

## Attachment I Other inputs to the financial model

### Purpose of this attachment

- I1 This attachment explains other inputs to the financial model we must include in addition to the forecasts of capex and opex discussed in earlier attachments. It discusses:
- I1.1 the estimate of the weighted-average cost of capital (WACC) we have used;
  - I1.2 forecasts of asset disposals;
  - I1.3 forecasts of depreciation on existing assets;
  - I1.4 base year financial information; and
  - I1.5 forecasts of CPI as the revaluation rate and for indexing the forecast revenue path.

### High level approach

- I2 The inputs discussed in this attachment (except for forecasts of asset disposals) are determined in accordance with the EDB Input Methodologies (IMs) (specifically the cost of capital and asset valuation IMs). As such, our high-level approach to these issues is largely to apply the relevant IMs, including amendments made as part of the 2023 IM Review.
- I3 This attachment comments on the results of applying the IMs, and in some instances on the source data and any adjustments necessary to apply them.

### Cost of capital

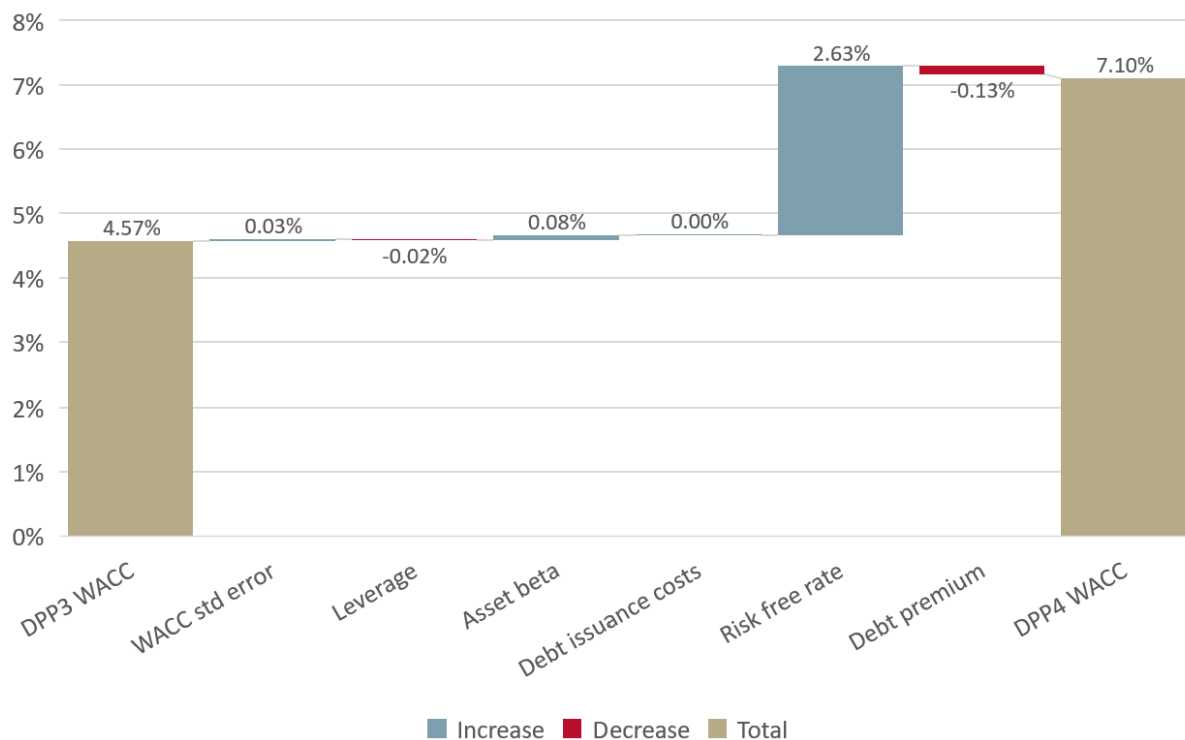
- I4 **Decision M1:** for the final decision, we have used a WACC estimate of 7.10%.
- I5 This figure was determined:
- I5.1 as at 1 September 2024;

15.2 using the input data as outlined in our EDB DPP4 and Transpower RCP4 WACC determination;<sup>1</sup> and

15.3 applying the recently amended EDB IMs, including using the 65th percentile in place of the previous 67th percentile.<sup>2</sup>

16 This is a decrease from the 7.37% WACC used in our draft decision.

**Figure I1 Cumulative effect of changes in WACC since DPP3**



## Forecast of asset disposals

17 **Decision M2:** we have forecast asset disposals by extrapolating historical asset disposals. This approach is unchanged from our DPP3 decision.

