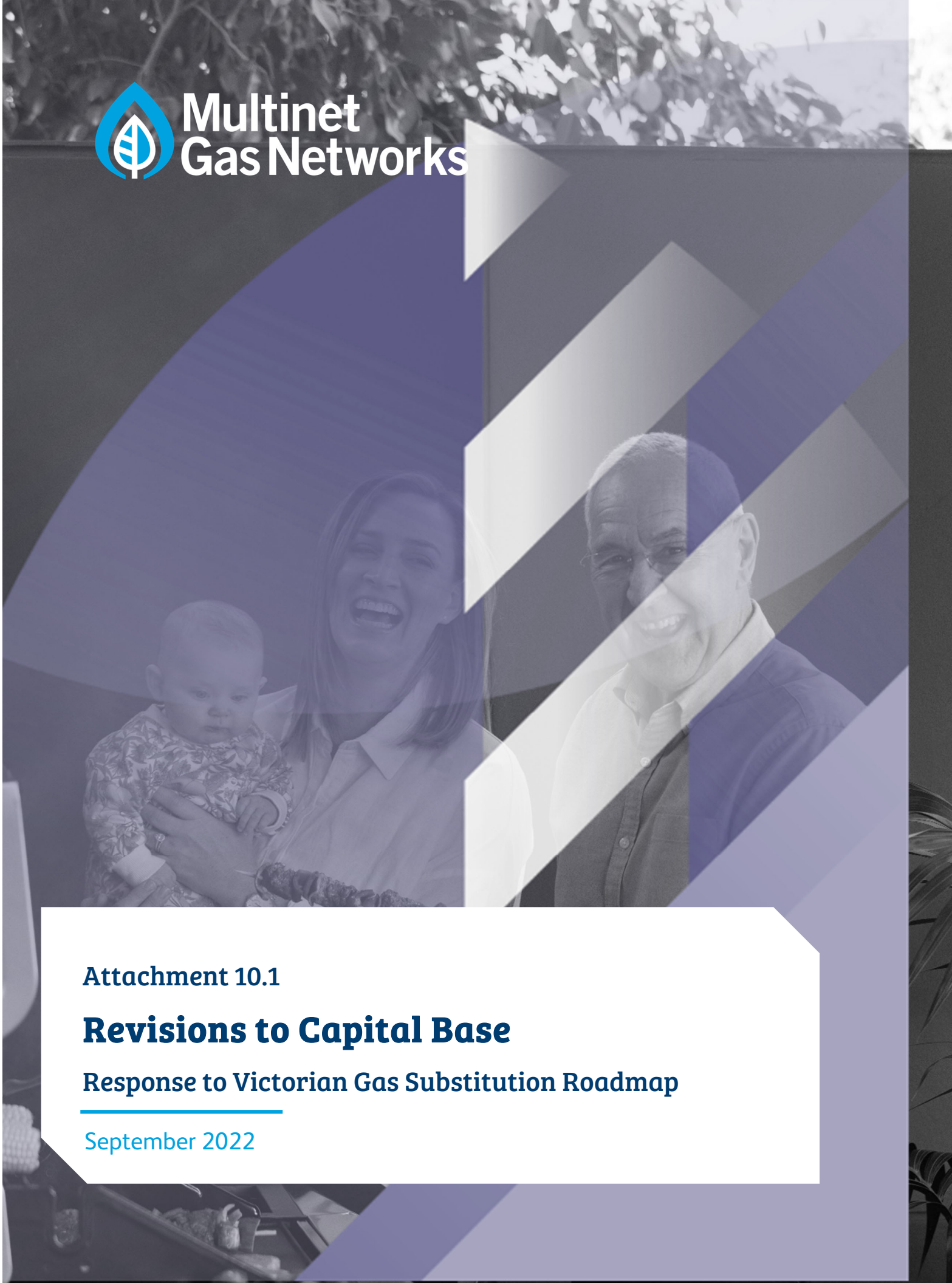

Multinet Gas Networks

Attachment 10.1

Revisions to Capital Base

Response to Victorian Gas Substitution Roadmap

September 2022

1 Revisions to our Capital Base

We have adjusted the capital base presented in our Final Plan in July 2022 to reflect revisions throughout this document in response to the Victorian Government's GSR. Our revised estimate is that the value of our capital base will grow from around $1.4 billion to $1.9 billion over the next AA period.

