

Attachment 5

Rate of return

Access arrangement information

ACT and Queanbeyan-Palerang gas
network 2021–26

Submission to the Australian Energy Regulator
June 2020

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5 Rate of return

Key points

Evoenergy has calculated the allowed rate of return based on the AER's 2018 rate of return instrument using placeholder values for the risk free rate and the return on debt. Evoenergy has calculated the return on the projected capital base using the AER's gas post-tax revenue model (PTRM), which reflects the requirements of the Rules. The resulting allowed rate of return and the return on the projected capital base are presented in the table below.

Return on projected capital base

| | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 |
|----------------------------------|---------|---------|---------|---------|---------|
| Allowed rate of return | 4.68% | 4.55% | 4.41% | 4.28% | 4.15% |
| Return on projected capital base | 17.89 | 17.78 | 17.61 | 17.26 | 16.82 |

5.1 Introduction

Division 2 (r.72) of the Rules sets out the specific requirements for access arrangement information relevant to price and revenue regulation. In relation to the rate of return, access arrangement information must include the allowed rate of return for each regulatory year of the access arrangement period.

In addition, Division 5 (r.87) of the Rules sets out how the return on the projected capital base should be calculated:

The return on the projected capital base for a service provider for a regulatory year of an access arrangement period for an applicable access arrangement (RPCB_t) is to be calculated using the following formula:

$$\text{RPCB}_t = a_t \times v_t$$

where:

- a_t is the allowed rate of return for the regulatory year; and
- v_t is the value, as at the beginning of the regulatory year, of the projected capital base for the regulatory year (as established under rule 78 and subject to rule 82(3)).

In accordance with the Rules, this section sets out Evoenergy's proposed allowed rate of return for each regulatory year of the access arrangement period and presents the resulting return on the projected capital base calculated using the method set out in the Rules and reflected in the AER's gas PTRM. This section also sets out Evoenergy's approach to capital raising costs.

5.2 Allowed rate of return

Evoenergy has calculated the allowed rate of return in accordance with the AER's 2018 rate of return instrument. Placeholder values have been used for the risk free rate and the return on debt. These will be replaced with final values closer to the start of the regulatory period. Confidential Appendix 5.1 sets out Evoenergy's nominated averaging periods for the final values of the risk free rate and return on debt.

For the placeholder risk free rate, Evoenergy has used an averaging period of 60 business days to 31 March 2020. The resulting risk free rate is 1.00 per cent.

For the placeholder return on debt, Evoenergy has calculated the trailing average return on debt for each year of the regulatory period by holding the 2020/21 annual return on debt constant for each year of the regulatory period. The resulting trailing average return on debt values are set out in Table 5.1.

Table 5.1 Trailing average return on debt

| | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 |
|---------------------------------|---------|---------|---------|---------|---------|---------|
| Annual return on debt | 3.06% | 3.06% | 3.06% | 3.06% | 3.06% | 3.06% |
| Trailing average return on debt | 4.91% | 4.69% | 4.47% | 4.24% | 4.02% | 3.80% |

The resulting allowed rate of return for each year of the 2021-26 regulatory period are set out in Table 5.2.

Table 5.2 Allowed rate of return

| | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Risk free rate | 1.00% | 1.00% | 1.00% | 1.00% | 1.00% |
| Equity beta | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Market risk premium | 6.10% | 6.10% | 6.10% | 6.10% | 6.10% |
| Return on equity | 4.66% | 4.66% | 4.66% | 4.66% | 4.66% |
| Return on debt | 4.69% | 4.47% | 4.24% | 4.02% | 3.80% |
| Gearing | 60% | 60% | 60% | 60% | 60% |
| Nominal vanilla rate of return | 4.68% | 4.55% | 4.41% | 4.28% | 4.15% |

5.3 Return on the projected capital base

Consistent with the Rules, the AER's gas PTRM calculates the return on the projected capital base by multiplying the allowed rate of return by the opening value of the projected capital base for each year of the regulatory period. These values and the resulting return on the projected capital base are presented below in Table 5.3.

Table 5.3 Return on projected capital base

| | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 |
|--|--------------|--------------|--------------|--------------|--------------|
| Allowed rate of return (a_t) | 4.68% | 4.55% | 4.41% | 4.28% | 4.15% |
| Value of projected capital base (v_t) | 382.31 | 391.18 | 399.09 | 403.41 | 405.68 |
| Return on projected capital base (RPCB_t) | 17.89 | 17.78 | 17.61 | 17.26 | 16.82 |

5.4 Capital raising costs

The AER's gas PTRM includes an allowance for the transaction costs associated with raising debt and equity. Debt raising costs are included in the opex forecast because these are regular and ongoing costs associated with refinancing debt. Equity raising costs are included in the capex forecast as these costs are incurred once and are associated with funding particular capital investments.

