction and improved productivity.

Homebush depot

Our Homebush depot is 65 years old. It is made up of multiple buildings, two of which are contaminated with asbestos and cannot be accessed by our employees. The site also contains network infrastructure.

Ausgrid's plan is to demolish the existing buildings at our Homebush site and develop a new depot in the 2019-24 period. This has been assessed to be the least cost option for Ausgrid and, ultimately, our customers. In reaching this view, we have considered the net present cost (NPC) analysis undertaken by JLL. Attachment 5.20.1 to our Revised Proposal sets out JLL's Feasibility Study for our Homebush depot in full.

In developing our Revised Proposal, our plan for responding to the risks at our aging Homebush site was put through a review and challenge process. At the start of this process, management proposed a capital plan to our IGC that aligned to our Initial Proposal. This was subsequently not accepted, with instructions given to reconsider whether the scope and size of the redevelopment could be reduced.

Further analysis was then undertaken. In consultation with JLL, a revised plan was developed that involved reducing the floorspace required at the Homebush site by 8.3%. This reduction in the size of the redevelopment will deliver a capex saving of [redacted] million, relative to our Initial Proposal. The IGC accepted this revised plan.

Narrowing the scope of our redevelopment will come at the expense of other potential benefits. The floorspace at our existing Homebush depot totals 17,021 square metres. Under our initial redevelopment plan, we would have delivered 3 buildings with a total floorspace of 13,000 square metres. Our revised plan further rationalises the floorspace at the site to 12,000 square metres. This is 30% less space than at our existing Homebush depot.

We consider our revised redevelopment plan to be sufficient to meet our needs in the immediate term. The Western suburbs of Sydney, which our Homebush depot services, is nonetheless within a significant growth corridor. As the population in this area increases, it is likely that additional capital investment will be needed to increase the size of our Homebush depot.

Our Revised Proposal, however, is to put forward a capital program that incorporates a reduction in the size of our Homebush site. While it does leave open a need for future capital investment at a potentially higher cost, Ausgrid is of the view that this is a trade-off our customers want us to make to promote greater affordability in our services in the 2019-24 period.

Oatley depot

Our Oatley depot, at 56 years old, is in a deteriorated condition that hinders its efficient use and operations. Investigation of other potential sites for a future depot has occurred; however, residential growth in this area means there are limited inexpensive and viable alternative locations available that can service the South Sydney region.

Our plan is to demolish the current facility in the 2019-24 period and rebuild a modern, fit-for-purpose depot located on the north western sector of the existing property away from nearby schools and residential dwellings. This option was revealed to be the least cost solution in JLL's Feasibility Study (see attachment 5.20.2).

We have also subjected our planned redevelopment of the Oatley depot to a review and challenge process led by our IGC. This identified that it was possible to retain an existing warehouse at the site until at least FY25, provided refurbishment works were undertaken. The building in question will eventually have to be replaced; however, by delaying this investment Ausgrid will defer the capital cost of a 3,000 square metre warehouse. This has reduced our forecast capex in the 2019-24 period at this site by approximately 47%, from [redacted] million to [redacted] million.

There will be trade-offs from narrowing the scope of our Oatley redevelopment. By deferring the replacement of an aging warehouse, the productivity benefits that would have been realised from a new building with a modern fitout will be delayed. We are nonetheless of the view that this is a trade-off that our customers want us to make as it leads to the deferral of capex ([redacted] million) in the 2019-24 period. Narrowing the scope of this project will also enhance our program delivery timetable.

3.2.3 Options analysis

In its Draft Decision the AER observed:

> Ausgrid's options analysis for each project scope was essentially "all or nothing". We would consider that between a full rebuild and "do nothing" options, there is a range of options to address individual risks identified in Ausgrid's analysis. These options could be potentially lesser in scope and cost relatively less.[9]

We agree with the AER. The application of an "all or nothing" approach to our options analysis would skew our investment decisions in a way that is unlikely to be in the long-term interests of customers. For that reason, we wish to clarify that our analysis did not take such an approach.

