Customer Forum – Week 5

Opex

23 July 2018

Overview

▸ **Overview**

▸ **Base year selection**

▸ **Opex forecasts**

Overview

Topic significance and objective

Topic Significance

Opex makes up approximately 35% of AusNet's revenue allowance and is a material driver of revenue and customer charges.

The Opex forecast is within scope for negotiation with the Customer Forum.

Objective

The objective of this session is to guide the Customer Forum through our preliminary position on our opex forecasts.

The forecasts presented in this presentation should reasonably reflect our opening position for negotiation with the Customer Forum. However, there may still be incremental changes prior to finalising our position.

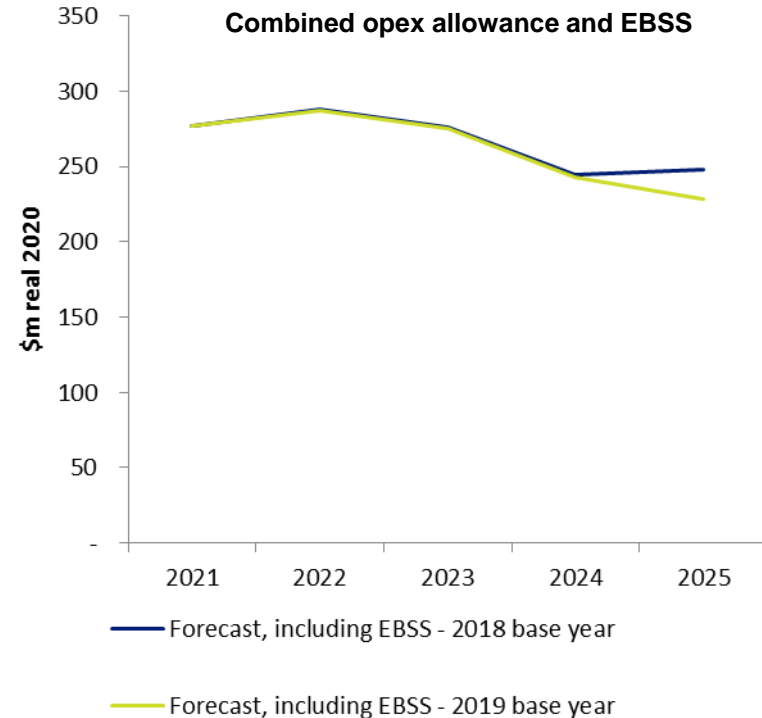# Base year selection and EBSS indifference

