

The cost of arranging debt issues

A report for Jemena Gas Network

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Prepared by:

Dr Tom Hird

Samuel Lam

Prepared for:

Jemena Gas Network

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1 Introduction

1. We have been asked by Jemena to provide advice and describe our methodology in estimating the debt raising costs for JGN for the determination period 2026-31.
2. This report is divided into the following sections:
 - a. Section 2 describes our method for arriving to a total debt raising cost of:
 - i. 8.23 basis points per annum (bppa) based on an arrangement fee that is used in AER's most recent decisions;
 - ii. 8.55 bppa based on an arrangement fee that is updated under the AER's stated methodology using Bloomberg.
 - b. Section 3 highlights the omission of the issue price discount as being highly conservative to the total debt raising cost.

2 AER's current methodology in estimating debt raising cost

3. In the most recent decisions, finalised on 30 April 2024, the AER maintained its previous approach in estimating debt raising cost for DNSPs.¹ In summary, the AER stated that:

In arriving at this decision, we [The AER] apply the approach from our final decision for SA Power Networks. That is, we use updated Bloomberg data to inform the 'arrangement fee' component of debt raising costs and Chairmont's updated estimates [in 2019] for the remaining components.
4. Based on the stated methodology, we estimate that the debt raising cost to be between
 - a. 8.23 bppa, including an upfront arrangement fee of 49.0 bp estimated by back solving from the AER's most recent decisions, and;
 - b. 8.55 bppa, with total arrangement fee of 51.4 bp by updating the Bloomberg data based on AER's stated methodology.
5. The above estimates do not include any allowance for the cost to the issuer of discounting the issue price relative to market value of the bond. Including the issue price discount would add 5.1bppa to the total debt raising costs – as discussed in section 3.
6. Our debt raising cost estimates uses inputs for the value of the RAB and WACC that were provided by JGN.
 - a. JGN's opening nominal RAB in 2025-26: \$3,978.3 million;
 - b. JGN's nominal vanilla WACC in 2025-26: 5.39%.
7. Other assumptions that are consistent with AER's stated methodology:³
 - a. Gearing: 60%;

¹ For example, the 2024–29 determinations for Ausgrid, Endeavour Energy, Evoenergy and Essential Energy, <https://www.aer.gov.au/industry/registers/determinations>, 30 April 2024 (The recent decisions).

² AER, Draft Decision Ausgrid Electricity distribution Determination 2024–29 – Attachment 3 Rate of return, September 2023.

³ We follow the steps described in the PwC 2013 report. PricewaterhouseCoopers, Energy Networks Association: Debt financing costs, June 2013 (PwC 2013 report).

- b. \$250 million per instrument;
 - i. Hence, a total of 10 instruments are needed ($\$3,978.3\text{m} \times 60\% / \250m).
- c. Upfront costs amortised over 10 years.

2.1 Direct non-arrangement fee costs

8. The table below summarises the direct non-arrangement fee costs for JGN in bppa using the mid-point of Chairmont's estimated range⁴, consistent with AER's stated methodology.

Table 2-1: Direct non-arrangement fee costs in bppa for JGN

	Chairmont's estimated range	Chairmont's Mid-point	In bppa for JGN
Legal Counsel - Master Program	\$70-\$150k	\$110,000	0.06
Legal Counsel - Fees for the Issuer (Dealer Counsel)	\$10-\$50k	\$30,000	0.16
Credit Rating - Initial Credit Rating	\$70-\$100k	\$85,000	0.04
Credit Rating - Annual Surveillance	\$10-\$20k	\$15,000	0.06
Credit Rating - Up front bond issue fee	5-10 bp	7.5 bp	0.99
Registrar - Upfront fees	\$6-\$20k	\$13,000	0.01
Registrar - Annual fee	\$6-\$7k	\$6,500	0.26
Agents' Out-of-pocket fees	\$20-\$50k	\$35,000	0.18
Total direct non-arrangement fee costs			1.76

Source: The Chairmont report, CEG analysis.

9. The total direct non-arrangement fee cost for JGN is 1.76 bppa.

2.2 Arrangement fee estimates

10. In all of its recent decisions, the AER has stated that:⁵

We [The AER] have updated the 'arrangement fee' using Bloomberg data and the selection criteria consistent with the PwC report.

11. However, the AER has not published any exact numbers or analysis on the arrangement fees they have used. Therefore, the below section provides calculation by:
- a. Back solving the arrangement fees based on AER's most recent decisions, and
 - b. Updating the arrangement fees based on the PwC 2013 report.

