Final decision

AusNet Gas Services
Gas distribution access arrangement
1 July 2023 to 30 June 2028

Attachment 2 – Capital base

June 2023

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2 Capital base

The capital base roll forward accounts for the value of AusNet's distribution network over the access arrangement period. The opening capital base value for a regulatory year within the access arrangement period is rolled forward by indexing it for inflation, adding any conforming capital expenditure (capex), and subtracting depreciation and other possible factors (for example, disposals or capital contributions).[1] Following this process, we arrive at a closing value of the capital base at the end of the relevant year. The opening value of the capital base is used to determine the return of capital (regulatory depreciation) and return on capital building blocks.

This attachment sets out our final decision on the AusNet's opening capital base as at 1 July 2023 for the 2023–28 access arrangement period (2023–28 period). It also sets out our final decision on AusNet's projected capital base over the 2023–28 period.

2.1 Final decision

Opening capital base as at 1 July 2023

Our final decision approves an opening capital base value of $1868.2 million ($nominal) as at 1 July 2023 for AusNet. This value is $2.8 million (0.2%) higher than the revised proposed value of $1865.3 million ($ nominal).[2] It reflects our updates to the roll forward model (RFM) capex estimates for 2022 which are higher than the amount in AusNet's revised proposal, reflecting more recent data.[3] This final decision is also $2.8 million (0.2%) higher than our draft decision value for AusNet's opening capital base value of $1865.3 million ($ nominal).[4]

To determine the opening capital base as at 1 July 2023, we have rolled forward the capital base over the 2018–23 period from 1 January 2018 to 31 December 2022. We then rolled forward the closing capital base value by a further six months to arrive at a closing capital base value at 30 June 2023 (the six-month extension period) [5] in accordance with our RFM. This roll forward process includes an adjustment at the end of the 2018–22 period to account for the difference between actual 2017 capex and the estimate approved in the 2018–22 access arrangement.[6]

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1 The term 'rolled forward' means the process of carrying over the value of the capital base from one regulatory year to the next.

2 AusNet, *ASG – GAAR 2024-28 RFM*, 24 January 2023.

3 AusNet, *Response to information request #028*, 15 March 2023.

4 This is also driven by the update to the capex estimate for 2022 in the final decision as AusNet's revised proposal accepted our draft decision opening capital base.

5 The six-month extension period reflects the decision by the Victorian Government to change the timing of the annual Victorian gas network price changes to a financial year basis from a calendar year basis. This change means the current access arrangement period of 2018–22 is extended by six months and the next access arrangement period will commence on 1 July 2023.

6 The end of period adjustment will be positive (negative) if actual capex is higher (lower) than the estimate approved at the 2018–22 decision; NGR, r. 77(2)(a).

In the draft decision, we determined an opening capital base of $1865.3 million ($ nominal) as at 1 July 2023 for AusNet. Our draft decision made the following changes to AusNet's proposed RFM for calculating the opening capital base as at 1 July 2023:[7]

- Amended the capex related to leases for 2019–21 to reflect our approach to mid-period changes in accounting standards.
- Included Software as a Service related costs as 2021–23 capex to reflect our approach to mid-period changes in accounting standards.
- Updated the inputs for expected inflation, nominal weighted average cost of capital (WACC) and forecast depreciation for the six-month extension period to be consistent with the final decision post-tax revenue model (PTRM) for that period.

Our draft decision also amended the following RFM inputs associated with the proposed accelerated depreciation, which did not affect the total opening capital base value:

- Removed the proposed new 'Transmission pipelines – post 1998', 'Distribution pipelines – post 1998' and 'Service pipes – post 1998' asset classes. These asset classes were used to implement the lives component associated with AusNet's proposed accelerated depreciation due to the uncertain future of gas. This component reflected the proposed recovery of accelerated depreciation by reducing the relevant asset classes' standard economic lives from 60 to 50 years.[8]
- For the proposed new 'Accelerated depreciation – Future of gas' asset class we updated the final year asset adjustment capital base reallocation amount to $92.7 million ($ nominal) as at 1 July 2023 resulting in a reduced accelerated depreciation amount of $83 million ($2022–23).[9]

Further, our draft decision noted that the capex for 2022 and the six-month extension period were estimates. We expected AusNet to update these inputs in its revised proposal.