Base Year – Indifference due to the opex efficiency incentives
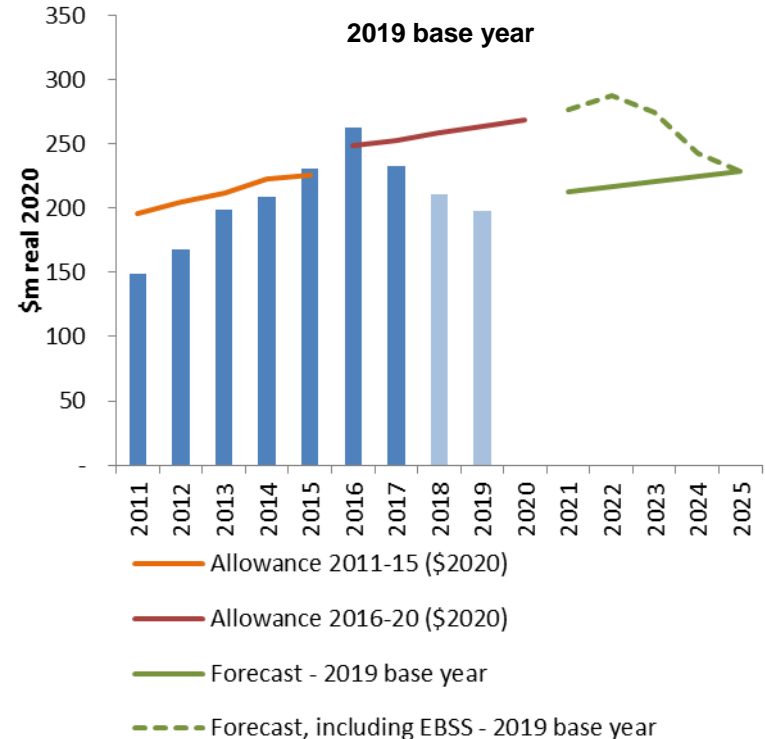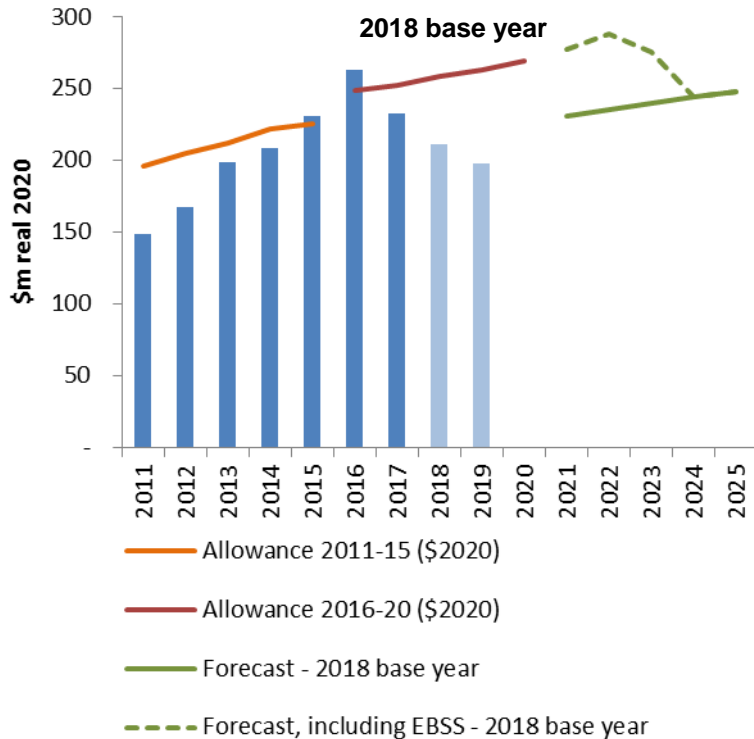
Using a 2019 base year is expected to result in a lower opex allowance, which is offset by higher EBSS rewards. There is greater uncertainty about 2019 opex and actual 2019 opex will not be known until after our submission to the AER.

The opex incentive scheme is designed to ensure that AusNet Services and its customers are both indifferent to the selection of the base year.

Base Year – Indifference due to the opex efficiency incentives

Impact of base year on opex allowance and EBSS

Legend:
- Forecast - 2018 base year
- EBSS - 2018 base year
- Forecast - 2019 base year
- EBSS - 2019 base year

Combined opex allowance and EBSS

Legend:
- Forecast, including EBSS - 2018 base year
- Forecast, including EBSS - 2019 base year
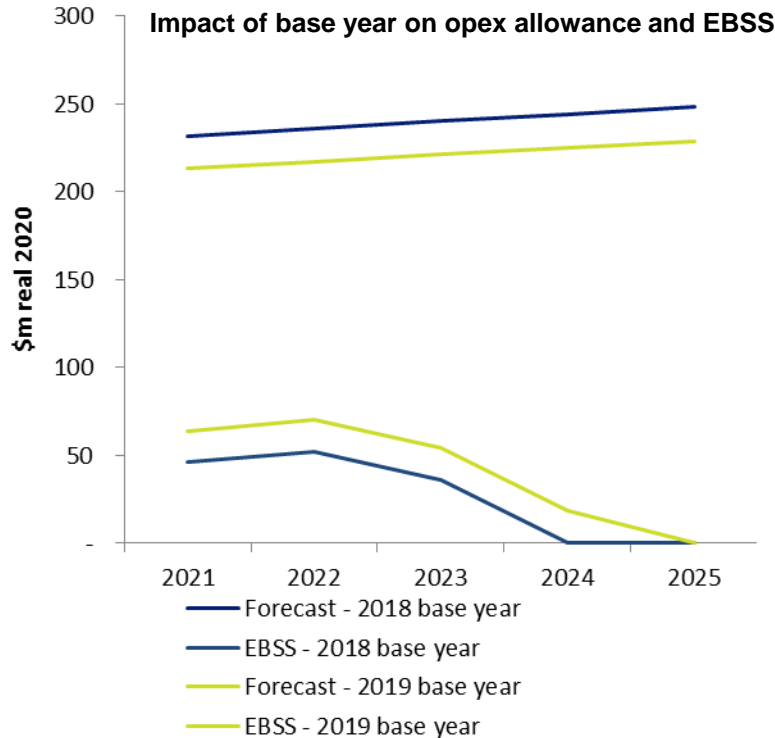
There is a difference in the combination of opex allowance and EBSS in 2025. However this difference is corrected in the year 1 calculation that is applied to the EBSS in the 2026-30 regulatory period.

