Our Fibre Plans

April 2021 Alignment Update

20 May 2021

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In December 2020 we submitted our proposal for regulated fibre fixed-line access services (**FFLAS**) services to the Commerce Commission for the three years from January 2022 (regulatory period one, or **RP1**). Our proposal was set out in the document Our Fibre Plans, which can be found here.

Since publishing Our Fibre Plans, we have completed related work on the opening (1 January 2022) value of our regulatory asset base (**RAB**). This has involved further review and refinement of the allocation methodology for attributing costs to FFLAS and allocating shared costs to FFLAS. We completed this work and submitted it to the Commerce Commission in March 2021. A public version of the RAB model can be found here.

In April, we provided the Commerce Commission with updated RP1 expenditure forecasts that bring Our Fibre Plans into alignment with the initial RAB modelling allocations. This note provides information to accompany public release of the April 2021 alignment update to help ensure stakeholders have the information they need to participate effectively in the RP1 determination process.

This process of staggered release and updating of RP1 and initial RAB information is due to the tight interaction between development of the FFLAS regulatory rules (called input methodologies, or IMs), modelling of the initial RAB and preparation of Our Fibre Plans. Early release of Our Fibre Plans has enabled evaluation to proceed to the Commission's timetable.

How have the RP1 forecasts changed?

The April alignment update has reduced forecast capex and opex for RP1[1]:

- total RP1 opex reduces by 12% from $599 million to $527 million
- total RP1 capex reduces by less than 1% from $983 million to $978 million.

It is important to note that the substance of our plans for RP1 have not changed. The above movements are due only to changes in the allocation of costs between FFLAS and non-FFLAS services (not changes in investment intentions or cost assumptions).

The main change driving the April update outcomes is that we are now treating some labour costs, that we fully attributed to FFLAS in December, as shared costs. This means only a portion of those costs are now allocated to FFLAS. This has reduced (in descending order of impact) *asset management*, *network operations* and *corporate opex.*

In addition, we revised our treatment of the Crown's contribution to the West Coast fibre project (a Crown, Provincial Growth Fund project). This is now treated as a capital contribution, which reduces required *resilience* capex.

We have also updated pre-RP1 forecasts

Our Fibre Plans includes information on expenditure from 2016 through to the end of RP1. It shows total (i.e. unallocated) expenditure for 2016 to 2019, and FFLAS expenditure for 2020 and 2021. The 2020 and 2021 years provide particularly helpful context for Our Fibre Plans because they indicate expenditure trends into and through RP1.

The full timeframe is directly relevant to the initial RAB assessment, including because it informs the scale of unrecovered revenue that will contribute to the 'loss asset' portion of the initial RAB. As with the RP1 forecasts, our April 2021 alignment update includes changes to the 2020 and 2021 forecasts. These include the allocation and capital contribution changes above, plus two further alignment updates:

- we have replaced our pre RP1 forecast for the eighteen months to the end of December 2021 with outturn expenditure – i.e., our revised forecast view of actual expenditure for the period
- the forecast only captures costs relating to the ultrafast broadband (UFB) initiative (called UFB FFLAS). This is a slightly narrower than the previous FFLAS-based scope. This UFB FFLAS forecast is of the value of commissioned assets (VCA) rather than a spend-based view of capex. VCA naturally lags capex due to the delay between first incurring costs relating to a new asset and putting that asset into service.

Our adoption of these conventions means there is a small discontinuity between 2021 and 2022 as our forecasts switch from UFB FFLAS to PQ FFLAS and from a VCA to a spend view of capex.

[1] All figures are expressed in 2020 dollar terms. Refer for Our Fibre Plans for more detail on conventions and assumptions.

How do the opex forecasts compare?

In Figures 1.1 and 1.2 we compare our December and April opex forecasts.

