Final decision

Multinet Gas Networks
Gas distribution access arrangement
1 July 2023 to 30 June 2028

Attachment 2 – Capital base

June 2023

AUSTRALIAN
ENERGY
REGULATOR

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2 Capital base

The capital base roll forward accounts for the value of MGN'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 MGN'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 MGN's projected capital base over the 2023–28 period.

2.1 Final decision

Opening capital base as at 1 July 2023

Our final decision is to accept MGN's revised proposal and approve an opening capital base value of $1416.2 million ($ nominal) as at 1 July 2023.[2] This final decision is $16.0 million (1.1%) lower than our draft decision value for MGN's opening capital base value of $1432.3 million ($ nominal).[3]

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)[4] in accordance with our roll forward model (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.[5]

In the draft decision, we determined an opening capital base of $1432.3 million ($ nominal) as at 1 July 2023 for MGN. Our draft decision made the following changes to MGN's proposed RFM for calculating the opening capital base as at 1 July 2023:[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 MGN, *Revised Final Plan 2023-28_Attachment 1.6B_Roll Forward Model*, 24 January 2023.

3 This is driven by updates to the capex estimates for 2022 and the six-month extension period in MGN's revised proposal, which we accept in our final decision.

4 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.

5 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).

6 AER, *Draft decision, Multinet Gas Networks Access Arrangement 2023–28, Attachment 2 – Capital base,* December 2022, pp. 13–14.

- Amended the 2017 forecast regulatory depreciation for the opening capital base associated with that year to be consistent with the current 2018–22 access arrangement RFM.
- Amended the forecast straight-line depreciation inputs for years 2020 to 2022 to be consistent with the 2018–22 post-tax revenue model (PTRM) updated for the most recent 2022 return on debt update.
- Updated the inputs for actual and 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 PTRM for that period.
- Updated forecast depreciation for the six-month extension period to be consistent with our final decision PTRM for that period.

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

- For the proposed new ‘Accelerated depreciation – Future of gas’ asset class we updated the final year asset adjustment capital base reallocation amount to $64.2 million ($ nominal) as at 1 July 2023 to target a reduced accelerated depreciation amount of $55 million ($2022–23).[7]
- For the proposed accelerated depreciation for its mains replacement program, we updated MGN’s modelling approach to reallocate the residual closing capital base value as at 30 June 2023 from the existing low pressure mains and services asset classes to two new asset classes of ‘LP mains – residual – 2030-31’ and ‘LP services – residual – 2030-31’.

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

In its revised proposal, MGN adopted all of our draft decision amendments. MGN’s revised proposed opening capital base is $1416.2 million.[8] This is $16.0 million (1.1%) lower than our draft decision. The decrease is due to MGN’s revised capex estimates for 2022 and the six-month extension period being lower than the amount approved in our draft decision, reflecting more recent data. MGN also amended the final year asset adjustment capital base reallocation amount to $100.1 million ($ nominal) to target the accelerated depreciation amount of $86 million ($2022–23), consistent with its initial proposal.

For the reasons discussed in Attachment 4, our final decision is to not accept MGN’s proposed amount of accelerated depreciation. We have therefore amended the final year

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7 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 $64.2 million will not match the target accelerated depreciation amount of $55 million over the 2023–28 period due to asset adjustment offsets in the RFM depreciation tracking module. We have also amended MGN’s proposed remaining asset life for this asset adjustment.

8 MGN, *Revised Final Plan 2023-28_Attachment 1.5B_Post Tax Revenue Model*, 24 January 2023.

asset adjustment capital base reallocation amount to $62.2 million ($ nominal) as at 1 July 2023 to target a reduced accelerated depreciation amount of $53 million ($2022–23).[9]

We have assessed MGN's revisions to its capex estimates for 2022 and the six-month extension period. Our final decision is to accept these capex estimates as they are more up to date compared to the estimates adopted in the draft decision.

For the reasons discussed in Attachment 5, we accept MGN’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 differences between actual and estimated capex.[10] With the revisions to the 2022 and the six-month extension period capex, we consider that conforming capex has been properly accounted for in the capital base roll forward, consistent with the requirements of the NGR.[11]

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

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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 $62.2 million will not match the target accelerated depreciation amount of $53 million over the 2023–28 period due to asset adjustment offsets in the RFM depreciation tracking module. We have also amended MGN’s proposed remaining asset life for this asset adjustment.

