

Revised Regulatory Proposal Property Capex Summary



Part of the Energy Queensland Group

Executive Summary

The AER's Property capex assessment method considered the forecast expenditure within four sub-categories:

- General Property Programs;
- Carry-over Work;
- Major Projects; and
- Other Property Programs.

In its Draft Decisions (DDs), the AER accepted Energex and Ergon Energy's forecasts for General Property Programs and Carry-over Work as proposed.

The AER is expecting further justification of the planned Major Projects and one of the Other Property Program investments, with improved business case analyses, verifiable costings and accounting for realised savings. The AER also identified errors in several of the provided Present Value (PV) economic analyses.

Energex and Ergon Energy appreciate the feedback and perspectives provided by the AER and our customers through the DD process.

In the Revised Regulatory Proposals (RRPs) we have revised the business cases for four planned Major Projects and the one non-accepted Other Property Program investment. This includes more thorough analyses of "counterfactual" base case scenarios, alternative options analyses, sensitivity analyses, condition assessments, quantity surveyor cost estimates, risk and benefit analyses. We have also included per annum step-changes in forward opex forecasts consistent with the tangible operating costs savings estimated for each investment.

The following property business cases have been redeveloped in support of the RRP:

- **Energex:** Brisbane Training Facility
- **Ergon Energy:** Maryborough Site Consolidation, Townsville Training Facility, Property Security
- **Energy Queensland Shared:** Rockhampton OT Hosting Facility

Energex and Ergon Energy support the AER's position regarding planned investments in Brisbane Office Accommodation and the Banyo Workshop. Our revised proposals therefore accept the AER's substitute amount for the Brisbane Office Accommodation investment and we have removed the Banyo Workshop investment from our forecasts.

Through the changes applied in our revised proposals and the further detailed business cases provided, we believe we have addressed all the items raised through the DD process.

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1 Introduction

This document summarises the changes Energex and Ergon Energy have made from the Regulatory Proposals (RPs) to the Revised Regulatory Proposals (RRPs) for Property capex in response to feedback received from the AER and our customers.

2 AER Draft Decisions

The AER's Property capex assessment method considered Property capex within four sub-categories. I.e. General Property Programs, Carry-over Work, Major Projects and Other Property Programs. Through the Draft Decisions (DDs), the AER has either accepted the proposed amounts for each sub-category in full or included reduced substitute amounts as summarised below.

2.1 General Property Programs

The General Property Programs capex consist of base capital and minor capital works to maintain facilities across the Energex and Ergon Energy property portfolio. Through the DDs, the AER noted that Energex and Ergon Energy's forecasts of General Property Programs expenditure is significantly lower than historical expenditure and that the forecasts reasonably reflect the efficient costs of a prudent operator. The AER therefore accepted 100% of the proposed General Property Programs capital for both Energex and Ergon Energy.

2.2 Carry-over Work

The Carry-over Work capex consists of a small number of inflight property projects which will continue into the early part of the coming Regulatory Control Period (RCP). In its DDs, the AER accepted 100% of the forecast Carry-over Work expenditure for both Energex and Ergon Energy.

2.3 Major Projects

The proposed Major Projects capex consisted of a set of six larger replacement, redevelopment or refurbishment projects across the property portfolio. In its DDs, the AER identified two overarching issues relating to the Major Projects investments based on the materials provided through the RPs and subsequent information requests:

1. Inadequacy of economic analyses, including incorrect present value (PV) calculations

The AER identified several errors in the PV calculations for proposed Property investments. The AER also noted incomplete assessment of Base Case ("counterfactual") options and economic assessment of realisable investment benefits.

2. Lack of evidence that forecast opex savings have been incorporated into opex forecasts

The AER highlighted that operational cost reductions arising from "capex opex trade-off" investments should be reflected as step-changes in forward forecasts. The AER particularly noted that property cost savings such as reductions in ongoing maintenance costs, rental costs, land tax (etc) do not relate to productivity improvements and there is an expectation that such savings will be included as negative opex step-changes.

The AER further identified specific concerns regarding each of the six individual Major Project investments as summarised below.

Maryborough Consolidation

This investment proposed the consolidation of Ergon Energy's property portfolio in Maryborough by refurbishing the Searle Street site, moving the functions performed within the Adelaide Street site to Searle Street, enabling the disposal of Adelaide Street. The AER found the investment was not

sufficiently justified. On this basis, together with the two overarching concerns, the AER did not accept the proposed capex and did not include this project in the substitute amount.

