



**Attachment 11.2**

# **Financing Costs**

**Response to AER Draft Decision**

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January 2023

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# 1 Financing Costs

**We accept the Draft Decision on rate of return and note that the Final Decision will be informed by the AER’s 2022 Rate of Return Instrument due to be published in February 2023. For the purposes of this response we have used the AER’s 2018 Rate of Return Instrument and data from December 2022.**

## 1.1 Overview

This attachment sets out our response to the AER’s Draft Decision on our financing costs for our Victorian and Albury gas distribution networks over the next (2023/24 to 2027/28) Access Arrangement (AA) period.

## 1.2 Customer and Stakeholder Feedback

We applied the AER’s Rate of Return Guideline and the AER’s Tax Review to calculate the rate of return and cost of tax in this revised Final Plan. We did not receive any stakeholder or customer feedback in relation to our financing costs.

## 1.3 AER Draft Decision

Table 1.1: Summary of AER Draft Decision

Issue	AER Response	AER Comment
<b>Financing Costs</b>		
Return on Equity	Accept	As per the AER’s current 2018 Rate of Return Instrument.
Return on Debt	Accept	As per the AER’s current 2018 Rate of Return Instrument.
Rate of Return	Accept	As per the AER’s current 2018 Rate of Return Instrument. Estimated a placeholder average rate of return of 5.84%, which will be updated in the final decision based on our nominated (confidential) averaging periods and the application of the 2022 Rate of Return Instrument to be finalised in February 2023.
<b>Tax Costs</b>		
Cost of tax	Accept	Accepted our approach to calculating the cost of tax using the approach in the AER’s 2018 Tax Review.
Value of imputation credits	Accept	Accepted the gamma value of 0.585 we adopted, which is consistent with 2018 Rate of Return Instrument.
Tax depreciation	Accept	Accepted our approach to determining tax depreciation, which reflects the approach in the AER’s Tax Review.
Tax asset base	Accept	Accepted our approach to determining the tax asset base, which reflects the approach in the AER’s Tax Review.

Note: In this ‘traffic light’ table, green shading represents the acceptance, orange represents a modification/modifications and red shading represents a rejection.

## 1.4 Our revised Final Plan

Our financing and tax costs collectively account for around half of our total costs. For the purposes of the revised Final Plan, we have continued to apply the AER’s 2018 Rate of Return Instrument and the AER’s 2018 Tax Review in determining our financing and tax costs.<sup>1</sup> Table 1.2 summarises our response to the AER Draft Decision on our financing and tax costs, which shows we have accepted all parts of its decision.

Table 1.2: Summary of Our response to the AER Draft Decision

Issue	AER Draft Decision	Our response	Our Comment
<b>Financing Costs</b>			
Return on Equity	Accept	Accept	As per the current AER Rate of Return Instrument and updated to reflect data from December 2022.
Return on Debt	Accept	Accept	As per the current AER Rate of Return Instrument and updated to reflect data from December 2022 and forecasts of the cost of debt through the next AA period to provide an average.
Rate of Return	Accept	Accept	As per the current AER Rate of Return Instrument and updated to reflect data from December 2022.
<b>Tax Costs</b>			
Cost of tax	Accept	Accept	We have used the approach in the AER’s 2018 Tax Review and note that it gives a cost of tax allowance of zero.
Value of imputation credits	Accept	Accept	As per the current AER Rate of Return Instrument.
Tax depreciation	Accept	Accept	We have continued to adopt the approach in the AER’s 2018 Tax Review.
Tax asset base	Accept	Accept	We have continued to adopt the approach in the AER’s 2018 Tax Review.

Note: In this ‘traffic light’ table, green shading represents the acceptance, orange represents a modification/modifications and red shading represents a rejection.

This results in an indicative average rate of return for the next AA period of 5.48%. We note that the AER will determine our final allowed rate of return in the Final Decision using:

- the averaging period approved by the AER in the Draft Decision; and
- the 2022 Rate of Return Instrument, which will be published in February 2023.

<sup>1</sup> We note that the AER’s Final Decision will be based on the 2022 Rate of Return Instrument, but this will not be released until February 2023 and is thus not available for this revised Final Plan.

Table 1.3: Indicative AER rate of return and gamma

	Revised Final Plan	Draft Decision	Final Plan
Risk Free Rate	3.60%	3.89%	3.01%
Beta	0.6	0.6	0.6
Market Risk Premium	6.1%	6.1%	6.1%
<i>Return on Equity</i>	7.26%	7.55%	6.67%
<i>Cost of Debt</i>	4.30%	4.69%	4.10%
<i>Gearing</i>	60%	60%	60%
<i>Nominal Vanilla WACC</i>	5.48%	5.84%	5.13%
Inflation	3.37% <sup>2</sup>	3.37%	3.05%
Gamma	0.585	0.585	0.585

As noted above, the average rate of return is affected by the forecasts of the cost of debt allowance through the next AA period as shown in Table 1.3 above.

Table 1.4 below provides our revised tax asset base over the next AA period.

Table 1.4: Roll forward of the tax asset base (\$m, nominal)

	2023/24	2024/25	2025/26	2026/27	2027/28
Opening tax asset base	779.6	889.4	1,004.5	1,068.1	1,137.4
<i>Plus gross capex</i>	142.8	169.6	141.9	147.4	155.1
<i>Less tax depreciation</i>	-32.9	-54.5	-78.3	-78.1	-82.9
<b>Closing tax asset base</b>	<b>889.4</b>	<b>1,004.5</b>	<b>1,068.1</b>	<b>1,137.4</b>	<b>1,209.6</b>

In respect of the tax building block, which is the component of our regulatory model informed by the tax calculations above, there is a tax allowance of \$22.1 million (\$ nominal) in our building blocks.

## 1.5 Summary

Our forecast average rate of return for the next AA period is 5.48%, comprising an allowance for equity of 7.26% and a forecast average allowance for debt of 4.30%. These calculations have been undertaken using the AER’s 2018 Rate of Return Instrument and are indicative values to be updated in the AER’s Final Decision in May 2023.

Our tax allocation, following the approaches in the AER’s 2018 tax decision and updating information on capex and other factors in response to the Draft Decision is \$22.1 million (\$ nominal).

<sup>2</sup> We note that the next RBA Statement of Monetary Policy will not be released until February 2023, and that the AER’s Draft Decision includes the most recent Statement. Thus, we have not changed the inflation estimate in this Revised Final Plan.