⁴ Chairmont, Debt raising costs, 29 June 2019 (The Chairmont report).

⁵ The recent decisions.

2.2.1 Back solving the arrangement fees based on AER's most recent decisions

12. The AER provides for each DNSP the exact debt raising cost figure with decimal places in their respective PTRM models. Therefore, together with each DNSP's RAB and WACC, we are able to back solve the implied arrangement fees the AER used for each DNSP.
13. For example, the 2024-29 determination for Ausgrid has debt raising cost of 8.31 bppa. With an opening RAB of \$19,136 million and a WACC of 5.95%, this equates to a total of 1.67 bppa in total direct non-arrangement fee cost. This implies that the arrangement fee in the determination for Ausgrid is 6.64 bppa or 49.0 bp (i.e., unamortised).
14. For reference, we have back solved the arrangement fees for four DNSPs published in April 2024, two in April 2023 and also the current arrangement fee for Jemena in the current determination.
 - a. Ausgrid Determination 2024-29 (published in April 2024);
 - b. Endeavour Determination 2024-29 (published in April 2024);
 - c. Essential Energy Determination 2024-29 (published in April 2024);
 - d. Evoenergy Determination 2024-29 (published in April 2024);
 - e. TransGrid Determination 2023-28 (published in April 2023);
 - f. ElectraNet Determination 2023-28 (published in April 2023), and;
 - g. Jemena Determination 2021-26 (published in April 2021).
15. All seven determinations resulted in a 49.0 bp total unamortised arrangement fees, which is equivalent to 6.47 bppa for JGN in the upcoming determination.
16. Therefore, together with a direct non-arrangement fee cost of 1.76 bppa, the total debt raising cost for JGN is 8.23 bppa.

2.2.2 Updating the arrangement fees based on AER's stated methodology

17. Based on the analysis from the previous section, it is unclear whether the AER has attempted to update the arrangement fee using Bloomberg data.⁶
18. The table below shows the summary of the eligible instruments obtained from Bloomberg between 2019 and 2024, based on the criteria listed in the PwC 2013 report, we exclude bonds that are:⁷
 - *Issued by financial institutions because they operate in a specific market separate to the corporate bond market;*
 - *Not investment grade;*
 - *Not identified by a credit rating from Standard & Poor's;*
 - *Convertible bonds, because they have equity-like characteristics, and therefore have an issuance cost structure that closely resembles equity issuance; and*
 - *Not making issuance cost data publicly available.*

⁶ The arrangement fee has stayed the same since at least 2021.

⁷ PwC 2013 report, pp.14-15.

Table 2-2: Summary of bonds issued between 2019 and 2024

Summary by company	No. of instruments	Average Tenor	Amount Issued per bond (AUD\$M)	Unamortised arrangement fee (bp)	Average bppa
Optus Finance Pty Ltd	1	10.0	\$921	35	4.63
Wesfarmers Ltd	1	12.0	\$1,087	38	4.32
Rio Tinto Finance USA Ltd	1	30.0	\$1,683	88	5.95
BHP Billiton Finance USA Ltd	8	9.1	\$1,442	42	7.46
Average	2.8	11.4	\$1,384	45	6.78

Source: Bloomberg, CEG analysis. Note that the averages are simple average of all instruments, hence, weighted average by number of instruments for each company in this table.

19. As shown in the table above, the average unamortised arrangement fee is 45 bp. However, each instrument should be adjusted for its tenor to obtain their respective bppa. After adjusting for the tenor, the average amortised arrangement fee is 6.78 bppa, which is equivalent to an unamortised arrangement fee of 51.4 bp.
20. This is 0.31 bppa (amortised) or 2.4 bp (unamortised) higher than the AER's most recent decisions. Therefore, together with a direct non-arrangement fee cost of 1.76 bppa, the total debt raising cost for JGN is 8.55 bppa.
21. If we use a WACC of 10%, consistent with what the PwC 2013 report used, the arrangement fee would be 8.3 bppa, 0.2bppa below PwC's estimate of 8.5 bppa.