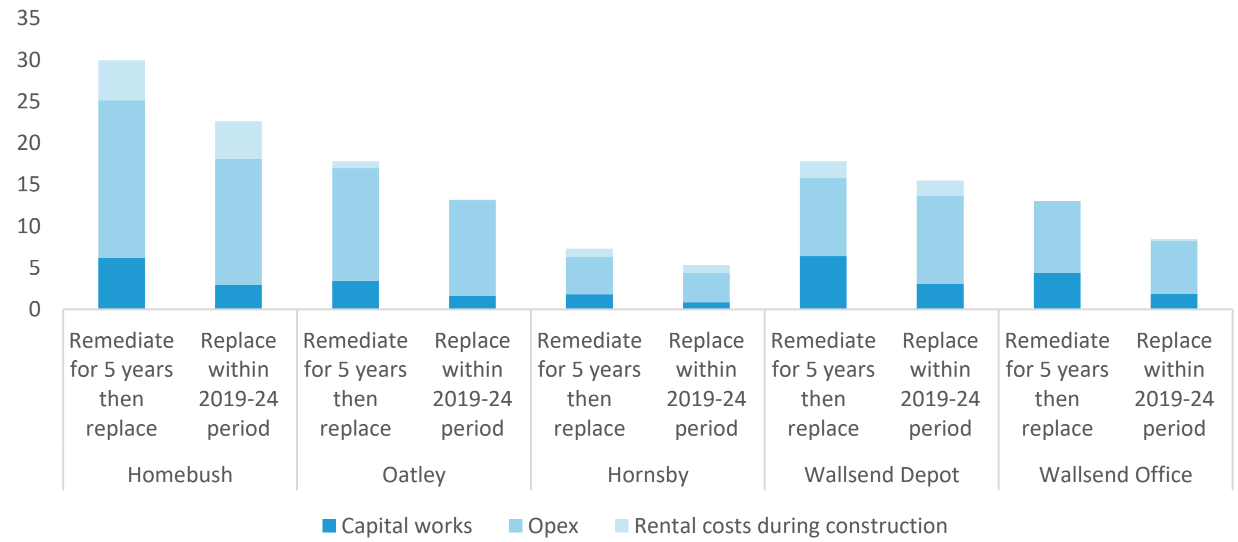
Undertaking a "do nothing" option is not open to Ausgrid. The condition of each building targeted for investment gives rise to risks and hazards that Ausgrid must, under the WHS Act, take steps to eliminate so far as is reasonably practicable. This regulatory obligation, together with our commitment to keep our workforce and the public safe from harm, drove our options analysis to consider two investment scenarios involving either:

- continuing to operate a building while undertaking significant remedial works that allows us to comply with our regulatory obligations and keep our employees and the public safe in the short term until a major rebuild can occur. Any remediation will still need to consider a replacement in the medium to long term given the advanced age of the targeted buildings (**remediate option**); or
- replacing a building with one that complies with workplace health and safety laws by either rebuilding the properties at the existing sites or moving to a new site (**replace option**).

The costs and benefits of these two options have been carefully analysed, with advice from commercial property experts JLL in relation to the long-term cost under each option. The results of this analysis are set out in Figure 4 below. It shows that we have factored in "ongoing capital works" in both the "remediate" and "replace" investment scenarios. These costs are higher under the remediate option given the additional work required to maintain a building that has passed its technical life and entered a condition of significant age-based dilapidation.

Figure 4

Total 10-year capital and operating costs at each site ($m, FY19)



Market sensitive information relating to the cost of rebuilding each site, while not presented above, has been factored into our NPC analysis. Including these capital costs, we found that the lowest NPC at each site was an option where the building under consideration is replaced in the 2019-24 period. This outcome is driven by lower ongoing capital works

9 AER, Draft Decision – Ausgrid Distribution Determination, November 2018, p. 5-10

and, as discussed below, the significant productivity benefits which we can unlock by replacing a dilapidated, expensive to maintain building with a modern, cheaper to operate depot or administration office.