Brisbane Office Accommodation

This investment proposed the consolidation of Energex and Ergon Energy's office property portfolio in Brisbane, by moving the functions performed in the Ann Street site to the Newstead facility, and then consolidating both the Newstead and Nundah sites to a new single site in the following RCP (2025-30). The AER included a substitute estimate to enable staff to relocate from Ann Street to Newstead only.

Brisbane Training Facility (Rocklea)

This investment proposed to redevelop the existing Brisbane Training Facility at Rocklea for long term sustainability, efficiency and operational effectiveness.

The AER determined that the business case had not demonstrated the prudence and efficiency of the proposed investment. There were specific concerns regarding the options analysis, particularly the inadequate assessment of lower cost alternative options and the potential to partly or fully refurbish the existing facility. On this basis, together with the two overarching concerns, only a small substitute estimate was included.

Townsville Training Facility (Garbutt)

Similar to the Brisbane Training Facility proposal, this investment proposed to redevelop the existing Townsville Training Facility at Garbutt for long term sustainability, efficiency and operational effectiveness. The AER determined that the business case had not demonstrated the prudence and efficiency of the proposed investment. For similar reasons as for the Brisbane Training Facility investment, only a small substitute estimate was included.

Rockhampton Operational Technology Hosting Facility (Data Centre Strategy)

The Data Centre Strategy investment proposed the relocation of the existing Rockhampton hosting facility from the Richardson Road site to the Energy Queensland site at Glenmore Road. Richardson Road is a former depot which is being progressively decommissioned. The existing facility is primarily used to host Operational Technology (OT) functions.

The AER determined that the business case had not provided quantitative assessment to demonstrate the need for the investment. There were also specific concerns regarding the options analysis, costs and benefits. On this basis, together with the two overarching concerns, the AER did not accept the proposed capex and did not include this project in the substitute amount.

Banyo Workshop

This investment proposed to transition the existing Banyo workshop from the current leased site to an owned-facility.

The AER determined that the business case had not demonstrated the prudence and efficiency of the proposed investment. There were specific concerns regarding evidencing of the investment need, the lack of a base case ("do nothing") option and the lack of benefit quantification. Based on the information provided, the AER did not accept the proposed capex and did not include this project in the substitute amount.

2.4 Other Property Programs

The Other Property Programs capex consists of a small number of initiatives related to the core property portfolio. Specifically, these include investments in Property Security, the Control Centre Strategy and the Asbestos Removal Program.

In its DD, the AER accepted that the programs for Energex are reasonable and allowed 100% of the

proposed Other Property Programs capex.

For Ergon Energy, the AER accepted the Asbestos Removal and Control Centre Strategy programs. However, for the Ergon Energy Property Security program the AER substituted a reduced amount given concerns regarding the justification of investment need and the analysis of risk, options, costs and benefits as provided in the investment business case.

3 Energex and Ergon Energy RRPs

Energex and Ergon Energy appreciate the feedback and perspectives provided by the AER and our customers through the DD process. As a result, an additional level of detailed analysis has been undertaken compared with the RP and previous regulatory proposals.

We specifically recognise the overarching concerns raised by the AER regarding the adequacy of the economic analyses, suitability of supporting evidence and traceability of cost savings into forward operating forecasts. Acting on those concerns, through the RRPs we have taken the following steps:

1. Redeveloped Business Cases

Energex and Ergon Energy have engaged external expertise to redevelop the business case analyses for four planned Major Project investments and the one non-accepted Other Property Program investment (Ergon Energy Property Security). Each of the business cases now includes:

- Further detailed analysis of the investment need(s).
- Definition and economic analysis of the Base Case scenario (also known as the “counterfactual case” or the “do-minimal / do-nothing” case). Investments with an asset lifecycle management investment driver also cite recent site condition assessments.
- Identification and economic analysis of multiple options to address the identified investment need(s). Each option includes detailed assumptions supported by cost estimates, benefits quantification and risk assessment. Site development cost estimates are provided by external quantity surveyors AECOM. Each cost estimate includes a tabular breakdown of the cost forecast consistent with the documented assumptions.
- A sensitivity analysis of key cost and benefit parameters with alternative Net Present Value (NPV) calculations for Best, Worst and Likely cases for each option.
- A qualitative assessment of advantages and disadvantages.
- A change impact assessment.