In its revised proposal, AusNet adopted most of our draft decision amendments. However, AusNet has reintroduced the 50 year standard life asset classes of 'Transmission Pipelines - post June 2023', 'Distribution Pipelines - post June 2023' and 'Service Pipes - post June 2023' for the new (2023–28 forecast capex) mains and services pipelines assets.[10] AusNet also amended the final year asset adjustment capital base reallocation amount to $228.5 million ($ nominal)[11] to target the proposed accelerated depreciation amount of $200 million

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7 AER, *Draft decision, AusNet Gas Services Access Arrangement 2023–28, Attachment 2 – Capital base, December 2022*, pp. 8–9.

8 For a given accelerated depreciation amount, this change does not affect the total value of the opening capital asset base at 1 July 2023 as any reduction in accelerated depreciation due to the removal of these asset classes is to be rebalanced in the 'Accelerated depreciation – Future of gas' asset class.

9 This is a capital base reallocation and does not affect the total value of the opening capital asset base at 1 July 2023. Note the asset adjustment value of $92.7 million will not match the draft decision accelerated depreciation amount of $83 million over the 2023–28 period due to asset adjustment offsets in the RFM depreciation tracking module.

10 These asset classes serve the same purpose to the asset classes of 'Transmission pipelines – post 1998', 'Distribution pipelines – post 1998' and 'Service pipes – post 1998' that were introduced in the initial proposal, under different year labels.

11 This reflects the 'Accelerated depreciation – Future of gas' final year asset adjustment value.

($2022–23), consistent with its initial proposal. AusNet's revised proposal did not make any updates to the capex estimates for 2022 and the six-month extension period.

In its response to our information request, AusNet provided us with its revised capex estimate for 2022. AusNet's revised capex estimate for 2022 is higher than the amount approved in our draft decision and its revised proposal for this period, whereas no updates were made to the capex for the six-month extension period.[12] This results in our final decision opening capital base to be $1868.2 million, which is $2.8 million (0.2%) higher than our draft decision and AusNet's revised proposal.

We have assessed AusNet's revision to its capex estimate for 2022. Our final decision is to accept this capex estimate as it is more up to date compared to the estimate adopted in the draft decision.

For the reasons discussed in Attachment 4, our final decision is to not accept the introduction of the new 50 year mains and services pipelines asset classes for accelerated depreciation purposes. We also do not accept AusNet's proposed amount of accelerated depreciation.

We have therefore amended the inputs associated with the proposed accelerated depreciation in the RFM resulting in a reduced accelerated depreciation amount of $105 million ($2022–23).[13] These input changes do not affect the total opening capital base value. Our final decision on accelerated depreciation is set out in Attachment 4:

- For the existing 'Cathodic protection' and new 'Cathodic protection - post 1998' asset classes, our final decision made minor updates to the final year asset adjustment capital base reallocation amounts and remaining asset lives to reflect the revised 2022 capex estimate.[14] This component reflects recovery of accelerated depreciation by reducing the cathodic protection asset classes' standard asset lives to 50 years from 60 years.
- For the 'Distribution pipelines' and 'Service pipes' asset classes our final decision also made minor updates to the remaining asset lives to reflect the revised 2022 capex estimate. Further, we have updated the final year asset adjustment capital base reallocation amounts and the associated new 'Accelerated depreciation – Future of gas' asset class to reflect our final decision accelerated depreciation amount of $105 million ($2022–23).[15]

For the reasons discussed in Attachment 5, we accept AusNet's proposed actual capex for 2018–2021 as conforming capex during the 2018–23 period. As the capex for 2022 and the six-month extension period are estimates, we will assess whether actual capex is conforming for these years in the subsequent (2028–33) access arrangement review and adjust for any

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12 AusNet's higher revised 2022 capex estimate is net of customer contributions and disposals. AusNet, *Response to information request #028*, 15 March 2023.

13 This accelerated depreciation relates to future of gas uncertainty and the risk of network stranding.

14 This reflects our updates for the revised 2022 capex estimate in AusNet's accelerated depreciation calculation spreadsheet. AusNet, *Response to information request #025,* 21 February 2023.