1.1 Capital Base at 1 July 2023

We have adjusted (or rolled-forward) our capital base to 1 July 2023 with capex, inflation and forecast depreciation over the current AA period. We have used forecast information for 2022 and the first half of 2023.

Table 10.1 shows the adjustments we have made to our capital base over the current AA period. The "funding adjustment" reflects an adjustment for the difference between the forecast and actual capex in the last year of the previous AA period (i.e. 2017). Consistent with AER practice, the adjustment reflects the return recovered by MGN that otherwise would have occurred if actual information for 2017 were available.

The closing value of the capital base forms the opening capital base for the next AA period.

We have also rolled forward the capital base for an additional 6 months to reflect the new start to the next AA period of 1 July 2023 (rather than the original date of 1 January 2023).

Table 10.1: Roll Forward of the Capital Base 1 January 2018 to 30 June 2023 ($nominal, million)

	2018	2019	2020	2021	2022	1H 2023
Opening Capital Base	1,192.9	1,252.1	1,299.6	1,332.1	1,339.9	1,397.3
Less Depreciation	62.9	66.3	70.2	72.4	77.9	32.7
Plus Conforming Capex	99.1	87.7	82.1	84.8	83.7	47.5
Plus Actual Inflation	23.1	26.0	20.7	-4.6	51.5	29.3
Less 2017 Capex Adjustments	N/A	N/A	N/A	N/A	N/A	-7.2
Less Funding Adjustment	N/A	N/A	N/A	N/A	N/A	-1.9
Closing Value	**1,252.1**	**1,299.6**	**1,332.1**	**1,339.9**	**1,397.3**	**1,432.3**

Note: Totals may not add due to rounding.

1.2 Capital Base as at 30 June 2028

This section discusses the forecast adjustments made to the capital base over the next AA period.

1.2.1 Capital Expenditure

Our revised forecast capex taking into account changes to reflect the GSR was discussed in Attachment 9.15 of this revisions to the Final Plan and is reproduced in Table 10.2, with the capex allocated to the same asset categories used to adjust our capital base. We note that the capex rolled into the capital base includes an amount equal to half a year of return in the year the capex is incurred (and is therefore not the same as our capex forecast in Attachment 9.15). The AER makes this adjustment to account for the fact that we do not earn a return on the capex within the year it was spent.

Table 10.2: Forecast Capex 2023/24 to 2027/28 ($2022/23, million)

	2023/24	2024/25	2025/26	2026/27	2027/28
Transmission and distribution	81.2	96.3	83.6	92.5	94.2
Services	19.2	16.9	15.3	13.7	11.7
Cathodic Protection	1.2	1.0	1.0	1.0	1.0
Supply Regs/Valve stations	1.6	1.2	0.9	1.1	1.4
Meters	6.6	7.2	7.4	8.9	9.7
IT	18.7	30.0	13.0	5.3	8.8
SCADA	1.3	0.9	0.9	0.9	0.8
Other	3.2	2.2	3.4	2.8	0.9
Closing Value	**135.2**	**155.7**	**125.4**	**126.1**	**128.5**

1.2.2 Forecast Depreciation

Our approach to depreciation is the outcome of work undertaken as part of the Future of Gas project, which is described in Chapter 6 of the Final Plan submitted 1 July, and Attachment 6.6 of this revision to the Final Plan. We have applied the standard approach to determining depreciation but have also sought to bring forward an amount of depreciation in recognition of Future of Gas asset stranding risks. This amount has been adjusted since the Final Plan (around $76m ($2022/23) at that time) to account for the Victorian Government's GSR and is now $86m ($2022/23).

The intent of the Future of Gas project was to identify the potential asset stranding risk under four possible future energy futures, ranging from full electrification to displacement of natural gas with renewable gas and then to determine an amount of accelerated depreciation which would enable us to deal flexibly with the consequences of a range of scenarios. While the GSR provides some additional certainty, we still need to respond to ongoing uncertainty.