2. Opex Step Changes

While some benefits arising from planned investments support our broad productivity improvement commitments, we also agree that there are direct savings which should be reflected as opex step-changes. Therefore, through the RRP we have:

- Included per annum step-changes in forward opex forecasts consistent with the tangible operating costs savings estimated for each investment.
- The savings include forecast reductions in maintenance costs, energy costs, rates, land tax (etc) as well as avoided or reduced lease costs.
- The step-changes have been calculated consistent with the assumptions and timing identified in each business case and the corresponding NPV analyses.
- In each case, the step-changes represent the per annum delta between the Base Case and the recommended option. As well as addressing the above overarching concerns, we have also taken the following steps to act on specific concerns with each business case investment.

Maryborough Consolidation

The revised business case considers multiple options to address the investment needs, including a partial refurbishment of the Searle Street site (recommended), a redevelopment of the site and an option to transition to a new “greenfield” site. The options are contrasted with the Base Case scenario of continuing operations across the two existing Maryborough sites (Searle Street and Adelaide Street).

Costs associated with the site refurbishment and development options are provided by quantity surveyors AECOM.

The disposal value for the Adelaide Street site is included in the Ergon Energy Post Tax Revenue Model (PTRM). Operating cost savings in reduced and avoided maintenance costs, rates, land tax and energy costs are included in the forecast property step-changes. The investment also mitigates risk and enables broader productivity improvement.

Brisbane Training Facility (Rocklea)

The revised business case considers multiple options to address the investment needs, including a new refurbishment option (recommended). The refurbishment option is compared with options to redevelop the site and the potential transition to a new “greenfield” site.

Costs associated with the site refurbishment and development options are provided by quantity surveyors AECOM.

Operating cost savings in reduced maintenance costs, energy costs, cleaning and sanitation costs are included in the forecast property step-changes. The investment also mitigates risk and enables broader productivity improvement.

In the RRP, this Brisbane Training Facility investment is treated as an Energex capital investment (in the RP this was proposed as a joint investment co-funded by Ergon Energy). Similarly, in the RRP the Townsville Training Facility investment is treated as an Ergon Energy capital investment. This RRP treatment is more appropriate as the Brisbane and Townsville facilities are primarily used by Energex and Ergon Energy respectively.

Townsville Training Facility (Garbutt)

The revised business case considers multiple options to address the investment needs, including a lower cost option to redevelop the training building / office (recommended). This option is compared with an option to transition to a new “greenfield” site.

Costs associated with the options are provided by quantity surveyors AECOM. Operating cost savings in reduced maintenance costs, energy costs and lease costs are included in the forecast property step-changes. The investment also mitigates risk and enables broader productivity improvement.

Rockhampton Operational Technology Hosting Facility (OTHF)

The revised business case considers multiple options to address the investment needs, including a lower rack-capacity option designed for future extensibility (recommended), larger capacity options of varying transition risk profiles and further consideration of alternative commercial hosting arrangements. The options are contrasted with the Base Case scenario to continue operation of the existing facility located at the former Richardson Road depot.

Costs associated with the options have been assessed by external specialists VirtuGrp.

Savings in reduced or avoided Richardson Road operating costs are included in the forecast property step-changes. The investment also mitigates risk and enables broader productivity improvement.

Property Security (Ergon Energy)

The primary drivers for the Property Security program are:

- Mitigation of risks relating to unauthorised access to Ergon Energy sites with a specific focus on ensuring community and workforce safety and network reliability.
- Requirement to invest consistent with security management best practices, in alignment with legislation, standards and community expectations.
- The opportunity to reduce costs of loss through break-in and theft incidents which result in both financial loss and disruptions in delivery of services to customers and the community.

Recognising the significance of risk mitigation as a primary driver, the revised business case proposes a more targeted investment in Ergon Energy's regional property security based on a structured site vulnerability assessment and economic risk quantification.

The business case considers multiple options, including a lower cost security upgrade program focussed on sites of greatest vulnerability (recommended). The economic analysis assesses the NPV of each alternative, including the value of mitigated risk.

Cost estimates are calculated based on pricing and rates acquired through a recent competitive procurement process. Operating cost impacts are included in the forecast property cost step-changes. The investment also enables broader productivity improvement.

Brisbane Office Accommodation

Energex and Ergon Energy support the AER's position regarding the planned investment in Brisbane Office Accommodation. Our revised proposals therefore accept the AER's substitute amount for the Brisbane Office Accommodation investment.

Banyo Workshop

Energex and Ergon Energy support the AER's position regarding the planned investment in the Banyo Workshop. Our revised proposals have therefore removed the Banyo Workshop investment from our forecasts.