Final revenue limits and quality standards for electricity lines companies for 2025-2030

Transpower RCP4 and EDB DPP4 final decisions

20 November 2024

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Briefing outline

- Main features of RCP4 and DPP4
- Key drivers
- Consumer impact
- Context
- Final decisions:
  - Transpower (RCP4)
  - Local lines companies (DPP4)
- Summary
- Q&A

RCP4 and DPP4 main features

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Transpower

$5.9 billion

Up $1.8 billion compared to RCP3 (projected)

Breaks down to a revenue allowance increase of:

- **16%** in years one and two; and
- **5%** for years three to five.

Electricity distributors

$11.5 billion

Up $3.5 billion compared to DPP3

Breaks down to a revenue allowance increase of:

- **24%** for year one (on average); and
- lower business-specific increases for years two to five.

- Higher revenue limits for both Transpower and local lines companies are to maintain reliability and support growth.
- Current quality standards are largely fit for purpose, and we propose only minor refinements.
- Collectively this represents around an **extra $10 on the average household's monthly bill from 1 April 2025** for affected networks(will vary across regions and consumer profiles).

Final decisions: key drivers

There are three main drivers behind the increase in revenue:

- An **increase in interest rates** since 2019 – this is reflected in the weighted average cost of capital (WACC) of 7.1% compared to 4.6% for RCP3/DPP3. The average across all regulatory periods is 6.9%.

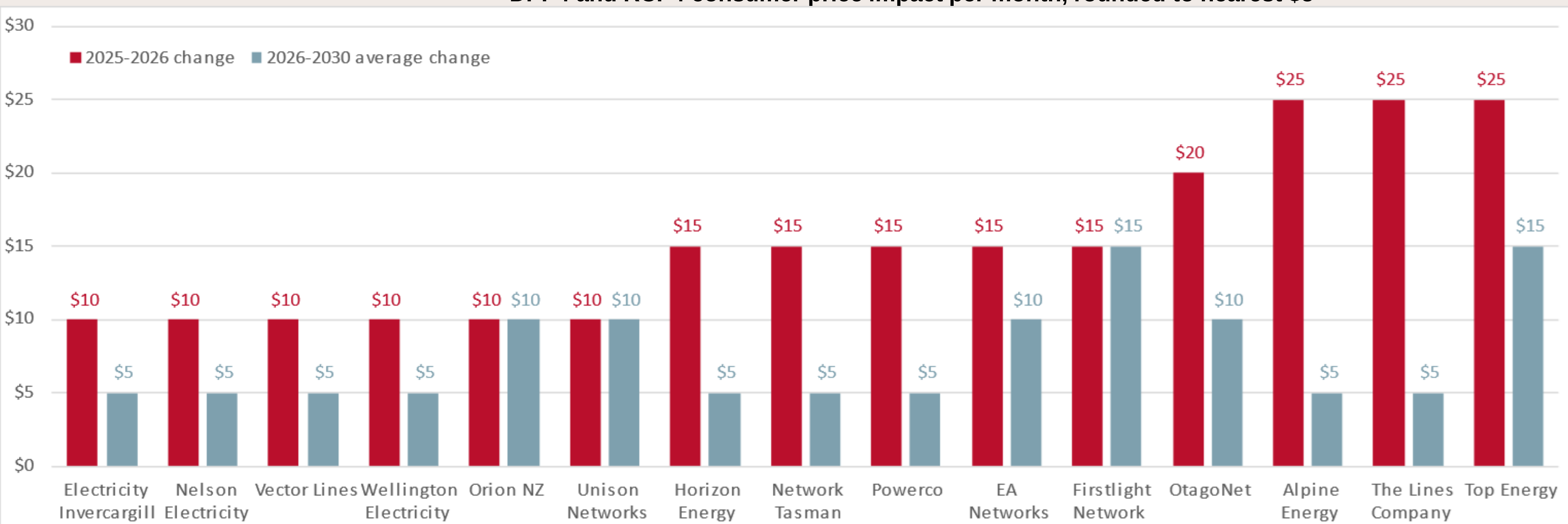
- An **increase in expenditure** to maintain reliability, meet growing demand, and address resilience needs.

- **Recent higher input costs (inflation)** due to strong international competition for skilled workers and equipment.