To inform our Revised Proposal, Ausgrid also engaged an independent firm to review the merits and risks of a “new build” option compared to fully refurbishing existing buildings. This resulted in Colliers providing Ausgrid with a report advising that a new build strategy is more advantageous from a risk point of view. Among other things, it minimises the risk of contamination by hazardous materials, latent site conditions and aged infrastructure. A new build option also provides greater certainty in cost planning and the construction process compared to a full refurbishment or ad hoc remediation approach.

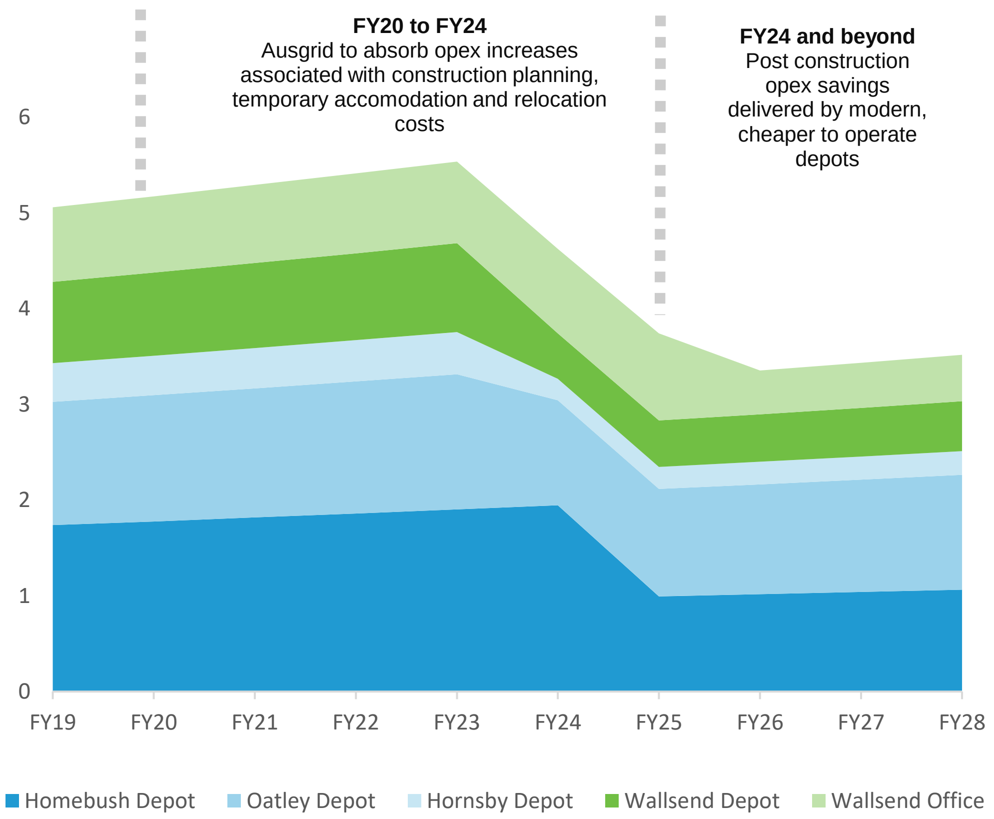
3.2.4 Customer benefits: Opex savings

Our capital investment analysis factors in the opex savings that are realised when an office or depot built in the 1950s to 1970s is upgraded to a modern fit-out. JLL advised that we should achieve, on average, a 50% reduction in the operating costs at each site once a building is replaced. We consider this to be a reasonable assumption based on the expertise of JLL as property investment expert.

The annual opex savings from each planned site replacement are set out in the figure below. It shows that, in gross terms, a $1.79 million (nominal) opex saving will be unlocked by our planned capex program. These gross savings do not incorporate the ‘one-off’ planning costs or the temporary accommodation and relocation costs we will incur with each replacement project, and which we proposing to absorb in the 2019-24 period.

