Attachment 10.2

Response to Draft Decision on our financing costs

SA revised Final Plan July 2021 – June 2026

January 2021

Australian Gas Networks

1. Response to Draft Decision on Financing Costs

Our single largest cost relates to financing our $1.8 billion investment in the South Australian natural gas distribution network.

1.1. Overview

This attachment sets out our response to the AER's Draft Decision on our financing costs for our SA gas distribution network over the next (2021/22 to 25/2026) Access Arrangement (AA) period.

1.2. Stakeholder and customer feedback

We applied the AER's Rate of Return Guideline and the AER's Tax Review to calculate the rate of return and cost of tax in this revised Final Plan. We did not receive any stakeholder or customer feedback in relation to our financing costs.

1.3. AER Draft Decision

The AER's Draft Decision in respect of our financing costs is summarised in Table 1.1 below.

Table 1.1: Summary of the AER's Draft Decision on our financing costs

	AER Draft Decision	AER Comment
Financing Costs		
Return on Equity	**Accept**	As per the AER's current 2018 Rate of Return Instrument.
Return on Debt	**Accept**	As per the AER's current 2018 Rate of Return Instrument.
Rate of Return	**Accept**	As per the AER's current 2018 Rate of Return Instrument. Estimated a placeholder allowed rate of return of 4.63%, which will be updated in its final decision based on our nominated (confidential) averaging periods.

	AER Draft Decision	AER Comment
Tax Costs		
Cost of tax	**Accept**	Accepted our approach to calculating the cost of tax using the approach in the AER's 2018 Tax Review.[1]
Value of Imputation Credits	**Accept**	Accepted the gamma value of 0.585 we adopted, which is consistent with 2018 Rate of Return Instrument.[2]
Tax depreciation	**Accept**	Accepted our approach to determining tax depreciation, which reflects the approach in the AER's Tax Review.[3]
Tax Asset Base	**Accept**	Accepted our proposal to establish the opening TAB as at 1 July 2021 but have made updates to reflect: [4] • historical annual RIN information we submitted after the Final Plan • reallocation of assets for accelerated tax depreciation purposes as a result of our mains replacement program

Note: In this 'traffic light' table, green shading represents the AER's acceptance of our Final Plan, orange represents the AER's modification of our Final Plan and red shading represents the AER's rejection of our Final Plan.

1.4. Our Response to the Draft Decision

Our financing and tax costs collectively account for around 33% of our total costs. For the purposes of the revised Final Plan, we have continued to apply the AER's 2018 Rate of Return Instrument and the AER's 2018 Tax Review in determining our financing and tax costs.[5] Table 1.2 summarises our response to the AER Draft Decision on our financing and tax costs, which shows we have accepted all parts of their decision.

[1] AER, Draft Decision, Attachment 7, p. 4.
[2] AER, Draft Decision, Overview, p. 39.
[3] AER, Draft Decision, Attachment 7, pp. 16-18.
[4] AER, Draft Decision, Attachment 7, pp. 15-16.
[5] Note that the AER is updating its Rate of Return Instrument in 2022, but this will not apply to our SA network until our next AA period in 2026/27.

Table 1.2: Summary of our response to the AER's Draft Decision on our financing and tax costs

	AER Draft Decision	Our response	Our Comment
Financing Costs			
Return on Equity	**Accept**	**Accept**	As per the current AER Rate of Return Instrument, and updated to reflect data from November 2020.
Return on Debt	**Accept**	**Accept**	As per the current AER Rate of Return Instrument, and updated to reflect data from November 2020 and forecasts of the cost of debt through the next AA period to provide an average.
Rate of Return	**Accept**	**Accept**	As per the current AER Rate of Return Instrument, and updated to reflect data from November 2020.
Tax Costs			
Cost of tax	**Accept**	**Accept**	We have used the approach in the AER's 2018 Tax Review, and note that it gives a cost of tax allowance of zero.
Value of Imputation Credits	**Accept**	**Accept**	As per the current AER Rate of Return Instrument.
Tax depreciation	**Accept**	**Accept**	We have continued to adopt the approach in the AER's 2018 Tax Review. We have made minor changes due to changes in capex.
Tax Asset Base	**Accept**	**Accept**	The tax asset base of $913 million as at July 2021 reflects the same approach as our Final Plan, as accepted by the AER in its Draft Decision.

Note: In this 'traffic light' table, green shading represents the acceptance, orange represents a modification and red shading represents a rejection

This results in an average rate of return for the next AA period of 4.16%. We note that the AER will determine our final allowed rate of return in the Final Decision using the averaging period approved by the AER in the Draft Decision. The average cost of debt assumes that the cost of each new tranche of debt in the forthcoming AA period will be the same as our November estimate, whereas, in reality, it will be updated based on the then prevailing debt costs.[6] For these reasons, the figures in the table below are indicative.

[6] Note that we do not have access to a Thomson Reuters terminal and have thus just used the RBA and Bloomberg indices as inputs into the AER's Final Return on Debt Instrument Model available from https://www.aer.gov.au/networks-pipelines/guidelines-schemes-models-reviews/return-on-debt-illustrative-model-review

Table 1.3: Indicative AER Rate of Return and Gamma

Parameters	Revised Final Plan
Return on Equity	4.52%
Average return on Debt	3.92%
Average Rate of Return	4.16%
Gamma	0.585

As noted above, the average rate of return is affected by the forecasts of the cost of debt allowance through the next AA period. This is shown in Figure 1 below. The rate of return falls because of the cost of debt allowance (return on equity is set once, at the start of the AA period), and the cost of debt allowance is falling largely because high cost debt tranches from the start of the current AA period diminish in weight as we transition to a ten-year trailing average.