Estimated consumer price impacts

- Delivering the service we need into the future requires investment.
- What this means for consumers is that from 1 April 2025, we estimate that the transmission and distribution component of a household's electricity bill will increase on average, **by $10 per month,** for the affected networks for the first year of the period. This represents an **additional $120 per year** on average across most of New Zealand.
- The regional range is for average increases between approximately $10 and $25 per month, for the first year of the period. There are various drivers for differences between lines companies, but a significant factor is the number of consumers to spread costs over.

DPP4 and RCP4 consumer price impact per month, rounded to nearest $5



Context for our final decisions

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- **Underlying macroeconomic conditions** – higher interest rates and inflation.
- **Further emergence of new technologies** – growing scope for innovation and non-network solutions.
- **Wider cost pressures for consumers** – price increases may be felt more as consumers face higher costs across their budgets.
- **Stakeholder feedback** – we received 50 submissions and 14 cross submissions in total for both the RCP4 and DPP4 draft decisions. We also held a workshop on the implementation design and application process for the innovation and non-traditional solutions allowance (INTSA).

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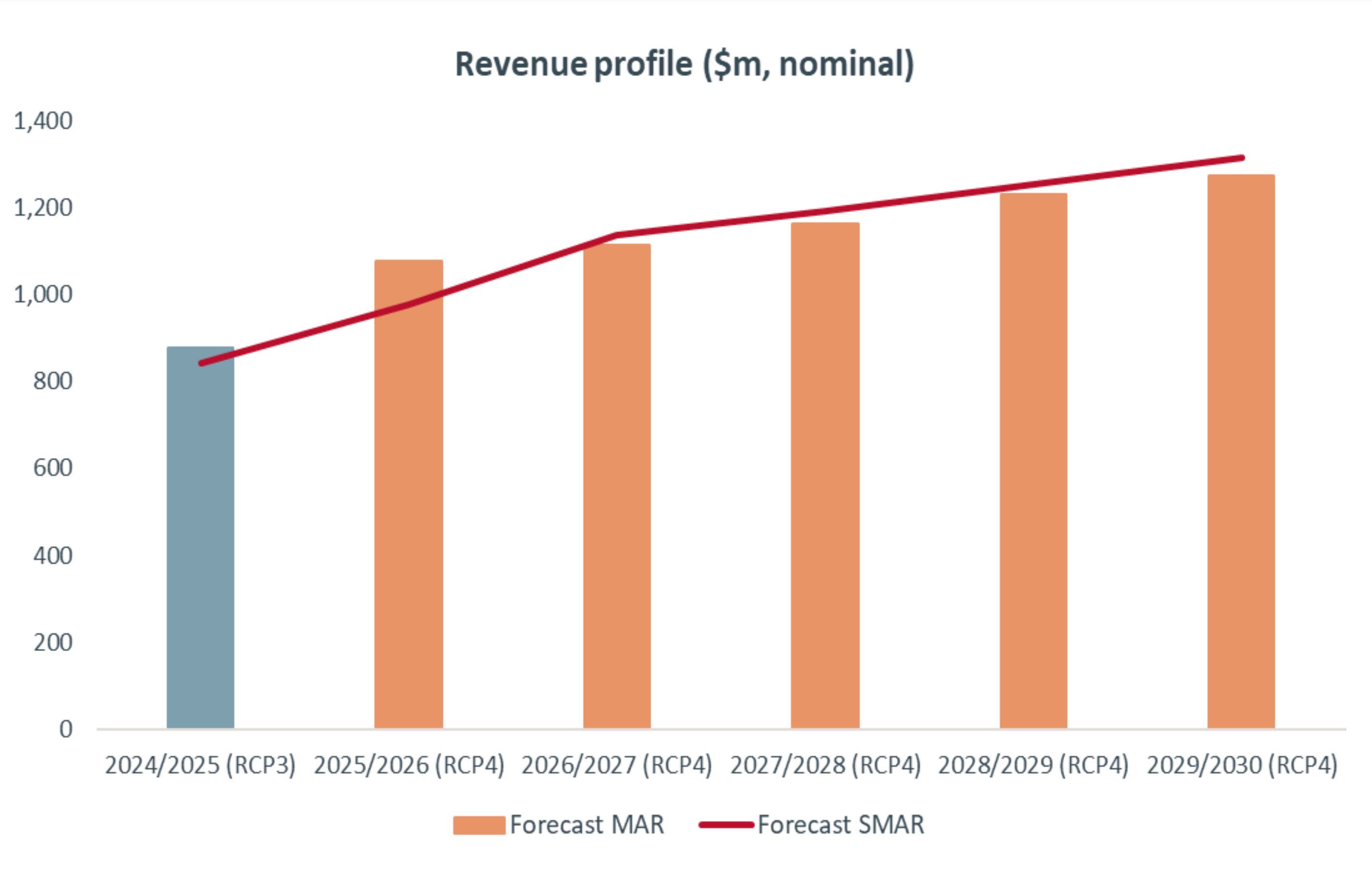
Transpower (RCP4)