We note that we are happy to use either year, if the Customer Forum has a preference for 2019.

Opex Forecasts

Preliminary Forecasts
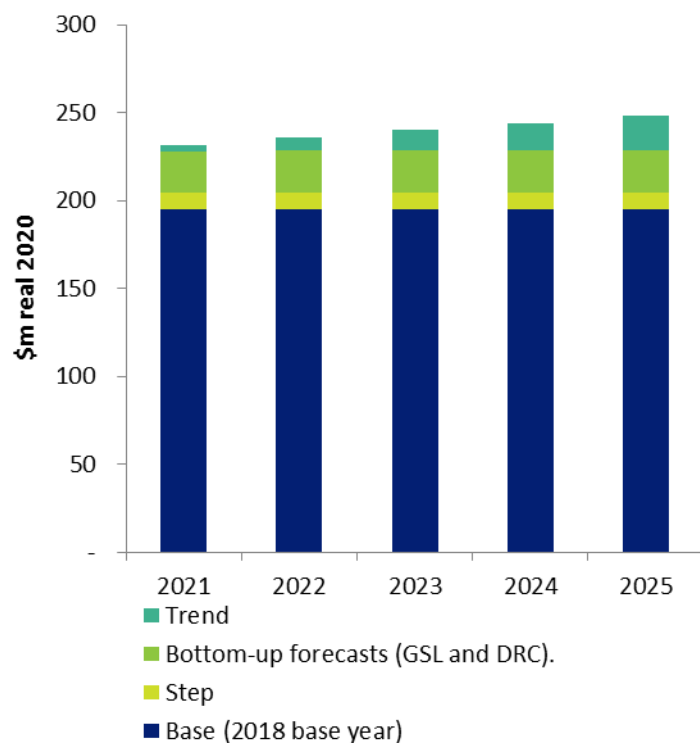
	2021	2022	2023	2024	2025	Total	% of opex allowance
Base (2018 base year)	195.1	195.1	195.1	195.1	195.1	975.6	195.1
Step	9.0	9.2	8.6	8.6	8.6	44.0	9.0
Trend	3.6	7.5	11.5	15.6	19.7	57.9	3.6
Bottom-up forecasts	23.5	24.0	24.9	24.8	24.8	121.9	23.5
Total	**231.2**	**235.8**	**240.1**	**244.1**	**248.2**	**1199.4**	**231.2**

▸ Real growth rate in forecast opex from 2021-25 is 1.42% per annum.

▸ Nominal growth in forecast opex from 2021-25 is 3.80% per annum.

▸ Forecast opex in 2021 is 9.5% higher than in 2018. This reflects three years of real growth from the 2018 base year and some step changes.

AusNet Services – Opex allowance per customer – actual and initial forecasts

Step changes and base year adjustments

Base year adjustments

We have identified one base year adjustment, which results in lower expected levels of opex going forward.