3 AER precedent to reject issue price discount component is highly conservative

22. When issuing new bonds, arrangers or underwriters often discount the issue price of the bonds relative to the market price as a form of compensation paid by the issuer to the arranger.
23. The AER has not previously considered the issue price discount as a direct cost to raising debt. It is however noted that the AER precedent to omit the issue price discount component is highly conservative to the total debt raising cost.
24. Our analysis of the issue price discount is described in more detail in one of our previous reports. In summary, we estimated an average issue price discount of 39 bp (unamortised) or 5.1 bppa (amortised) uplift to the debt raising cost.⁸
25. One of our key analyses in the report is the illustration of a strong negative relationship between direct arrangement fee and issue price discount:⁹

...there is a clear negative relationship between the arrangement fee and the issue price discount. Most of these bonds are issued with tenor of 3 to 7 years (104 bonds). When I restrict the sample to these tenors the strong negative relationship remains (demonstrating that it is not an artefact of

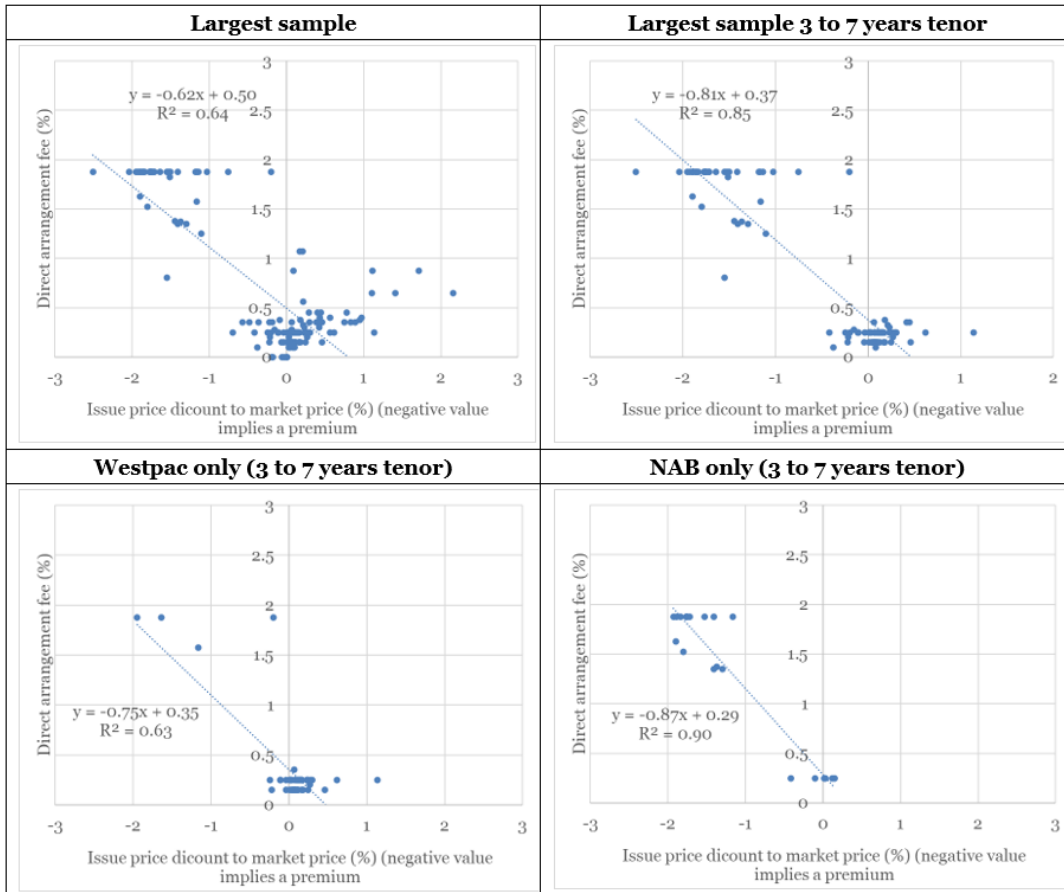
⁸ CEG submission to the AER commissioned by ATCO, Debt arranging and liquidity management costs, April 2022 (CEG 2022 report).

⁹ CEG 2022 report, pp. 18-19.

different tenors in the sample). The two largest issuers in this restricted tenor sample are Westpac (50 bonds) and NAB (21 bonds). When I restrict the sample further to only examine Westpac or NAB bonds the strong negative relationship remains (demonstrating that the negative relationship is not an artefact of different issuers or tenors in the sample).

Figure 3-1: Reproduction of figure 3 of CEG 2022 report

Figure 3: Arrangement fee vs issue price discount for various samples.



Source: Bloomberg and CEG analysis