RCP4: Revenue path

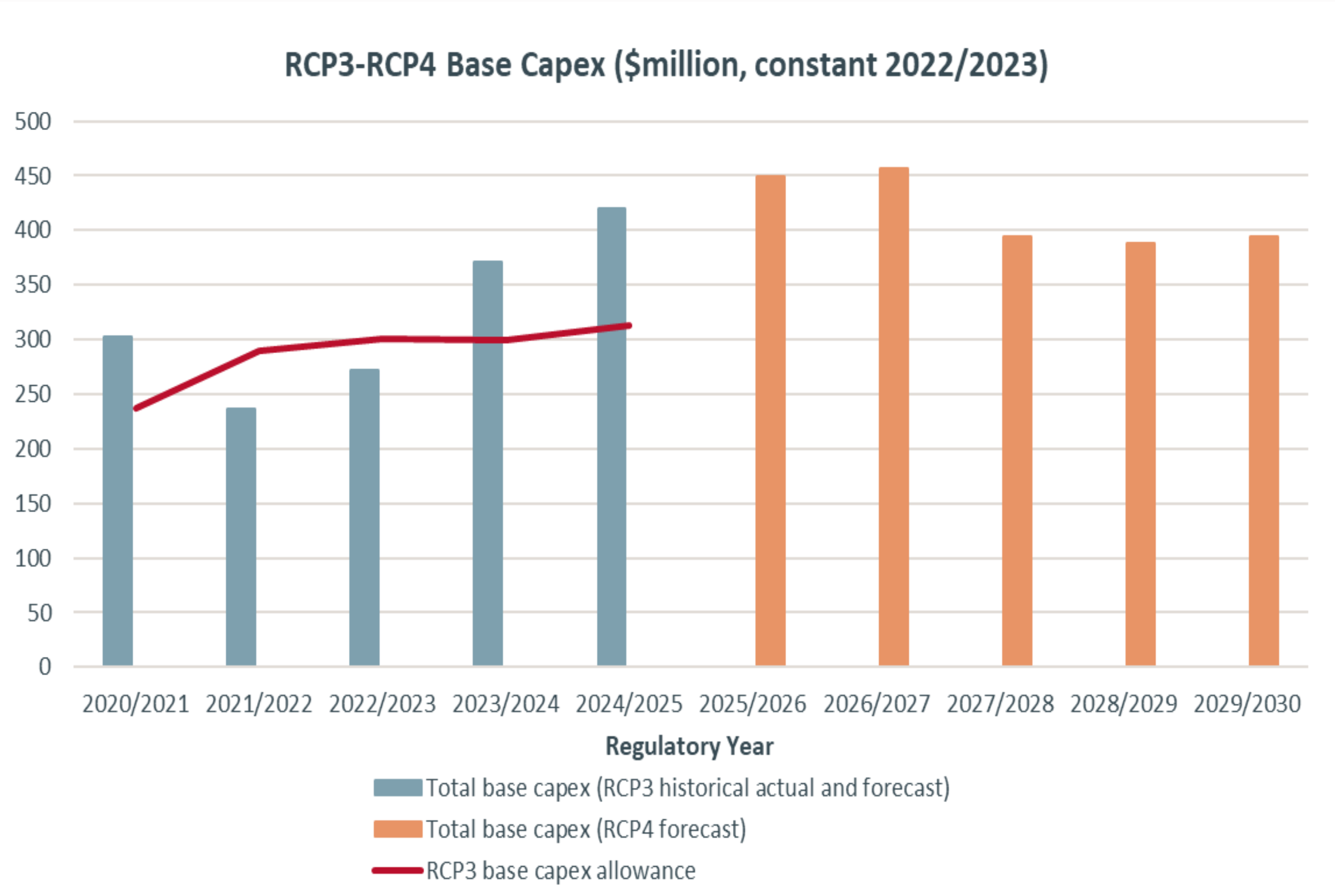


- Total RCP4 revenue allowance of $5.9 billion – a $76 million increase from our draft decision.
- WACC and inflation are significant drivers.
- Smoothing the price path to soften initial consumer impacts.
- 16% annual increase for years one and two.
- 5% annual increase for years three to five.