Figure 5

Building operating costs pre and post investment ($m, nominal)



Including one-off planning, temporary accommodation and relocation costs, our property related opex is actually forecast to increase over the 2019-24 period. This, however, is a timing issue. When viewed over a longer 10-year period, JLL concluded that each of the options selected as part of our planned capex program carries the lowest NPC. This is in part due to the step down in our property related opex from FY25 onwards.

It should be noted that we plan to complete our Wallsend administration office construction in the 2025-29 period. Our accommodation strategy for the 2025-29 period also includes the replacement of depots at Muswellbrook, Cessnock, Dee Why and Meadowbank. These projects will result in construction planning, accommodation and relocation costs not set out in Figure 5 above.

3.2.5 Customer benefits: Disposals in the 2019-24 period factored into our forecast

Our planned investment program in the 2019-24 period incorporates further land sales in addition to those already made in the current regulatory period. These disposals are contingent on our replacement programs at our Hornsby and our Alexandria depots going ahead as planned. The completion of our Wallsend administration office replacement project will also unlock an opportunity to dispose of surplus land in the 2025-29 period.

Once alternative sites have been developed, the disposal of land surplus to our needs will deliver substantial benefits to our customers. As shown in the table below, up to 65% of the Hornsby depot and 68% of the Wallsend administration building capex can in effect be self-funded through land sales. This will deliver benefits to our customers through the construction of modern, cheaper to operate buildings that address all the identified health and safety risks, at the lowest possible cost.

We anticiapte the disposal of land at our Hornsby depot site and, as noted above, the Wallsend office site to occur after the 2019-24 period. Ultimately, this will lead to further customer bill savings. This is in addition to the $30 per customer saving that customers will receive in the 2019-24 period following land sales in the current period.

Table 2

Planned disposals as a percentage of replacement cost

	DISPOSAL AS % OF REPLACEMENT COST
Hornsby depot	65%
Wallsend admin building	68%

3.2.6 Deliverability and investment strategy

In its Draft Decision the AER raised concerns about whether our proposed non-network building replacement programs at five sites could be delivered within the 2019-24 period. It observed:

> We would consider that when all five major property projects were implemented in parallel, it would put unusually high strain on Ausgrid's internal delivery capability. We conclude… it [planned investment program] is unlikely to be achieved in practice.[10]

Noting the AER's concerns, we engaged Colliers to undertake an independent assessment of our ability to deliver the planned capex program. This assessment was also requested by our IGC. Colliers' review did not identify a deliverability risk. The project management firm further advised that the program could be delivered in full through the employment of consistent delivery methodologies, phasing works over the 2019-24 period and segmenting development-application approvals. Further to this, Ausgrid will implement a "one program" delivery method when implementing our property capex program. This approach, based on best practice industry advice from Colliers, will enable planning delivery, design and procurement efficiencies across the program which is different to Ausgrid's previous practice of delivering each capital project as an individual project with different teams assigned to each.

3.2.7 General refurbishment and workplace improvement

In relation to our general refurbishment program, EMCa observed:

> Ausgrid has not justified the General Depot Refurb forecast… With significant investment in new depots and office buildings planned, we would have expected this cost to reduce in the next RCP compared to the current RCP.[11]

The AER made a similar observation in it Draft Decision, as did stakeholders. Since lodging our Initial Proposal, Ausgrid's capital plan for non-network property in the 2019-24 period has also gone through a further internal review and challenge process led by our IGC.

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[10] AER, Draft Decision – Ausgrid Distribution Determination, November 2018, p. 5-10

[11] EMCa, Ausgrid Revenue Proposal 2019-24, Review of aspects of Ausgrid's forecast capital expenditure, August 2018, p. 110.

The IGC reassessed the required level of capex for both our general refurbishment and our planned workplace improvement programs. The general refurbishment program is targeted at ensuring that buildings not subject to a planned replacement in the 2019-24 period are safe, secure and fit-for-purpose. Its focus is on minor works that address immediate safety and compliance issues. The workplace improvement program seeks to create a working environment where employees can achieve their daily tasks collaboratively and in a connected and flexible manner.