Figure 1.1: Opex forecast – Original Our Fibre Plans values (December 2020)

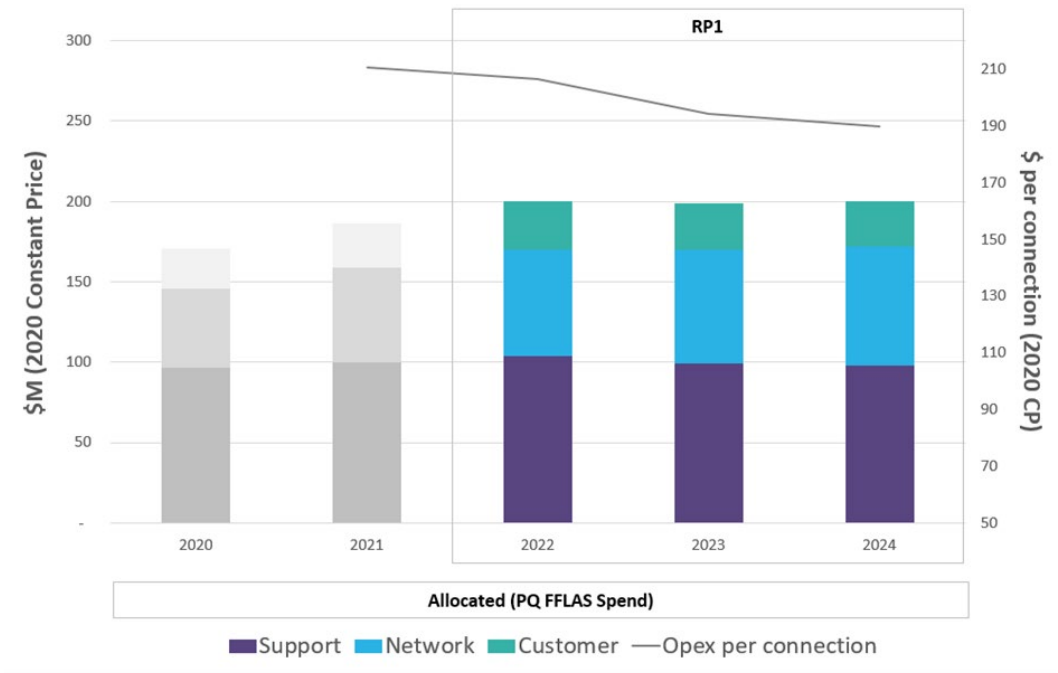
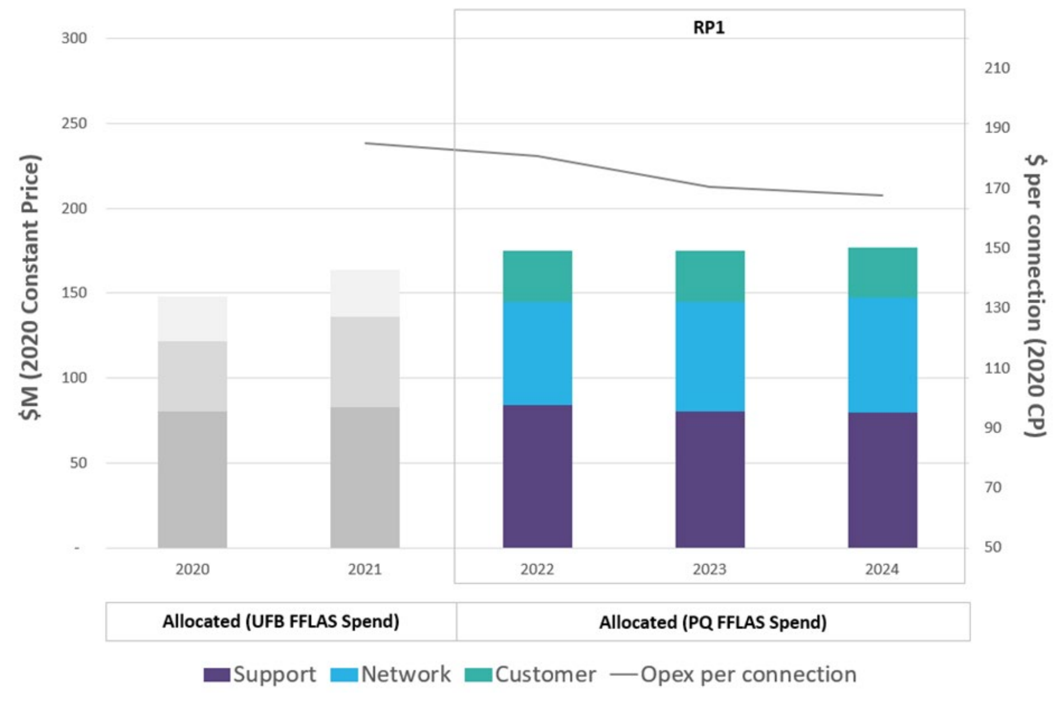