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<sup>1</sup> [Commerce Commission Cost of capital determination for electricity distribution businesses' default price-quality path commencing 2025 and Transpower New Zealand Limited's 2025-2030 individual price-quality path \[2024\] NZCC 21 \(25 September 2024\).](#)

<sup>2</sup> [Commerce Commission "Input methodologies review 2023 - Final decision - Cost of capital topic paper" \(13 December 2023\), Chapter 6.](#)

- 18 A disposed asset is an asset that is sold or transferred, or irrecoverably removed from a distributor's possession (but is not a lost asset). We are required to forecast disposed assets because disposed assets are removed from the RAB when rolling forward the RAB value.
- 19 For our decision, the forecast value of disposed assets in each year of the regulatory period has been forecast in real terms as equal to the historical average real value of disposals. The real forecast time series has then been converted to a nominal time series by adjusting for forecast CPI changes. These results are set out in Table I1.
- 110 We have made one exclusion to the historic data series for Vector Lines to remove the impact of a one-off extraordinary disposal in 2020.<sup>3</sup>

**Table I1 Forecasts of disposed assets (nominal \$ million)**

EDB	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
<b>Alpine Energy</b>	0.08	0.08	0.08	0.09	0.09	0.09
<b>EA Networks</b>	1.00	1.02	1.04	1.06	1.08	1.10
<b>Electricity Invercargill</b>	0.12	0.12	0.12	0.13	0.13	0.13
<b>Firstlight Network</b>	0.03	0.03	0.03	0.04	0.04	0.04
<b>Horizon Energy</b>	0.52	0.53	0.54	0.55	0.56	0.57
<b>Nelson Electricity</b>	0.18	0.18	0.19	0.19	0.19	0.20
<b>Network Tasman</b>	1.23	1.25	1.28	1.30	1.33	1.36
<b>Orion NZ</b>	1.00	1.02	1.04	1.07	1.09	1.11
<b>OtagoNet</b>	0.12	0.12	0.12	0.12	0.13	0.13
<b>Powerco</b>	19.15	19.56	19.95	20.35	20.75	21.17
<b>The Lines Company</b>	0.27	0.28	0.28	0.29	0.29	0.30
<b>Top Energy</b>	0.34	0.34	0.35	0.36	0.37	0.37
<b>Unison Networks</b>	1.69	1.73	1.76	1.80	1.83	1.87
<b>Vector Lines</b>	17.00	17.36	17.71	18.06	18.42	18.79
<b>Wellington Electricity</b>	–	–	–	–	–	–

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<sup>3</sup> The value of disposals in 2020 was \$289 million, compared to an average historical figure of \$17 million.

## Forecasts of depreciation for existing assets

- I11 As part of the 2023 IM Review, we amended the asset valuation IMs to change the way forecast depreciation on existing assets is calculated.<sup>4</sup> This change was to ensure depreciation attributable to fully depreciated assets was not incorrectly included in depreciation forecasts.
- I12 To obtain these forecasts, on 20 March 2024 we issued an information gathering notice to EDBs for forecasts of depreciation applying the IMs.<sup>5</sup>
- I13 In the draft decision, in most cases, we included the EDBs forecasts as they were provided. However, in two cases (Electricity Invercargill and OtagoNet) we had to apply the DPP3 forecasting method as a proxy, given the data they provided implied no change in weighted-average remaining asset lives over the period (an impossible outcome).
- I14 Following the draft decision, we engaged with EDBs and auditors to clarify the requirements and to ensure the IMs were applied correctly in calculating these forecasts and that they would be provided free of error.
- I15 We issued a s 53ZD information gathering notice on 30 July 2024.<sup>6</sup> This notice incorporated feedback from EDBs to make expectations clearer and included audit requirements that were not in the notice sent out prior to the draft decision.
- I16 Aurora was not subject to this notice, and we intend to issue a notice to them in 2025 to inform their transition to DPP4. For the purpose of providing indicative amounts in the DPP4 final reasons paper we have used the information from their draft notice.
- I17 Unlike at the draft decision, we have not had to use any alternative measures as all EDBs submitted feasible results.

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<sup>4</sup> [Commerce Commission "Input methodologies review 2023 - Final decision - Report on the Input methodologies review 2023 paper" \(13 December 2023\)](#), Decision AV16, p.38.

<sup>5</sup> [Commerce Commission "EDB DPP4 – s53ZD Notice for non-exempt EDBs" \(20 March 2024\)](#).

<sup>6</sup> [Commerce Commission "EDB DPP4 - s53ZD Notice - Information on Operating Leases and Depreciation of Existing Assets" \(31 July 2024\)](#).

118 Submissions on the draft decision highlighted inconsistencies between the forecasts of disposed assets we published in Table I1 and the disposed asset forecasts EDBs used in preparing their forecasts for existing asset depreciation.<sup>7</sup> To ensure consistency for the final decision we have used the same forecast of disposals in both places. Given the variation in how EDBs forecast disposals, we have decided to use our forecast of disposals, outlined in I9.<sup>8</sup> The results of this approach are set out in Table I2.