Evoenergy has adopted the AER's preferred approach for estimating both debt and equity raising costs, with the exception of the benchmark arrangement fee estimated by Chairmont.¹ In a review of the Chairmont approach undertaken by Competition Economists Group (CEG) for Jemena², CEG found some significant shortcomings with the Chairmont approach. Evoenergy has therefore adopted the CEG benchmark for direct debt raising costs. This approach results in equity raising costs of zero and debt raising costs as set out in Table 5.4 below. Evoenergy notes that the AER accepted Jemena's estimate of debt raising costs based on a revised estimate of the arrangement fee³.

Table 5.4 Debt raising costs

| | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 |
|-------------------------|---------|---------|---------|---------|---------|
| \$ million real 2020/21 | 0.19 | 0.19 | 0.19 | 0.19 | 0.19 |
| \$ million nominal | 0.20 | 0.20 | 0.21 | 0.21 | 0.21 |

¹ Chairmont 2019, Debt Raising Costs, 29 June.

² CEG 2019, The cost of arranging debt issues, December (provided as Attachment 5.7 to Jemena's response to the AER's draft decision).

³ AER 2020, Attachment 3: Rate of return | Final decision – Jemena Gas Networks (NSW) Ltd) Access arrangement 2020-25, June, p. 12-13.

Shortened forms

| Term | Meaning |
|------------------------------------|---|
| AA | Access Arrangement |
| ACT | Australian Capital Territory |
| ACT climate change strategy | ACT Government's Climate Change Strategy 2019-25 |
| ACTCOSS | ACT Council of Social Service |
| AEMC | Australian Energy Market Commission |
| AEMO | Australian Energy Market Operator |
| AER | Australian Energy Regulator |
| ANU | Australian National University |
| ARENA | Australian Renewable Energy Agency |
| BISOE | BIS Oxford Economics |
| CABS | A Jemena Ltd proprietary system providing retailer billing, demand customer management, network balancing and retailer nomination services. |
| CALD | culturally and linguistically diverse (community) |
| capex | capital expenditure |
| CCP, CCP24 | the AER's Consumer Challenge Panel (number 24) |
| CEG | Competition Economists Group |
| CEPA | Centre for Efficiency and Productivity Analysis (University of Queensland) |
| CESS | Capital Expenditure Sharing Scheme |
| CIE | Centre of International Economics |
| CIT | Canberra Institute of Technology |
| CPI | consumer price index |
| DAE | Deloitte Access Economics |
| DAMS | Distribution asset management services (agreement) |
| DC | Demand Capacity Tariff |
| DT | Demand Throughput Tariff |
| E2G | Electricity-to-gas |
| EEIS | Energy Efficiency Improvement Scheme |
| ECM | Efficiency Carryover Mechanism |
| ECRC | Energy Consumer Reference Council |
| EGWWS | electricity, gas, water and waste services (sector) |
| EI | Economic Insights |
| EIL | Energy Industry Levy |
| ETC | Estimated cost of corporate income tax |
| EPSDD | ACT Environment, Planning and Sustainable Development Directorate |

| | |
|----------------|---|
| GDBs | gas distribution businesses |
| GN21 | Evoenergy gas network access arrangement 2021–26 |
| GJ | gigajoule = 10^9 joules |
| GWh | gigawatt hour |
| I&C | Industrial and commercial |
| ITAUUF | Information Technology Asset Utilisation Fee |
| km | kilometre |
| LPG | liquid petroleum gas |
| MDLs | Meter Data Loggers |
| NGL | National Gas Law |
| NGO | National Gas Objective |
| NSW | New South Wales |
| opex | operating expenditure |
| PPF | Partial Factor Productivity |
| PJ | petajoule = 10^{15} joules |
| PLS | Pressure Limiting Station |
| PPA | power purchase agreement |
| PTRM | post-tax revenue model |
| QPRC | Queanbeyan–Palerang Regional Council (local government authority) |
| RAB | regulatory asset base |
| RFM | roll-forward model |
| RIN | Regulatory Information Notice |
| Rules | National Gas Rules |
| SDRS | Secondary District Regulator Sets |
| TAB | tax asset base |
| TJ | terajoule = 10^{12} joules |
| UAG | unaccounted for gas |
| UNFT | Utilities Network Facilities Tax |
| VB | Volume Boundary (tariff class) |
| VI | Volume Individual (tariff class) |