RCP4: Overview

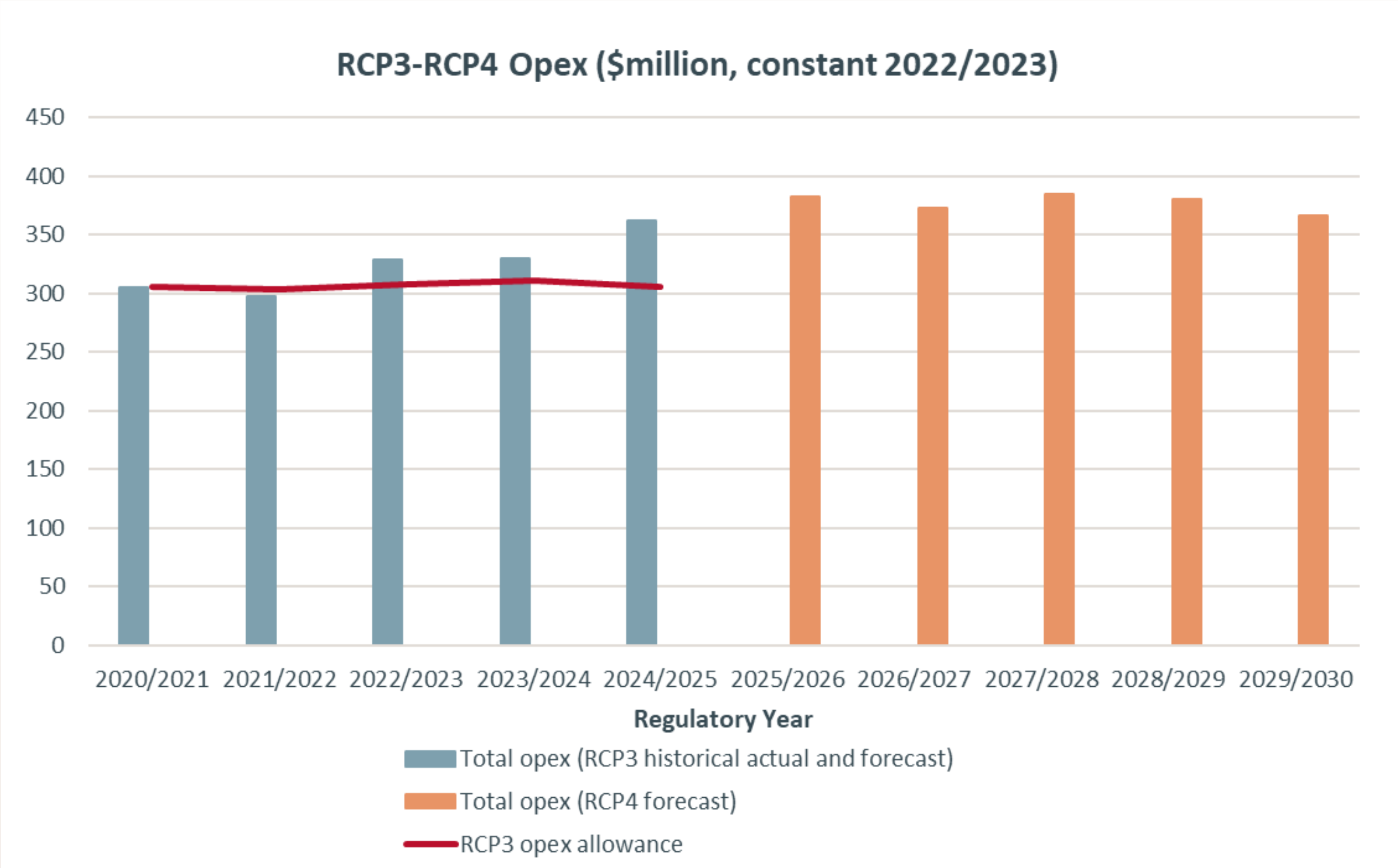
- **We have made minor changes from draft to final decisions to reflect submitter feedback** - we consulted and updated the settings for the deliverability reopener to reflect updates from Transpower on its progress towards workforce targets.
- **Increased replacement and renewal need** - Transpower proposed a substantial work programme to replace and renew assets that were built mid-last century to ensure a safe and reliable supply as New Zealand becomes more reliant on electricity.
- **We are largely satisfied by Transpower's proposal** - we have reviewed Transpower's proposal and the independent verifier's report and allowed for the majority of Transpower's proposed expenditure.
- **We have applied a downward adjustment to address deliverability concerns -** additional expenditure can be unlocked during the period if Transpower meets predetermined recruitment targets.
- **We are introducing an annual delivery reporting requirement -** given the increase in Transpower's work programme.
- **Grid output measures remain largely unchanged** - we based Transpower's grid output measures largely on the previous period with minor refinements based on Transpower's actual performance.

