

Review of the common cost of capital rules

10 March 2026



Consumers want reasonable, stable prices and good essential services.

To achieve this, we seek to ensure that regulated businesses are neither over- nor under-compensated, so they can undertake necessary investment at the lowest reasonable cost to consumers.

We regularly review the rules that help set the revenue that providers of monopoly infrastructure can earn in regulated sectors. These rules affect the prices that people pay and make sure the regulated businesses can invest in safe, reliable services. This overview explains what we reviewed, what we found, and what we're proposing.

Why we review these rules

The “input methodologies” (IMs) are the basic rules we use to run the regulatory system. They cover things like how we value assets, how we work out financing costs, and how prices are set.

Keeping these rules clear and consistent helps with stable pricing, investment, and reasonable outcomes for consumers and providers. Regular reviews make sure the rules stay effective and up to date.

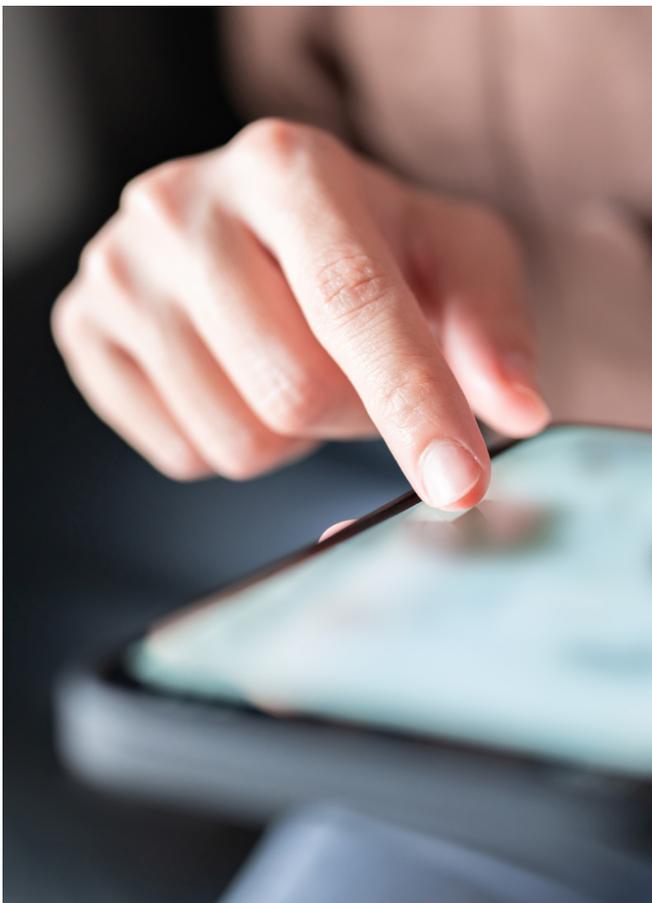
What the cost of capital is and why it matters

A significant proportion of the cost of regulated services is to finance the assets used to deliver those services.

The cost of capital is the return investors and lenders need to support essential infrastructure investment.

Setting it at an appropriate level helps ensure businesses can raise money to maintain and upgrade services while keeping prices as reasonable as possible.

The settings aim to balance investor returns with consumer interests.



A quick look at WACC

The **Weighted Average Cost of Capital (WACC)** reflects overall financing costs. WACC is not directly measurable or available from market data, so it must be derived using a set of informed estimates and assumptions.

We use the WACC to help set revenue allowances so suppliers can cover efficient costs and earn reasonable returns.

Some parts of WACC are common across sectors and have been reviewed together, while sector specific settings will follow their own cycles.

Weighted Average Cost of Capital

WACC combines the cost of equity, debt, and the firm's capital structure. Each part is estimated separately, then weighted.

Cost of Equity

What shareholders expect to earn



Cost of Debt

Interest paid on loans or bonds



Capital Structure

The mix of debt and equity



Tax Effects

Interest costs are tax deductible



Our draft view at a glance

Our draft decision is outlined on the [Common cost of capital input methodologies review \(fibre and regulated suppliers under Part 4\) draft decision reasons paper](#).

The draft decision relates to the weighted average cost of capital (WACC) input methodologies (IMs) and applies across Part 6 (regulated fibre fixed line access services), and Part 4 (electricity lines, gas pipelines, airports).

The draft decision is:

- The current rules are largely **fit for purpose** and should remain in place.
- How we estimate the tax-adjusted market risk premium (TAMRP), which is a part of the cost of equity, should change. We propose to clarify the estimation method in the rules and the timing of future updates—these can be characterised as refinements to the current approach.

This is a draft decision, and we welcome feedback before a final decision is made.

Price shocks: what we heard and what we tested

The total revenues we allow the regulated businesses are comprised of operating expenses, cost of equity, tax, depreciation and the cost of debt.

The cost of debt is the aspect that stakeholders have mostly focussed on.

They have had concerns about price shocks to consumers when price paths are reset every four to five years. Some have advocated for us to smooth changes in the cost of debt by moving to what is called a “trailing average” from our current “prevailing” approach.

We looked closely at this idea, including the trade-offs with added complexity and transition costs.

What a trailing average means

When we estimate financing costs, we look at borrowing (debt) and investor returns (equity). Both start from a basic risk-free rate plus an extra amount for risk.

A **trailing average** uses an average of past interest rates to smooth ups and downs. This approach can be applied to **debt** because it aligns with what companies pay on past borrowings. Equity investment decisions are forward looking, so we keep the cost of equity settings based on expected future returns. This is consistent with how many regulators overseas set the cost of equity.

For the debt side, we currently use **prevailing government bond rates, at the time of a price path reset**, for the risk-free part and a **five-year trailing average** for the corporate bond margin (the debt premium).