Management initially put forward a proposal to the IGC to spend a total of [redacted] million in capex (SCS only) in the 2019-24 period on both our general refurbishment and workplace improvement programs. The same amount was put forward to the AER in our Initial Proposal.[12] During our internal review and challenge processes, it was noted to the IGC that both programs are expected to deliver capital works at 83% of our property portfolio yet they have a combined value equal to less than 10% of our total non-network property forecast.

The IGC recognised that the combined value of the general refurbishment and workplace improvement programs, although relatively small, is expected to have significant coverage in terms of ensuring that properties within our portfolio are safe, secure and fit-for-purpose. In considering management's proposal, additional information was nonetheless sought about whether there was any scope for the programs to be reduced without significantly impacting the level of risk to which Ausgrid is exposed.

Management gave effect to this instruction by considering if major projects completed within the current 2014-19 period would unlock efficiencies going forward. Ultimately, this review resulted in a reduction to our general refurbishment forecast, from [redacted] million to [redacted] million in our Revised Proposal. We have also narrowed the scope of our workplace improvement program, reducing our forecast from [redacted] million to [redacted] million. These adjustments have brought the combined value of these programs to [redacted] million – a 9% reduction from our Initial Proposal.

We expect the lower capital spend we have put forward to increase our risk profile in the 2019-24 period. Ausgrid is nonetheless satisfied that this additional level of risk will be manageable. In the short term, our decision to trade-off capex for a manageable increase in risk is also guided by what customers told us in the lead up to the submission of our Revised Proposal. This is that their main priority in the 2019-24 period is, above all else, the promotion of improved affordability in the services we offer.

3.2.8 Construction costs

Prior to submitting our Revised Proposal, Ausgrid engaged with the AER and customers about our forecast non-network property capex programs. During this engagement, we provided Energy Consumers Australia (ECA) with our forecast capex per square metre ($/sqm) construction costs. We provided this information on a confidential basis given the market sensitivity of these inputs.

The ECA sought additional information about why we considered our forecast construction costs to be reasonable. As a reference point, the ECA provided Ausgrid with a 'Napier & Blakeley Construction Costs Data Card'. This is a publicly available report which sets out indicative $/sqm construction costs. The firm which publishes this report provides nation-wide consultancy services in property investment, development and sustainability.

The ECA pointed out that our forecast $/sqm construction costs at our Homebush site did not align with the rates in the Napier & Blakeley Data Card. We subsequently reviewed both sets of construction costs but could not conclusively explain what would be driving any differences. To provide greater clarity, we decided to approach Napier & Blakeley directly. In response, they provided Ausgrid with a report noting the following:

> It must be stressed that these publications [Napier & Blakeley Construction Costs Data Card] are issued for each Australian stated location as a general guide only to a range of indicative construction costs applied to gross building areas.
>
> While this guide is useful for assistance in setting of initial broad project feasibilities, the average building types and contents are generally based and cannot take account of specific site or design related information and for which more detailed appraisal is always strongly recommended.
>
> …
>
> Also, the range of costs indicated are for pure construction and are exclusive of loose furniture and fit out or any specialist operating equipment such as gantry cranes and the like, and any abnormal or onerous site and foundation conditions, etc.[13]

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[12] SCS component was [redacted] million once adjustments described in section 3.1.1 are made.

[13] Napier & Blakely, Ausgrid Property Capex Program Year 2020-2024 Period, 21 December, p. 2.

We have passed this additional information from Napier & Blakeley onto the ECA. Ausgrid acknowledges that the assumed construction costs for each building replacement program are a significant input into our Revised Proposal. To that end, we should note that our forecast construction costs have been independently verified by JLL and their in-house quantity surveyor.