Accounting treatment of leases – From 1 April 2019, operating leases must be capitalised, rather than treated as opex. We have removed the entire amount of the relevant leases, from our base year expenditure.

Base year adjustments – $m real 2020

	2021	2022	2023	2024	2025	Total
Accounting policy change	-6.3	-6.3	-6.3	-6.3	-6.3	-31.7

Likely step changes

We have identified 3 step changes to our opex, which result in higher opex going forward.

REFCL (Bushfire Mitigation) – program requires additional annual testing to demonstrate compliance and ongoing network activities to ensure that the required capacity can be met.

Cloud base software – IT software is increasingly moving to a cloud based Software as a Service approach, which is an opex solution.

5 minute metering – The operation of upgraded systems to handle 5 minute metering data requires additional ongoing opex.

Step changes – $m real 2020

	2021	2022	2023	2024	2025	Total	% of opex allowance
REFCL (Bushfire Mitigation)	1.6	1.6	1.8	1.8	1.8	8.5	0.7%
Cloud based software	6.0	6.0	6.0	6.0	6.0	30.0	2.5%
5 minute meter data - step change	1.5	1.6	0.8	0.8	0.8	5.5	0.5%
Total	9.0	9.2	8.6	8.6	8.6	44.0	3.7%

Bottom-up Forecasts

Likely bottom-up forecasts

We have used bottom-up forecasts for four elements of the opex forecasts.

Guaranteed Service Levels - These are payments to specific customers who receive poor reliability outcomes. This forecast is based on average expenditure in 2016 and 2017. This should be updated to include GSL payments in 2018, prior to submission to the regulatory.

The GSL scheme changed in 2016 and so prior expenditure no longer reflects expected future expenditure.

Bottom-up forecasts – $m real 2020

	2021	2022	2023	2024	2025	Total	% of opex allowance
GSL Payments	10.5	10.5	10.5	10.5	10.5	52.6	4.4%
Metering	10.2	10.6	11.5	11.4	11.3	54.9	4.6%
Debt Raising Costs	2.2	2.3	2.4	2.4	2.4	11.8	1.0%
Innovation expenditure	0.5	0.5	0.5	0.5	0.5	2.6	0.2%
Total	23.5	24.0	24.9	24.8	24.8	121.9	10.2%

Likely bottom-up forecasts

Metering - A number of our IT Systems are used by both the Metering business and the Distribution business. Both have regulatory obligations in regards to the provision of metering data and so neither business could operate without these system. As such a portion of the costs has been allocated to both the ACS metering services and the SCS distribution business.

To ensure consistency across ACS and SCS, we have forecast these costs on a bottom-up basis and allocated the costs between the ACS and SCS services.

Debt raising costs - We have applied the benchmark approach previously used by the AER. We note that this is less than our actual debt raising costs and we have previously contested this approach with the AER. However we are not intending to re-open this argument at this time.

Innovation - Where innovation is intended to lead to expenditure reductions, the current regulatory framework truncates the returns of this innovation and, therefore, the incentive for networks to invest in unfunded innovation is very weak. Where the Demand Management Incentive Allowance Mechanism can not apply, an ex ante allowance for particular innovation projects would provide a more appropriate incentive to invest. This forecast expenditure is opex associated with the innovation program previously presented to the Customer Forum.

Trend (Growth Parameters)

Trend Parameters

	2021	2022	2023	2024	2025
Forecast Price Change % (real)	0.63%	0.70%	0.70%	0.70%	0.70%
Forecast Output Change % (real)	1.31%	1.29%	1.27%	1.25%	1.24%
Productivity Adjustment % (real)	0.0%	0.0%	0.0%	0.0%	0.0%

	2021	2022	2023	2024	2025	Total
Forecast Price Change $ (cumulative)	1.2	2.6	3.9	5.3	6.7	19.7
Forecast Output Change $ (cumulative)	2.4	5.0	7.6	10.3	13.0	38.2
Productivity Adjustment $ (cumulative)	0	0	0	0	0	0
Total	3.6	7.5	11.5	15.6	19.7	57.9

Trend Parameters – Price Change

This relates to expected cost increases due to wage increases and the cost of materials.