RCP4: Capex



- Total capex allowance of $2.3 billion.
- Mature asset health modelling underpins Transpower forecast.
- Providing funding for resilience expenditure.
- Reducing capex by $110 million due to deliverability concerns.
- Re-openers available for deliverability and other uncertain expenditure.

RCP4: Opex



- Total opex allowance of $1.9 billion.
- Opex is forecast using base, step and trend methodology.
- Step change to support delivery of increased work programme.
- Increase in maintenance to manage aging asset base.
- Reduced opex by $62 million due to deliverability concerns.

RCP4: Quality and IM amendments

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Quality

- Keep Transpower's package of quality standards and grid output measures largely unchanged – to ensure Transpower maintains the current quality of service it is providing to customers.
- Metrics updated to reflect improving performance and to take into account Transpower's work programme, where relevant.

Input methodologies

- Targeted IM amendments to give effect to our IPP reset.

Next steps

- Transpower sets prices from 1 April 2025 based on its Transmission Pricing Methodology.

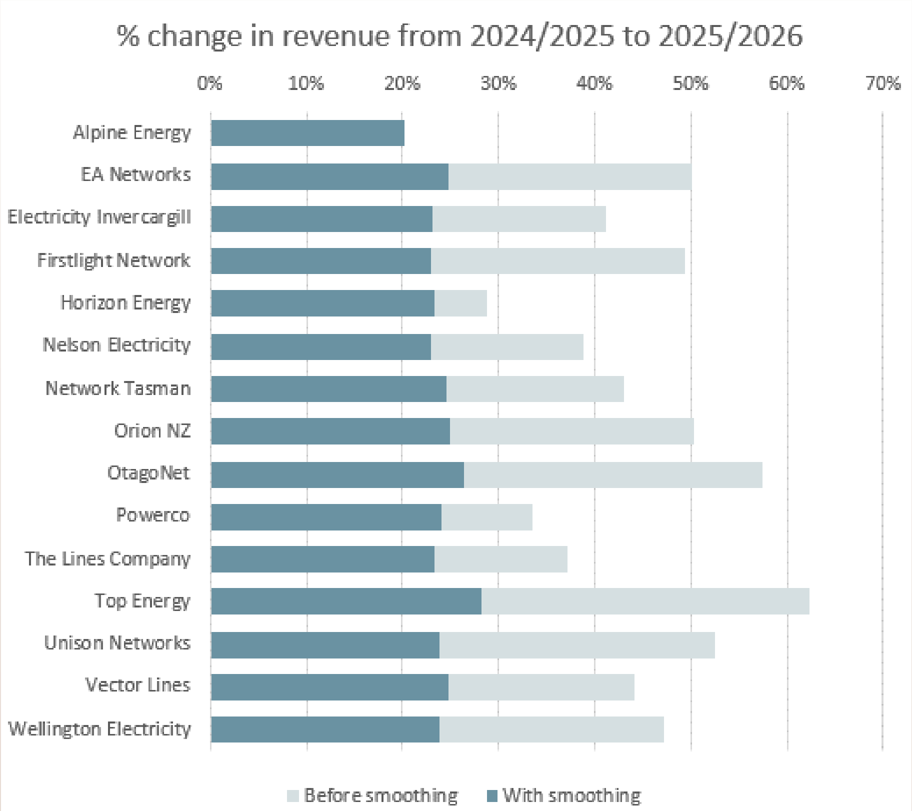
Electricity distribution businesses (DPP4)