**Table I2 Forecasts of depreciation on existing assets (nominal \$ million)**

EDB	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
<b>Alpine Energy</b>	12.49	12.36	12.25	12.19	12.24	12.30
<b>EA Networks</b>	13.10	13.27	13.38	13.50	13.63	13.79
<b>Electricity Invercargill</b>	4.30	4.34	4.37	4.40	4.43	4.38
<b>Firstlight Network</b>	8.50	8.52	8.51	8.28	8.35	8.19
<b>Horizon Energy</b>	7.94	7.84	7.67	7.52	7.25	7.13
<b>Nelson Electricity</b>	2.12	2.14	2.17	1.87	1.86	1.78
<b>Network Tasman</b>	8.45	7.96	7.10	6.91	6.88	6.89
<b>Orion NZ</b>	58.46	58.10	56.97	56.42	55.77	55.31
<b>OtagoNet</b>	11.44	11.15	10.94	10.88	10.91	10.78
<b>Powerco</b>	113.91	108.31	103.78	100.66	99.44	98.82
<b>The Lines Company</b>	12.27	11.65	10.62	10.54	10.36	10.30
<b>Top Energy</b>	13.35	13.34	13.07	12.99	13.10	13.06
<b>Unison Networks</b>	41.17	39.46	38.12	35.95	34.62	33.94
<b>Vector Lines</b>	175.92	169.18	161.75	157.29	157.09	151.14
<b>Wellington Electricity</b>	32.84	32.84	31.02	30.68	30.54	30.36

<sup>7</sup> Vector “Submission on EDB DPP4 draft decisions” (12 July 2024), p. 34.

<sup>8</sup> To align the forecasts of disposals with the depreciation of existing assets, we used the provided depreciation and RAB forecasts to derive a weighted-average remaining life forecast. We then updated the RAB forecasts for our disposals forecast and updated CPI data. Finally using the derived weighted-average remaining life forecast, we then recalculated depreciation.

I19 In response to the draft decision, we received a number of submissions that considered 45-year default asset life for additional assets was not appropriate.<sup>9</sup> Amending this would require an IM change, and given that EDBs are made whole for differences between the default asset life assumption and actual asset lives via the capex wash-up, we have decided not to make a change as part of the IM amendments package that is occurring alongside the final DDP4 decision. We may consider this issue at the next IM review.

## **Base year financial information**

I20 To calculate necessary values such as the roll-forward of the RAB and tax building block, the DPP financial model requires “initial conditions” data from a base year. For the final decision, the base year is 2024 and we have used actual Information Disclosure (ID) data from 2024 disclosures.

## **Treatment of Alpine Energy’s base year data**

I21 On 6 October 2023, Alpine Energy redisclosed its ID data for the years between 2013 and 2023 to correct for an error in the calculation of depreciation. Our final decision is based on this redisclosed data.

I22 The DPP does not include any adjustments to account for any historic over-recovery of allowable revenue due to these errors. The matter is subject to an ongoing investigation by the Commission.

## **Forecasts of CPI**

I23 The revenue path is determined on a nominal basis (consistent with the CPI-X DPP/CPD regime outlined in Subpart 6 of the Act). When using a BBAR/MAR model to determine starting prices, we require a forecast of CPI to project annual revenues for each year of the DPP4 period. Because the asset valuation IMs requires the RAB to be revalued at the rate of change of CPI, we also require a forecast of CPI to determine BBAR.

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<sup>9</sup> [Electricity Networks Aotearoa \(ENA\) “Submission on EDB DPP4 draft decisions” \(12 July 2024\)](#), pp 8-9; [Powerco “Submission on EDB DPP4 draft decisions” \(12 July 2024\)](#), p. 11; [Vector “Submission on EDB DPP4 draft decisions” \(12 July 2024\)](#), pp. 33-34.

124 For both the rate of change of forecast CPI for RAB revaluations and the rate of change forecast for the price path calculation, the forecasts are based on the Reserve Bank of New Zealand’s (RBNZ) forecasts of inflation issued as part of the Monetary Policy Statement immediately prior to the determination of the WACC for the DPP.<sup>10</sup> The results of this approach are set out in Table I3.

**Table I3 Forecasts of CPI**

Pricing year ending in calendar year	CPI used for revaluations	CPI element of the price path
2025	2.20%	n/a
2026	2.10%	2.27%
2027	2.00%	2.00%
2028	2.00%	2.00%
2029	2.00%	2.00%
2030	2.00%	2.00%

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<sup>10</sup> [Reserve Bank of New Zealand “Monetary Policy Statement August 2024” \(14 August 2024\).](#)