Attachment 01.20P

Lease treatment explanation

We lease the majority of our fleet and some of our property. Historically, we treated our leases as operating expenditure (opex) by accounting for lease payments in the year in which they were incurred.

Australian Accounting Standard AASB 16 Leases recently changed. The effect of this change is that, from 1 July 2019, the full amount (over its term) of an operating or finance lease must be capitalised up-front when it is first entered into, or is renewed. From 1 July 2019, our leases will therefore be reflected on our balance sheet, recognising both an asset for the right to use the leased asset and an obligation to make lease payments over the lease term.

RIN and Modelling Treatment

Our responses to the Category Analysis, Economic Benchmarking and Regulatory Determination Regulatory Information Notices (RINs), and our associated regulatory models, treat our fleet and property leases as opex up to, and including, the 2018-19 financial year.

Our opex models for Standard Control Services (SCS) and Alternative Control Services (ACS) Metering (Attachments 12.4 and 12.5) both then make an adjustment to remove the fleet and property leases from the 2019-24 opex forecasts. This adjustment is specified in Table 1 below.

Table 1 – Lease adjustment – operating expenditure ($M, 2016-17)

	Lease Adjustment[1]
SCS	-$5.24
ACS Metering	-$0.13

The adjustment to opex includes the direct lease costs and the indirect cost of leases, which is the increased amount of capitalised overhead costs when these leases become capital expenditure (capex).

From 2019-20 onwards, fleet and property leases are treated as capex in our Regulatory Determination RIN and regulatory models, as per the forecasts outlined below, and consistent with the change in accounting treatment.

Fleet leases

Table 2 details our fleet lease capex forecast for our next regulatory period.

[1] This adjustment does not include an allocation of property leases costs for Power and Water shopfronts. These leases are held by Power and Water Corporate and Power Networks was not allocated any costs for these leases in the 2016-17 financial year. They have, however, been appropriately included in the property lease capex forecasts from 2019-20.

The adjustment also excludes the East Arm depot lease costs as it has been incorporated into the 10 per cent top down efficiency reduction.

Table 2 – Fleet lease capex forecast ($M, Real 2017-18)[2]

	2019-20	2020-21	2021-22	2022-23	2023-24	Total
Fleet lease capex	14.54	3.72	3.32	3.81	2.99	28.39

We have many small leases for our fleet – one for each of our vehicles that directly support the provision of our distribution services. In our revised forecasts, we have capitalised the remaining value of our existing fleet leases, as at 1 July 2019 in 2019-20. This, together with the leases being renewed, results in forecast capex of $14.54 million (Real 2017-18) in the first year of the period.

We expect that our fleet numbers will remain stable over the current and next regulatory periods. Consequently, at the end of a lease period, we replace a vehicle with another of a similar type. For example, a light vehicle would be replaced with another light vehicle, and a heavy truck would be replaced with another heavy truck. The replacement schedule is a condition of the leasing arrangements between PWC and NT Fleet.

For the purposes of our capex forecast, we have also assumed that the lease cost will remain constant in real terms for the duration of the regulatory control period. Because our fleet lease renewals are also spread relatively evenly over time, our capitalised lease profile is relatively stable between 2020-21 and 2023-24 (i.e. after the first year of the period, 2019-20, when all of the existing fleet leases are capitalised).

Given the above, we have removed Power Networks' fleet lease costs from our opex forecast for the next period, consistent with the term of the lease period.

Property leases

Table 3 details our property lease capex forecast for our next regulatory period.

Table 3 – Property lease capex forecast ($M, Real 2017-18)[3]

	2019-20	2020-21	2021-22	2022-23	2023-24	Total
Property lease capex	4.60	-	[redacted]	-	[redacted]	[redacted]

We have a small number of relatively large leases. Our lease costs are for:

- Leases directly related to the provision of Power Networks' distribution services, and
- An allocation of leases held by Power and Water Corporate related to services that indirectly support the provision of Power Networks' distribution services.

In our revised forecasts, we have capitalised the remaining value of our existing property leases as at 1 July 2019 in 2019-20. This results in forecast capex of $4.60 million (Real 2017-18) in the first year of the period, 2019-20. In the remaining years of the next period, the full value of each new or replacement lease entered into is recognised as capex as the present value of future lease payments.

The number of properties leased is expected to remain relatively constant over the regulatory control period for this analysis. At the end of a lease period, it is assumed the existing lease is

[2] The capital expenditure specified in this table does not align exactly with 'BNI - Vehicle Fleet Forecast' (Attachment 13.44) as only expenditure related to ACS Metering and Standard Control Services has been included in the regulatory modelling.
[3] BNI - Property Leases (Attachment 13.45).

renewed. We have also assumed that the lease cost will remain constant in real terms for the duration of the regulatory control period.

Our forecasts have removed costs associated with the East Arm Depot as a result of the upgrade of the 19 Mile Depot Project, and [redacted]. The Mitchell Centre property is used for offices for corporate staff, such as the Office of the CEO, Human Resources, Legal, and ICT, that provide essential support to the Power Networks business unit.

We have removed property lease costs from our opex forecast for the next period, consistent with the term of the lease period, with the exception of the costs associated with the East Arm depot. The East Arm depot lease costs were already incorporated into the 10 per cent top down efficiency reduction that we reflected into our opex forecast in our 31 January 2018 regulatory proposal.