15 This is a capital base reallocation and does not affect the total value of the opening capital asset base at 1 July 2023. Note the 'Accelerated depreciation – Future of gas' final year asset adjustment value of $117.2 million will not match the final decision accelerated depreciation amount of $105 million over the 2023–28 period due to asset adjustment offsets in the RFM depreciation tracking module.

differences between actual and estimated capex.[16] With the revision to the 2022 capex, we consider that conforming capex has been properly accounted for in the capital base roll forward, consistent with the requirements of the NGR.[17]

Table 2-1 sets out our final decision on the roll forward of AusNet's capital base during the 2018–23 period to determine the opening capital base as at 1 July 2023.

Table 2-1 AER's final decision on AusNet's capital base for the 2018–23 period ($ million, nominal)

	2018	2019	2020	2021	2022[a]	2023[b]
Opening capital base	1562.7	1611.6	1671.8	1717.4	1735.2	1808.7
Net capex[c]	98.1	97.0	93.2	101.0	92.6	54.4
Indexation of capital base	30.2	33.5	26.6	–6.0[f]	66.7	38.1
Less: straight-line depreciation[d]	79.4	70.3	74.3	77.2	84.1	38.3
Interim closing capital base	1611.6	1671.8	1717.4	1735.2	1810.5	1862.8
Difference between estimated and actual capex in 2017					–1.4	
Return on difference for 2017 capex					–0.4	
Closing capital base as at 30 December 2022					1808.7	
Final year asset adjustment[e]						5.3
Closing capital base as at 30 June 2023						**1868.2**

Source: AER analysis.

(a) Based on estimated capex. We expect to true-up the capital base for actual capex at the next review.

(b) The six-month extension period of 1 January to 30 June 2023. Based on estimated capex. We expect to true-up the capital base for actual capex at the next review.

(c) Net of disposals and capital contributions, and adjusted for actual consumer price index (CPI) and half-year WACC.

(d) Adjusted for actual CPI. Based on forecast capex.

(e) Includes the addition of capitalised leases as at 30 June 2023.

(f) A negative indexation of the capital base was due to the annual CPI rate of –0.35% (based on June 2020 quarter) published by the Australian Bureau of Statistics.

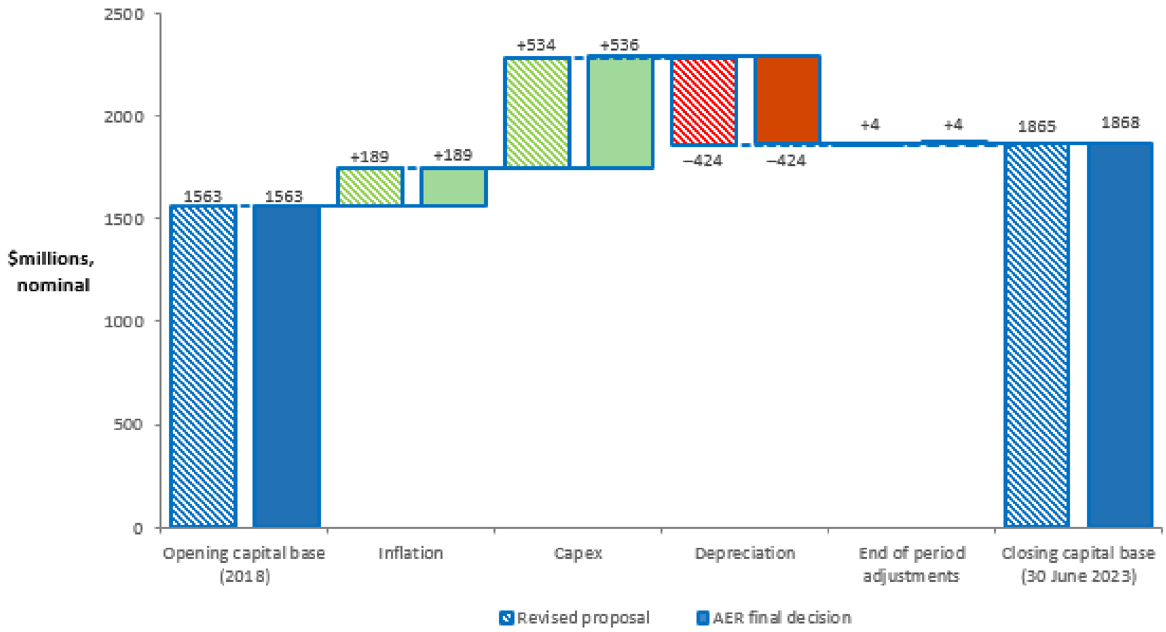
Figure 2-1 shows the key drivers of the change in the value of AusNet's capital base over the 2018–23 period for this final decision. Overall, the closing capital base at the end of the 2018–23 period is 19.5% higher than the opening capital base at the start of that period, in