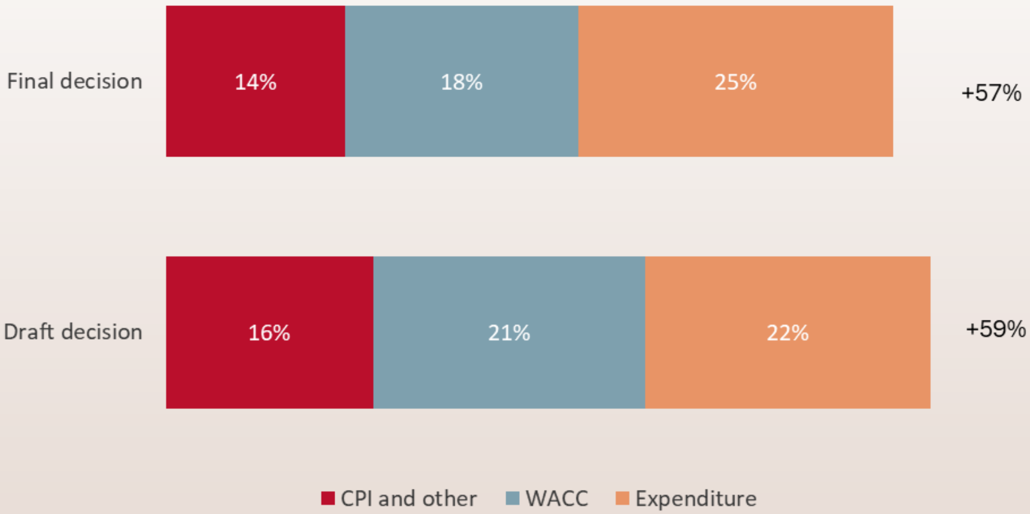
DPP4: Overview

- **The final decision -** total forecast net allowable revenue allowances of **$11.5 billion** in nominal terms over a five-year DPP4 regulatory period.
- **Higher overall costs –** uplift in revenues compared to DPP3 to cover costs and enable investment to maintain reliability and support growth.
- **Flexible regulatory framework enables us to get the best for consumers** – our final decision allows for a small increase in expenditure from the draft decision but does not accept businesses' forecasts in full due to uncertainty and deliverability concerns.
- **We have provided for some specific increases in operating costs –** our final decision allows for six step changes for new or above inflationary operating cost increases.
- **We are further incentivising innovation within the regime –**the innovation and non-traditional solutions allowance encourages EDBs to find new solutions for the long-term benefit of consumers.
- **We have introduced revenue smoothing to help mitigate price increases for consumers** –we have limited initial increases in revenue to soften the impact of price rises for consumers.
- **Key changes from draft decision -** expand the innovation allowance and exclude specified insurance and low-voltage data costs from the cap applied to opex step change increases.

DPP4: Total revenue

Total forecast net allowable revenue allowances is $11.5 billion in nominal terms.