We have used the AER's most recent decision (from ElectraNet) as the basis of this forecast. We will provide an expert consultants report closer to submission of our regulatory proposal.

We will submit a forecast that is the average of the latest available forecasts, consistent with the AER's approach in the ElectraNet decision.
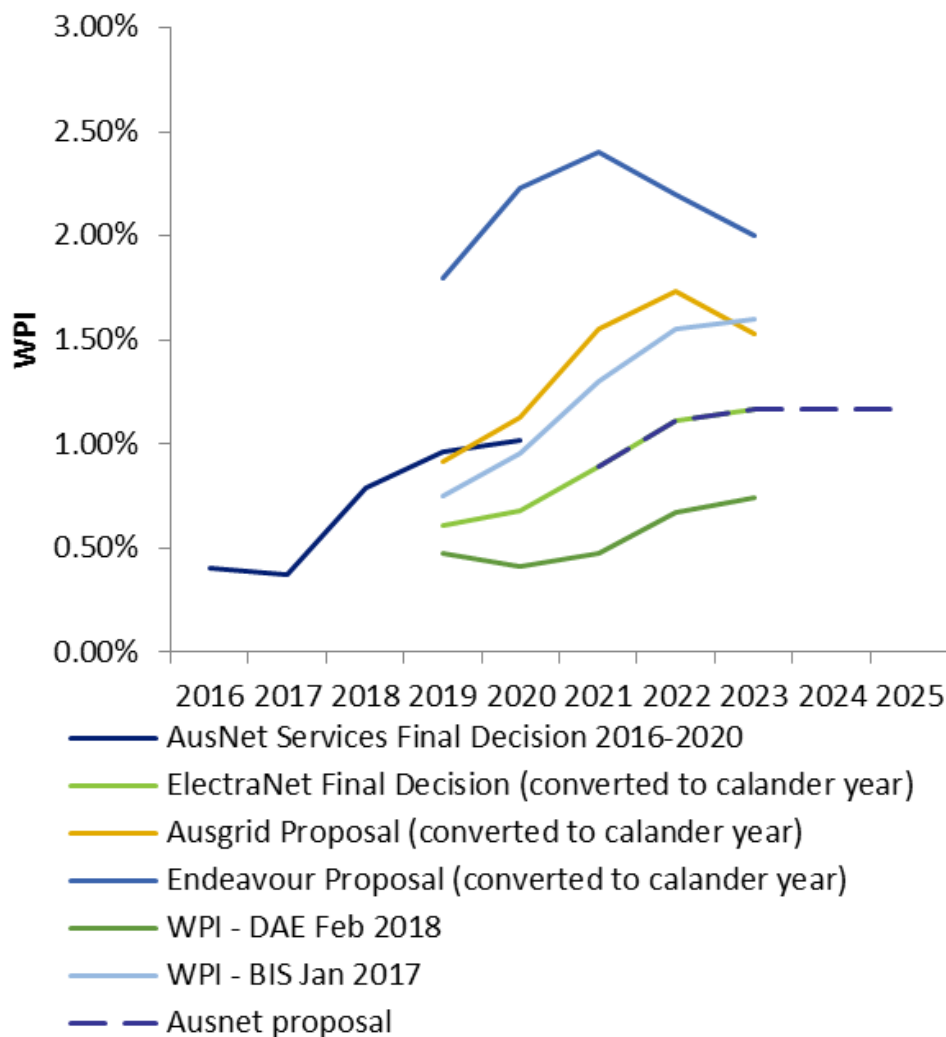
Trend Parameters – Network Growth

This relates to expected cost increases due to the increased scale of our network. We have applied existing AER approaches to forecast this.

The AER uses forecasts of the growth in customer numbers, circuit length and ratcheted maximum demand. These are weighted by factors derived from their benchmarking model.

All approaches are below the forecasts approved for the 2016-2020 period.