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

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

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

	2018	2019	2020	2021	2022[a]	2023[b]
Opening capital base	1192.9	1252.1	1299.6	1332.1	1339.9	1376.4
Net capex[c]	99.1	87.7	82.1	84.8	71.8	43.4
Indexation of capital base	23.1	26.0	20.7	–4.6[e]	51.5	29.0
Less: straight-line depreciation[d]	62.9	66.3	70.2	72.4	77.8	32.6
Interim closing capital base	1252.1	1299.6	1332.1	1339.9	1385.4	1416.2
Difference between estimated and actual capex in 2017					–7.0	
Return on difference for 2017 capex					–1.9	
Closing capital base as at 30 December 2022					1376.4	
Closing capital base as at 30 June 2023						**1416.2**

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.

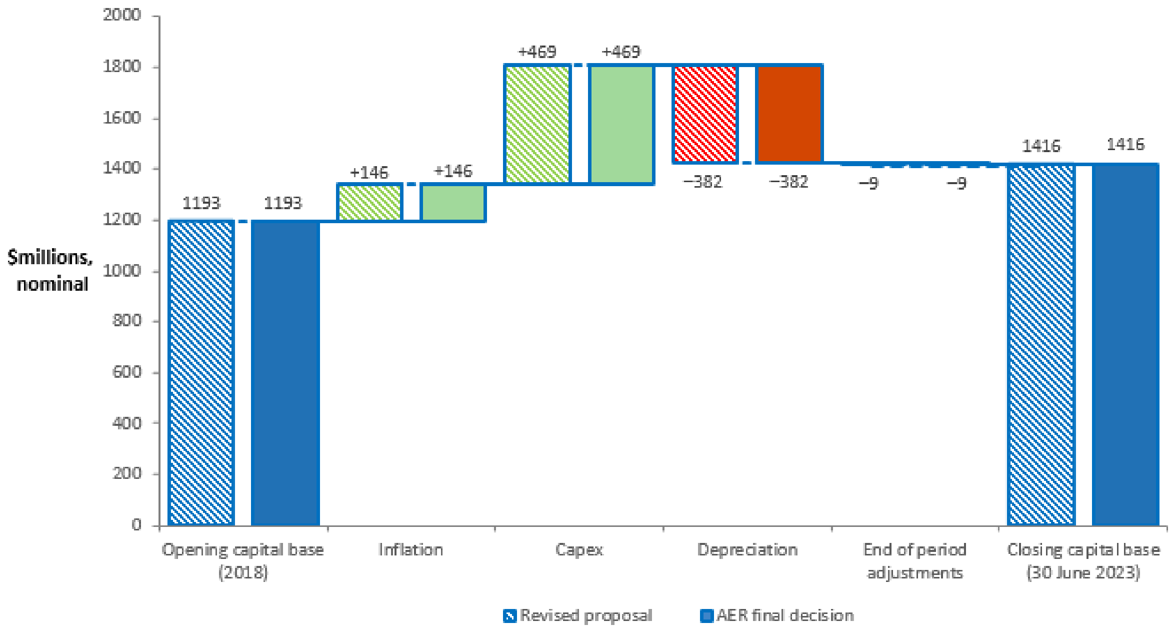
(d) Adjusted for actual CPI. Based on forecast capex.

(e) 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 MGN'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 18.7% higher than the opening capital base at the start of that period, in nominal terms. The net capex increases the capital base by 39.3%, while inflation indexation increases it by 12.2%. Depreciation,[12] on the other hand, reduces the capital base by 32.0%.

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

Figure 2-1 Key drivers of changes in the capital base over the 2018–23 period—MGN'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 $1931.0 million ($nominal) as at 30 June 2028 for MGN.[13] This is $2.5 million (or 0.1%) lower than the $1933.5 million ($nominal) in MGN's revised proposal. This decrease is mainly due to the lower expected inflation rate applied in our final decision which more than offsets the reduction to MGN's proposed forecast straight-line depreciation resulting from our final decision to reduce MGN's proposed accelerated depreciation amount.[14] Our final decision on the projected closing capital base reflects our final decisions to the opening capital base as at 1 July 2023,[15] forecast capex (attachment 5)[16], expected inflation (attachment 3) and forecast depreciation (attachment 4).