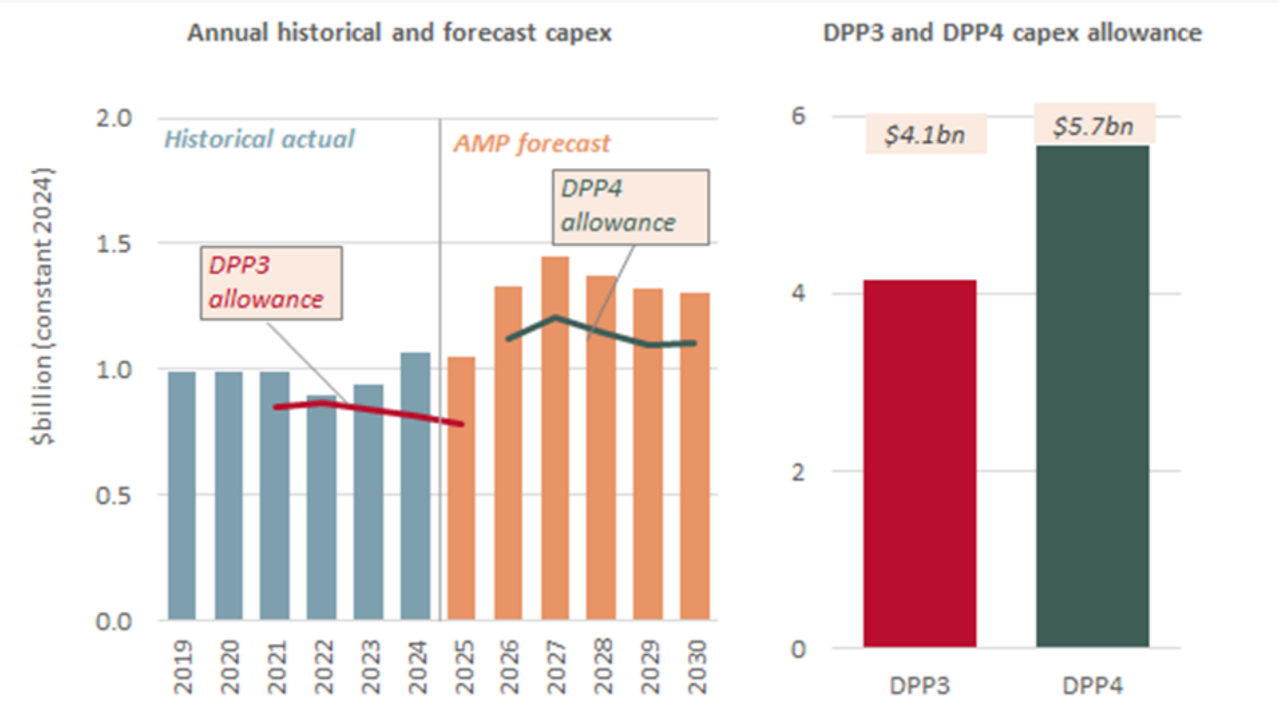




DPP4: Capex

Lines companies have forecast a significant increase in investment.
The capex allowance provided reflects our assessment of what is appropriate in an evolving environment with high levels of uncertainty and potential deliverability challenges.

Capex profile (constant 2024 dollars)



In 2024 constant prices, our decision is for a DPP4 capex allowance of $5.7 billion.

This is $1.5 billion or 37% higher than the DPP3 allowance of $4.1 billion (in 2024 constant prices).

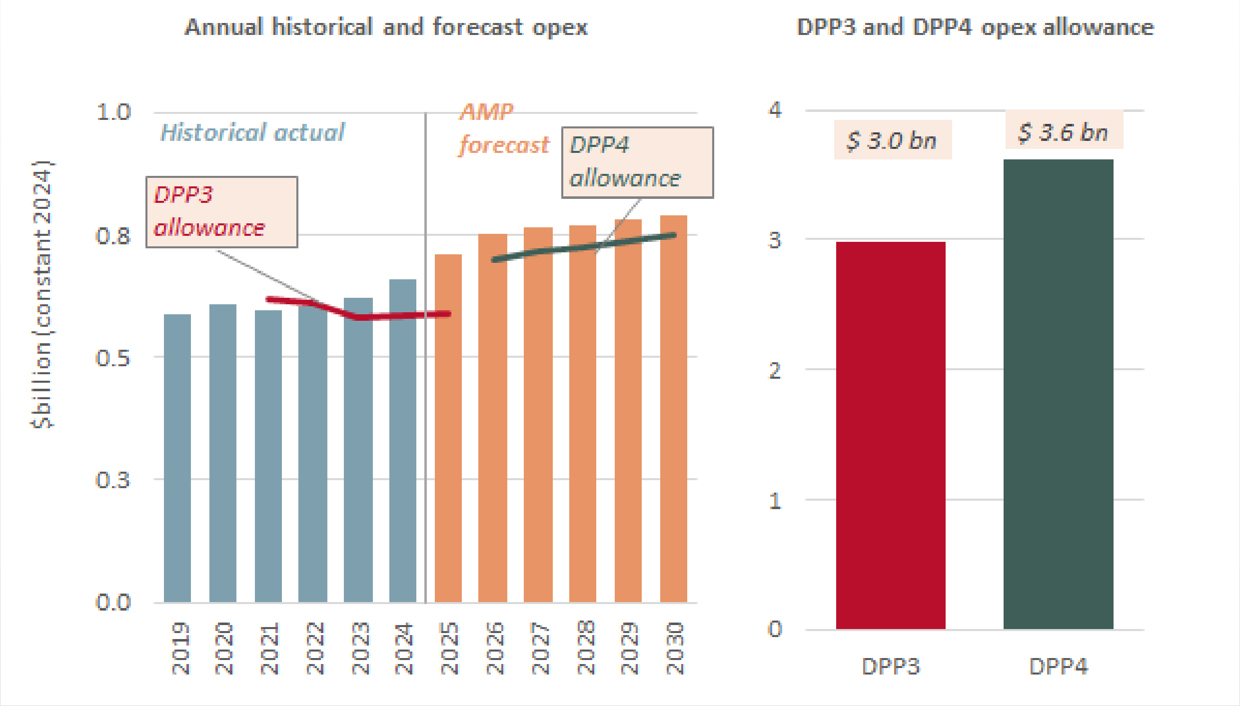
The allowance is 17% less than EDBs' 2024 asset management plan forecast (nominal).