16 NGR, rr. 77(2)(b), 79(1).

17 NGR, rr. 77(2)(b), 79(1).

nominal terms. The net capex increases the capital base by 34.3%, while inflation indexation increases it by 12.1%. Depreciation,[18] on the other hand, reduces the capital base by 27.1%.

Figure 2-1 Key drivers of changes in the capital base over the 2018–23 period—AusNet's revised proposal compared with AER's final decision ($ million, nominal)



Source: AER analysis.

Note: Capex is net of disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the RFM.

Forecast closing capital base as at 30 June 2028

We approve a forecast closing capital base value of $2055.7 million ($nominal) as at 30 June 2028 for AusNet.[19] This is $80.7 million (or 4.1%) higher than the $1975.1 million ($nominal) in AusNet's revised proposal. This increase is mainly due to the reduction to AusNet's proposed forecast straight-line depreciation resulting from our final decision to reduce AusNet's proposed accelerated depreciation amount which more than offsets the lower expected inflation rate applied in our final decision.[20] Our final decision on the projected closing capital base reflects our final decisions to the opening capital base as at 1 July 2023, forecast capex (attachment 5) [21], expected inflation (attachment 3) and forecast depreciation (attachment 4).

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18 This refers to straight-line depreciation. Regulatory depreciation is straight-line depreciation less the inflation indexation of the capital base.

19 NGR, r. 78.

20 Regulatory depreciation is the net total of straight-line depreciation and inflation indexation of the capital base.

21 Our final decision accepts AusNet's revised proposed forecast capex subject to updated WACC and inflation figures.

Table 2-2 sets out our final decision on the projected roll forward of the capital base for AusNet over the 2023–28 period.

Table 2-2 AER's final decision on AusNet's capital base for the 2023–28 period ($ million, nominal)

	2023–24	2024–25	2025–26	2026–27	2027–28
Opening capital base	1868.2	1931.0	1993.4	2039.6	2058.9
Net capex[a]	110.4	109.9	100.9	82.0	65.7
Indexation of capital base	54.5	56.4	58.2	59.5	60.1
Less: straight-line depreciation	102.1	103.9	112.9	122.2	129.0
Closing capital base	**1931.0**	**1993.4**	**2039.6**	**2058.9**	**2055.7**

Source: AER analysis.

(a) Net of forecast disposals and capital contributions. In accordance with the timing assumptions of the PTRM, the capex includes a half-year WACC allowance to compensate for a six-month period before capex is added to the capital base for revenue modelling.