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

13 NGR, r. 78.

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

15 Our final decision is to accept MGN's revised proposal opening capital base value as at 1 July 2023.

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

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

	2023–24	2024–25	2025–26	2026–27	2027–28
Opening capital base	1416.2	1516.1	1643.7	1737.2	1831.5
Net capex[a]	140.5	167.0	138.6	143.4	150.6
Indexation of capital base	41.3	44.3	48.0	50.7	53.5
Less: straight-line depreciation	81.9	83.8	93.0	99.8	104.6
Closing capital base	**1516.1**	**1643.7**	**1737.2**	**1831.5**	**1931.0**

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.

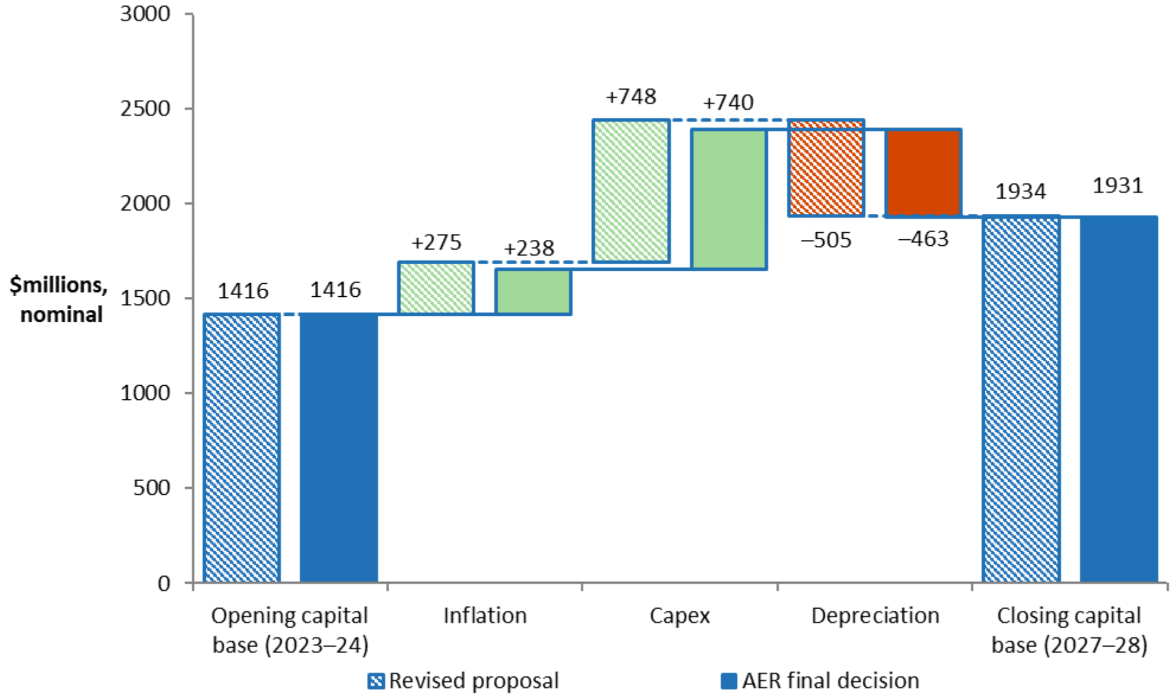
For this final decision, we confirm our draft decision position that the opening capital base as at 1 July 2028 is to be established using the approved depreciation schedules (straight–line) based on forecast capex at the asset class level.[17]

Figure 2-2 shows the key drivers of the change in MGN'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 36.3% 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 52.3%, while expected inflation increases it by 16.8%. Forecast depreciation,[18] on the other hand, reduces the capital base by 32.7%.

17 NGR, r. 90.

18 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—MGN'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 MGN's revised proposed forecast capex, the difference shown reflects updated WACC and inflation figures.

MGN's revised proposed forecast straight-line depreciation for the 2023–28 period is $505.3 million ($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 MGN'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 MGN's revised proposed total net capex for the 2023–28 period of $739.9 million ($nominal).[19] Our review of MGN's forecast capex is set out in Attachment 5 of this final decision.

19 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.[20]

[20] AER, *Draft decision, Multinet Gas Networks Access Arrangement 2023–28, Attachment 2 – Capital base*, December 2022, pp. 9–12.

Glossary

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