The final decision is $66 million (nominal) or 1% higher than the draft decision for capex allowance.

DPP4: Opex

We have set opex allowances to reflect the increases in operating costs faced by the sector since 2020.
We have capped opex step change increases at 5% excluding specified amounts for insurance and low-voltage data costs.

Opex profile (constant 2024 dollars)



In 2024 constant prices, our final decision is for a DPP4 opex allowance of $3.6 billion.

This is $0.6 billion or 22% higher than the DPP3 allowance of $3.0 billion (in 2024 constant prices).

This includes six step-changes – Insurance, low-voltage monitoring, cybersecurity, Software as a Service, consumer engagement and a graduate programme.

Our final decision is a $144 million (nominal) or 3.7% increase from the draft opex allowance.

DPP4: Innovation and Quality

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Innovation

- Maintain equivalence between IRIS incentives for capex and opex, to ensure the regime continues to incentivise EDBs to choose the most efficient solution.
- To introduce an innovation and non-traditional solutions allowance which EDBs will be able to apply. We have increased this from our draft decision to be up to 0.8% of their maximum allowed revenue over the DPP4 period.
- To encourage collaboration between EDBs, 0.2% of the 0.8% will only be available for projects where the EDB is working with at least one other EDB.

Quality

- Retain the same quality standards as applied in DPP3, at levels that ensure no material deterioration in quality.

DPP4: IM amendments - three packages

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Reopener and other matters (EDBs and Transpower)

- Proposed amendments to reopeners, the reopener event allowance, and other matters, to:
  - ensure the input methodologies (IMs) correctly give effect to our policy decisions;
  - improve the workability of the IMs relating to reopeners; and
  - improve the clarity and certainty of the rules and processes for reopeners, to reduce compliance and regulatory costs.
- Draft decision to be published in December 2024.

Insurance proceeds (EDBs, Transpower and Gas Pipeline Businesses)

- Proposed amendments in relation to the treatment of insurance entitlements, other compensatory entitlements, and other regulated outcomes.
- Final decision to be published in December 2024.

Wash-up amounts (EDBs)

- Proposed amendments to the EDB IMs to correct errors in the EDB revenue wash-up and to reduce volatility of the revenue path.
- Final decision published today.

DPP4 Guidance

- Reopener guidance to be published by April 2025.
- Innovation Allowance (INTSA) guidance to be published by April 2025.

To conclude

- **We are increasing the maximum allowable revenues** for both Transpower and local lines companies to help ensure consumers have a reliable network that meets their needs now and into the future at a reasonable cost.
- The increase is primarily driven by:
  - an increase in **interest rates**
  - an increase in forecasted **expenditure**
  - recent increases in **input costs** (inflation)
- **Increased investment required** to meet the future needs of consumers.
- **Balance required** between allowing for revenues upfront and relying on other options for flexibility, as there are risks for consumers on both sides.
- **Innovation incentives are heightened** to help improve quality of service and reduce costs over the longer-term.
- **To soften the impact on consumers**, we have smoothed revenue recovery by spreading it over a longer period

Questions

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