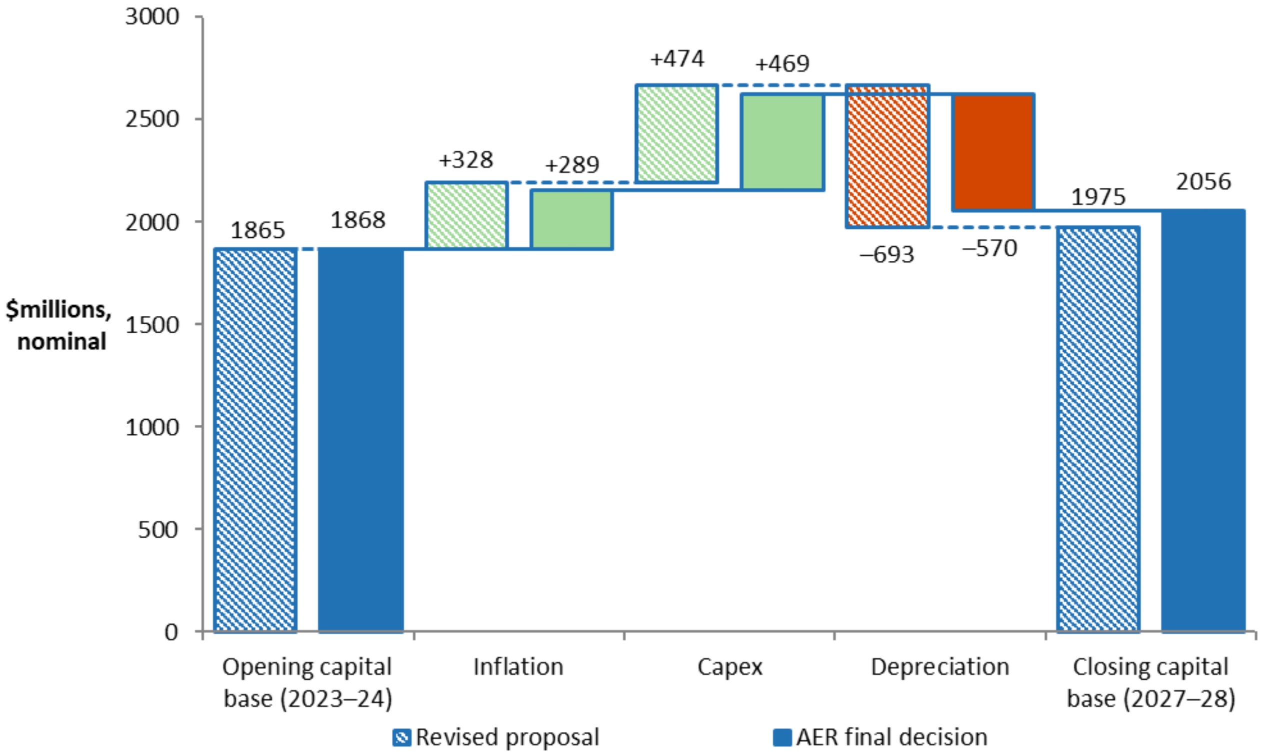
For this final decision, we confirm our draft decision position that the opening capital base as at 1 July 2028 is to be established using the approved depreciation schedules (straight–line) based on forecast capex at the asset class level.[22]

Figure 2-2 shows the key drivers of the change in AusNet's projected capital base over the 2023–28 period for this final decision. Overall, the closing capital base at the end of the 2023–28 period is forecast to be 10.0% higher than the opening capital base at the start of that period, in nominal terms. The approved forecast net capex increases the capital base by 25.1%, while expected inflation increases it by 15.5%. Forecast depreciation,[23] on the other hand, reduces the capital base by 30.5%.

22 NGR, r. 90.

23 This refers to straight-line depreciation. Regulatory depreciation is straight-line depreciation less the inflation indexation of the capital base.

Figure 2-2 Key drivers of changes in the capital base over the 2023–28 period—AusNet's revised proposal compared with AER's final decision ($ million, nominal)



Source: AER analysis.

Note: Capex is net of forecast disposals and capital contributions. It is inclusive of the half-year WACC to account for the timing assumptions in the RFM. Our final decision accepts AusNet's revised proposed forecast capex, the difference shown reflects updated WACC and inflation figures.

AusNet's revised proposed forecast straight-line depreciation for the 2023–28 period is $692.8 million ($nominal). The depreciation amount largely depends on the proposed level of accelerated depreciation and the opening capital base. The opening capital base, in turn, depends on capex in the past. Depreciation associated with forecast capex is a relatively smaller amount. For this final decision, while we accept AusNet's proposal for accelerated depreciation, we have reduced the proposed amount and this is discussed in Attachment 4.

Forecast net capex is a significant driver of the increase in the capital base. In this final decision, we also accept AusNet's revised proposed total net capex for the 2023–28 period of $469.0 million ($nominal).[24] Our review of AusNet's forecast capex is set out in Attachment 5 of this final decision.

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24 This amount is net of asset disposals and capital contributions, and inclusive of half-year WACC adjustment. It also reflects our final decision on expected inflation and WACC.

2.2 Assessment approach

We have not changed our assessment approach to the capital base from our draft decision. Attachment 2 (section 2.3) of our draft decision details that approach.[25]

[25] AER, *Draft decision, AusNet Gas Services Access Arrangement 2023–28, Attachment 2 – Capital base, December 2022*, pp. 5–8.

Glossary

Term	Definition
AusNet	AusNet Gas Services
Capex	Capital expenditure
CPI	Consumer price index
NGR	National Gas Rules
PTRM	Post-tax revenue model
RFM	Roll forward model
WACC	Weighted average cost of capital