Use of a weighted trailing average

Hird presentation to expert conclave

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What should the AER attempt to do?

Recapping from my previous slides, the AER must made two decisions in relation to the cost of debt allowance.

Decision 1: Define an efficient benchmark debt strategy.

Decision 2: Determine a method for accurately estimating the cost to NSPs of implementing that efficient benchmark debt strategy.

Whether the trailing average should be weighted or unweighted (or, indeed, whether an "on-the-day" estimate should be used instead) is an element of "Decision 1" from my earlier slides.

Implications for trailing average

I consider that a trailing average should be used (be it weighted or unweighted). This is because I consider that:

- The objective is to define an efficient (which requires, at a minimum, replicability by an NSP) debt management strategy; and

- The efficient debt funding strategy of any large infrastructure company – including NSPs is to have a staggered debt issuance/maturity profile.

I am agnostic about the adoption of weighted trailing average.

Whether this is appropriate will depend, as the AER recognises, on:

- the extent to which a weighted trailing average better reflects an efficient debt funding strategy in the face of lumpy capex; and

- whether the additional complexity is justified by any additional accuracy.

Why do Professor Partington and I differ

Professor Partington's proposal is to set the cost of debt allowance 'as if' all debt were being refinanced at rates available at the beginning of the regulatory period.

We differ because we adopt different versions of the NPV=0 requirement.

- My approach is based on the objective to setting the NPV=0 for returns to existing equity investors - given an efficient debt management strategy undertaken by those equity investors.

- Professor Partington's approach is to set the NPV=0 for returns to hypothetical equity investors who have not yet incurred any debt obligations.