In response to inquiries made by ECA we have also had our unit cost reviewed by Napier & Blakeley. Its advice was that our unit rates are reasonable. This included our construction rates for office buildings, workshop buildings, office and training buildings, and warehouse buildings. Napier & Blakeley further noted that, in some respects, our forecast construction unit rates do not account for the full set of costs we will incur, such as unenclosed covered areas (awnings and breezeways), car parking or outbuildings (fire pump rooms, wash-down bays, gatehouses). Napier & Blakeley concluded that these 'additional ancillary-build requirements will need to be absorbed out of the overall generic building cost rate allowance allowed in the [JLL] feasibilities'.[14]

Napier & Blakeley also reviewed our development allowances. Its advice was that these inputs are all within a reasonable bound. In relation to contingency, Napier & Blakeley stated that our allowance 'appears reasonable given the proposals are at early feasibility stage and within the expected industry range'.[15]

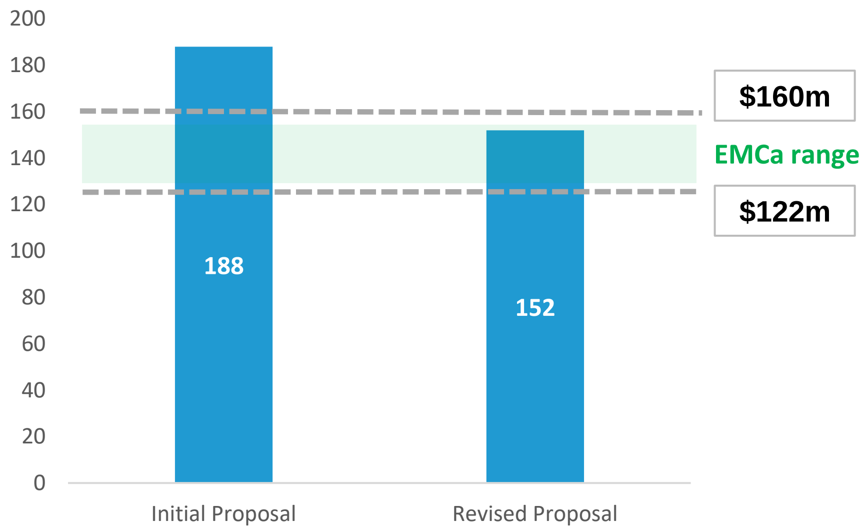
3.2.9 EMCa's analysis

In the development of our Revised Proposal, we have taken EMCa's findings and the AER's Draft Decision into account. Along with our IGC review and challenge processes, this has resulted in a capex forecast for non-network property that now falls within a capex range that EMCa considered reasonable.

As noted in section 3.1.2 above, EMCa recommended a 15% to 35% reduction to our Initial Proposal. In doing so, it referenced the requirements in the national electricity rules (NER) stating: 'We consider that an adjustment to Ausgrid's Buildings and Property capex forecast of between minus 15% and minus 35% would more reasonably meet the requirements of the NER'.[16] Figure 6 sets out this range and shows that our Revised Proposal, at $152 million, sits well within it.

Figure 6

Testing our proposal against the EMCa range ($m, FY19)



The above range is based on a 15% to 35% reduction applied to $188 million, which it what we intended to represent as our Initial Proposal. It should be noted that, to the best of our knowledge, EMCa most likely considered our CAM adjusted SCS component of our initial forecast to be $208 million (see section 3.1.1 above). This implies that EMCa's recommended range was in fact higher than is shown above, at between $177 million and $135 million. In any case, our Revised Proposal sits within what the AER's engineering consultant considered should be accepted at the Draft Decision stage.

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[14] Napier & Blakely, Ausgrid Property Capex Program Year 2020-2024 Period, 21 December, p. 2.

[15] Napier & Blakely, Ausgrid Property Capex Program Year 2020-2024 Period, 21 December, p. 5.

[16] EMCa, Ausgrid Revenue Proposal 2019-24, Review of aspects of Ausgrid's forecast capital expenditure, August 2018, p. 110.