Figure 1.2: Opex forecast – April alignment update (April 2021)



Key observations are that:

- opex is lower each year, and lower overall. This is as expected with a smaller portion of shared costs allocated to FFLAS
- there is a slightly stronger upward trend across RP1. This is because, although total opex is gradually reducing across Chorus, the allocation of shared costs to FFLAS will increase as FFLAS connections grow
- our underlying opex forecast trends and drivers remain, including reduced capitalisation of network build costs and we have an increasing network support demands as connections grow
- despite the upward trend in FFLAS opex, the cost per connection still improves steadily as connection numbers grow.

Capex overview comparison

In Figures 1.3 and 1.4 we compare our December and April capex forecasts.

Figure 1.3: Capex forecast – Original Our Fibre Plans values (December 2020)

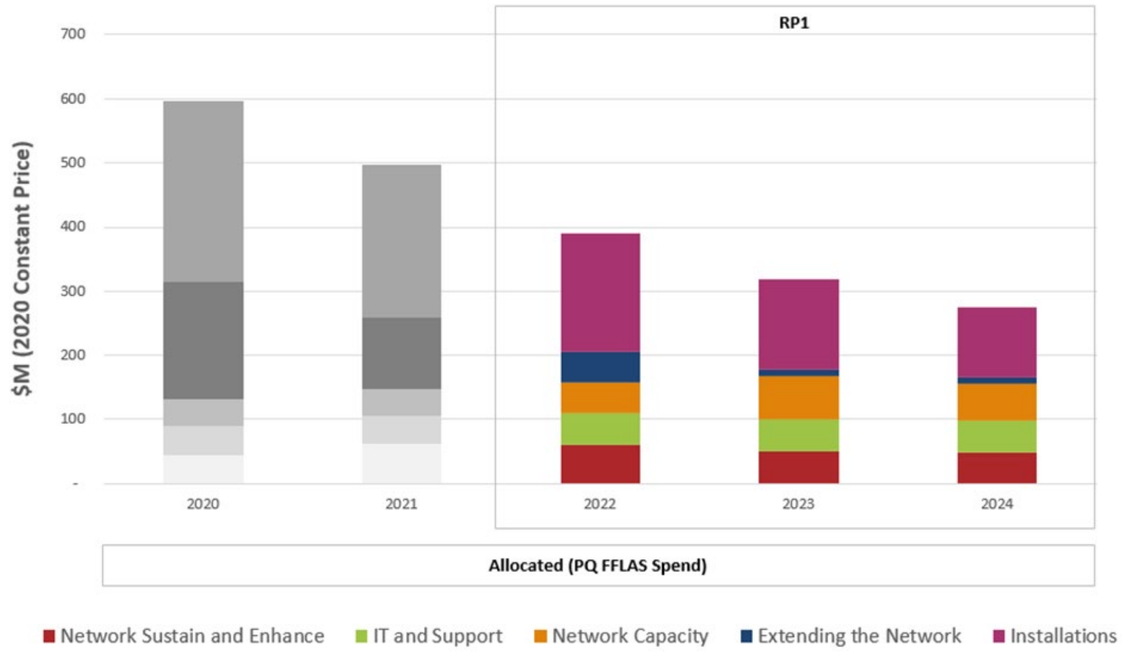
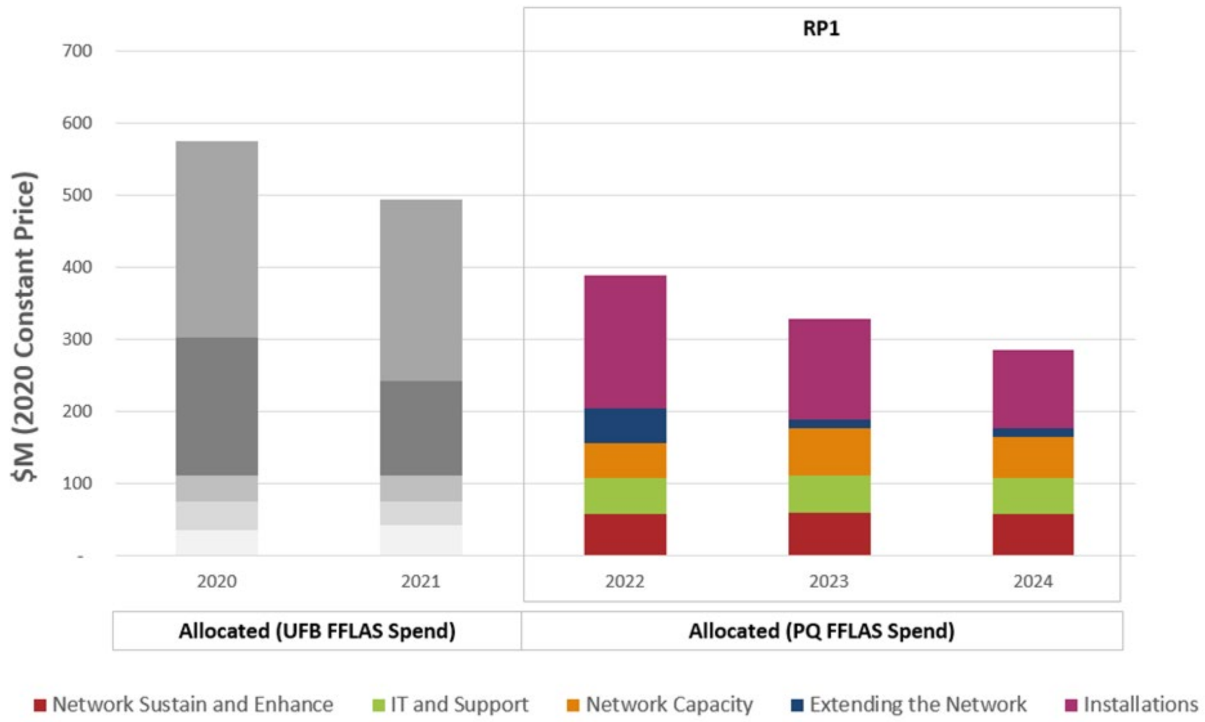


Figure 1.4: Capex forecast – April alignment update (April 2021)



Key observations are that:

- total capex across RP1 has changed very little
- there is negligible change during RP1 in extending the network, installations, IT and support and network capacity
- the biggest single change during RP1 is a reduction of around 20% in *resilience* capex due to the revision in capital contribution treatment for the West Coast project. This is partly offset by a slight increase in the allocation of *field sustain* capex
- the change in capital contribution treatment and the inclusion of outturn (our revised forecast view of actual expenditure).

Will forecasts change again?

If needed, we will update RP1 forecasts again as the RP1 determination is finalised. This could include updates for such matters as:

- ensuring alignment with any changes to allocation methodologies that may be decided through the initial RAB determination process
- implementing any Commerce Commission decisions about RP1 expenditure levels
- updating input parameters, such as cost escalation indices.