The AER have identified in their information paper "Regulating gas pipelines under uncertainty" that it is appropriate for regulated gas networks to assess the future asset stranding risk arising from the

decarbonisation of the national energy supply over the coming decades, and then to apply potential remedies now which will mitigate that future risk but also provide for stable prices for customers over the long term.

We consider our approach meets this objective and is supported by our engagement on this issue. Table 10.3 shows the standard lives of each asset class and Table 10.4 shows our forecast straight-line depreciation, which includes the adjusted depreciation.

Table 10.3: Summary of Lives Used to Calculate Depreciation

Asset Category	Standard Useful Life (years)
Transmission and distribution	50
Services	50
Cathodic Protection	50
Supply Regs/Valve stations	50
Meters	15
IT	5
SCADA	15
Other	10

Table 10.4: Forecast Straight-line Depreciation, 2023/24 to 2027/28 ($nominal, million)

	2023/24	2024/25	2025/26	2026/27	2027/28
Straight-line Depreciation	90.6	92.7	99.2	106.0	110.9

1.2.3 Inflation

Forecast inflation is unchanged from the Final Plan 3.05%, and forms a critical element in determining our total revenue and pricing. As explained earlier, forecast inflation is used to adjust the capital base over the next AA period. This forecast is later updated for actual inflation when adjusting the capital base for the previous AA period.

Forecast inflation is also used in determining the total revenue that we can recover (and hence the prices we can charge). This is reflected in the methodology that the AER uses to determine our total revenue, which relies on inflation to determine the following two costs:

- Return on capital – which is calculated by multiplying a nominal rate of return by the nominal capital base determined in this section (where a nominal value includes the impact of inflation); and
- Regulatory Depreciation – which is calculated by deducting from forecast straight-line depreciation (see Table 10.5) the forecast inflation adjustment applied to the capital base.

The AER removes inflation in determining regulatory depreciation to essentially remove the additional compensation for inflation in determining the return on capital, which arises from multiplying a nominal rate of return by a nominal capital base (referred to as a double count of inflation).

The AER changed its approach to inflation in December 2020 to better reflect the way inflation operates within the context of the PTRM. We have followed this approach, and at present, it produces an estimate of 3.05%. This will be updated with the AER's Final Decision.

We have not adjusted the estimate of inflation for the purposes of this addendum to the Final Plan.

1.2.4 Forecast Regulatory Depreciation

Forecast regulatory depreciation is used to determine the total revenue that we can recover over the next AA period. This is calculated as forecast straight-line depreciation that is used to adjust the capital base less the inflation adjustment that is applied to the capital base. Table 10.5 shows forecast regulatory depreciation that is used to determine assumed total revenue for the next AA period, which as explained has been determined using the AER's preferred approaches to calculating both depreciation and inflation. We have created a new asset class called Future of Gas which will be depreciated over the next AA period, reflecting the rapid transition in the energy sector going forward. There is $86 million ($2022/23) additional depreciation proposed in the next period.

Table 10.5: Forecast Regulatory Depreciation, 2023/24 to 2027/28 ($nominal, million)

	2023/24	2024/25	2025/26	2026/27	2027/28
Straight-line Depreciation	90.6	92.7	99.2	106.0	110.9
Less Inflation	43.7	46.5	50.2	52.9	55.7
Regulatory Depreciation	**46.9**	**46.2**	**49.0**	**53.1**	**55.2**

1.2.5 Forecast Capital Base

The forecast capital base over the next AA period, taking into account forecast depreciation, capex and inflation, and as a result of revisions reflecting the Victorian Government's GSR is set out in Table 10.6. This shows a closing capital base of $1,923 million as at 30 June 2028 in nominal dollar terms.

Table 10.6: Forecast Capital Base, 2023/24 to 2027/28 ($nominal, million)

	2023/24	2024/25	2025/26	2026/27	2027/28
Opening Capital Base	1,432.3	1,526.1	1,646.9	1,736.5	1,827.0
Less Depreciation	90.6	92.7	99.2	106.0	110.9
Plus Conforming Capex	140.8	167.0	138.6	143.6	150.9
Plus Actual Inflation	43.7	46.5	50.2	52.9	55.7
Closing Value	**1,526.1**	**1,646.9**	**1,736.5**	**1,827.0**	**1,922.7**

Note: Totals may not add due to rounding.