Return on Debt Methodologies – NER cl. 6.5.2(j)(1)-(3)

This note provides a high-level framework for considering potential approaches to implementing the three benchmark return on debt methods listed (without limitation) in clause 6.5.2(j) of the National Electricity Rules (NER). For ease of presentation the benchmark corporate bond is assumed to be BBB+ 10 year, and transitional issues, bid/offer spreads, and debt issuance costs are not addressed (these are to be discussed during the Rate of Return Guidelines consultation).

	1. On the Day	**2. Trailing Average Portfolio**	**3. Hybrid Portfolio**
What is estimated?	i) Yield on 10 year BBB+ fixed rate corporate bond.	i) Average yield on 10 year BBB+ fixed rate corporate bond over previous 10 years.	i) 5 year fixed base swap rate; and ii) 10 year fixed debt margin (relative to BBSW).
When is it estimated?	i) Prior to regulatory period ("Averaging Period").	i) Annually.	i) Base swap rate prior to regulatory period ("Averaging period"); and ii) 10 year fixed debt margin annually (relative to BBSW).
When is it incorporated into the revenue requirement?	i) Every regulatory reset (i.e. 5 yearly).	i) Annually or every regulatory reset (i.e. 5 yearly with a true-up mechanism)	i) Annually or every regulatory reset (i.e. 5 yearly with a true-up mechanism)
What hedging arrangements might it require?	i) None if entire debt balance (including for capex) is financed during averaging period; ii) Otherwise, 5 year 'pay fixed' swaps over entire debt balance (including for capex). Debt margin is unhedgeable (no available instruments).	i) None, if $1/10^{th}$ of debt portfolio is refinanced every year.	i) 5 year 'pay fixed' swaps over entire debt balance (including for capex).; and ii) None for debt margin if $1/10^{th}$ of debt portfolio is refinanced every year.