Figure 1: AGN SA Debt allowance and rate of return

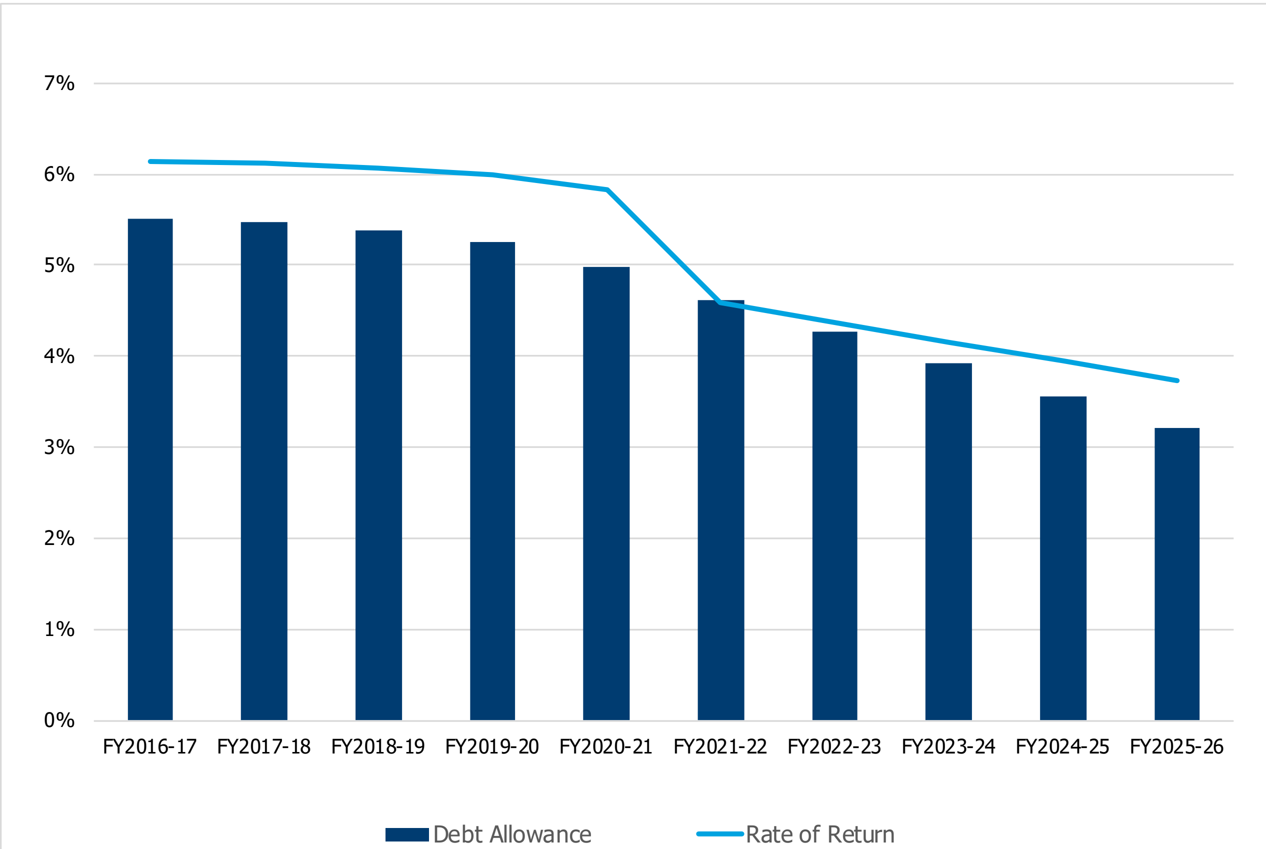

Table 1.4 provides our revised tax asset base, including the opening tax asset base value as at 1 July 2021.

Table 1.4: Roll forward of the tax asset base ($m, nominal)

	2021/22	2022/23	2023/24	2024/25	2025/26
Opening tax asset base	913.4	916.5	905.6	885.8	865.1
Plus gross capex	114.1	112.5	112.1	118.0	103.6
Less tax depreciation	111.0	123.4	131.9	138.6	134.6
Closing tax asset base	**916.5**	**905.6**	**885.8**	**865.1**	**834.2**

In respect of the tax building block, which is the component of our regulatory model informed by the tax calculations above, there is a tax allowance of zero in our building blocks.

1.5. Summary

Our average rate of return for the next AA period is 4.16%, comprising an allowance for equity of 4.52% and a forecast average allowance for debt of 3.92%. These calculations have been undertaken using the AER's 2018 Rate of Return Instrument and are indicative values to be updated in the AER's Final Decision in April 2021.

Our tax allocation, following the approaches in the AER's 2018 tax decision and updating information on capex and other factors in response to the draft decision is zero. For this reason, although we have followed the AER's 2018 Rate of Return Instrument and used a gamma of 0.585, the gamma value has no practical effect on our allowed revenues.