	2021	2022	2023	2024	2025	2016-2020 Average
Customer number growth	1.62%	1.59%	1.57%	1.54%	1.52%	1.73%
Circuit length growth	0.73%	0.73%	0.72%	0.72%	0.71%	0.86%
Ratcheted Maximum Demand	0.00%	0.00%	0.00%	0.00%	0.00%	1.41%
Weighted growth rate	1.31%	1.29%	1.27%	1.25%	1.24%	1.60%

Trend Parameters – Productivity

We have not applied a productivity adjustment to our opex forecast.

We consider the EBSS ensures there is an appropriate sharing of productivity gains with customers.
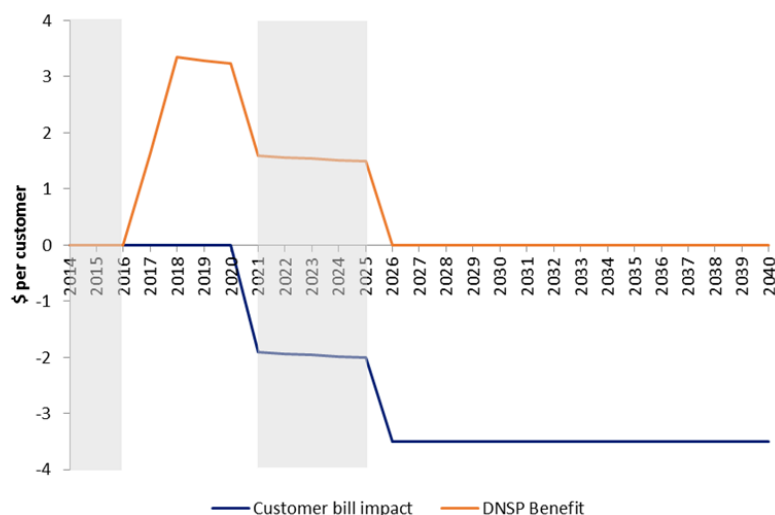
Example: In 2017 AusNet Services exited a lease at William St and increased utilisation at its remaining offices. This saved AusNet Services $2.4m per annum and will do so indefinitely.

AusNet Service makes some profit in the short term, however customers bills will be $3.50 lower indefinitely.

	2016-2020	2021-25	Thereafter
Customer bill reduction	$0	$1.9 per customer per annum	$3.5 per customer per annum
DNSP profit	$3.4 per customer per annum	$1.5 per customer per annum	$0

Summary of approaches

Component	Forecasting Approach	AER's approach?	Need to update before submission?
Base year	Based on expected 2018 opex.	✓	✓
Base year adjustment – Accounting policy change	Relevant existing leases will no longer be incurred as opex. Have based forecast on 2017 lease payments.	Tbc	✓
Step Change - REFCLs	There is opex associated with the REFCL installation program and then additional ongoing opex for annual testing.	n/a	✓
Step Change – Cloud based software	Expected costs of moving ICT systems (capex) into the Cloud (opex)	n/a	✓ Refined costs
Step Change – 5 minute metering	Additional costs due to implementing the 5 minute settlement rule change	n/a	✓ Refined costs
Bottom-up forecast – GSL payments	Based on average of 2016 and 2017.	✓	✓ Include 2018 GSLs
Bottom-up forecast - Metering	Based on bottom-up forecast of system costs and allocation between ACS and SCS.	n/a	✓ Refined costs
Bottom-up forecast – Debt raising costs	Based on the AER's benchmark approach.	✓	✓
Bottom-up forecast – Innovation	Forecast of innovation program costs.	n/a	✘
Trend – Price Growth	We will propose an average of two consultant reports. We have used the AER's last decision as the basis for these initial forecasts.	✓	✓
Trend – Network Growth	• Customer Numbers – Internal forecasts built-up from public data • Circuit Length – Internal forecast based on historical experience • Maximum Demand – Internal forecast.	✓	✓
Trend Productivity	0 productivity adjustment applied.	✓ Although the AER has indicated it may change its approach	✘