If we adopted a trailing average for the **whole** cost of debt, we may apply the averaging approach across all debt components.



What makes the most difference to revenues (and what doesn't)

Debt costs include three parts:

1. the risk-free rate (the base interest rate, based on Government bonds),
2. the debt premium (the extra margin for corporate default risk), and
3. issuance costs (the cost of arranging and maintaining debt).

We already average the debt premium over five years, and we use the current rate (as at the price path reset) for the risk-free part. Moving to a trailing average would only change how we handle the risk-free rate.

Our analysis shows the real risk-free rate is a small part of total costs—**less than 10%**—so changing that piece would have only a minor impact on allowed revenues. Inflation is a bigger driver in how revenues move over time.

What our modelling suggests

We assessed five and ten-year trailing average options against the current method. On balance we found:

- A **ten-year trailing average** may reduce investment incentives and would likely increase regulated prices because ten-year interest rates are generally higher than five-year rates. This would also create the risk of excessive profits. It may be less suited to supporting healthy competition in telecommunications. For these reasons, we think it may not deliver the best long term outcomes for consumers.
- A **five-year trailing average** performs very similarly to the current method: both can encourage investment, help manage the risk of excessive profits, and support workable competition where relevant. The difference between them is small.
- Adopting a trailing average **would likely add complexity to our regulatory regimes**. To achieve the benefits of a trailing average it could mean annual updates to revenue allowances and several changes to keep the framework conceptually sound, increasing administrative and compliance costs for both regulators and suppliers. Suppliers would also face transition costs if we moved to a new approach. These costs don't decide the issue on their own, but they are part of the overall picture.
- We already have **other tools** that can smooth revenues effectively across regulatory periods, which reduces the need to change this part of the framework.

An example: electricity reset 2024/25

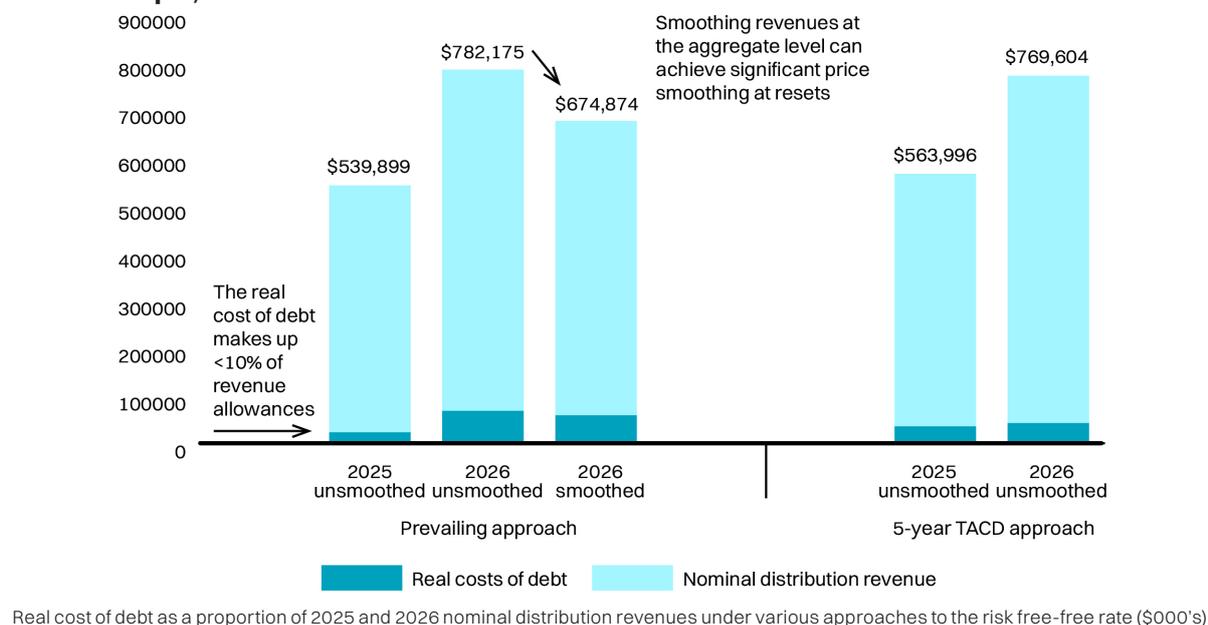
We tested a real-world example from the last round of electricity resets, in which we used smoothing tools to manage changes in the revenues required by the regulated businesses to cover their costs.

Without smoothing, some companies could have seen distribution revenue jump by as much as **60%**; instead, the average sector increase was around **25%**.

Based on our modelling a trailing average would have slightly reduced the initial price shock, but the existing smoothing tools achieved much more smoothing.

However, no matter how the cost of debt is calculated, a revenue jump in the 2025 reset was unavoidable. This is because high inflation after Covid pushed up prices across the board, including materials and operating costs, and because networks now need more investment to support the energy transition and replace aging infrastructure.

As an example, for Vector



Why we propose to keep the current approach

We consider the current hybrid cost of debt method (prevailing risk-free rate + trailing average debt premium) is effective and efficient.

It has enabled regulated suppliers to invest around \$21 billion since 2013, with electricity lines businesses forecasting significant uplifts in capex throughout their current regulatory period.

It avoids unnecessary complexity and transition costs, and we have other tools to smooth revenues across regulatory periods when needed.

We are proposing to retain the current approach, because—when weighed against our objectives (investment incentives, limiting excessive profits, promoting competition where relevant, and supporting regulatory certainty and mitigating regulatory complexity)—**the status quo better promotes long-term consumer outcomes.**

Have your say

The Commission emphasises that the draft decision on **the choice** between a prevailing versus trailing average for the real risk-free rate incorporated in the cost of debt is **finely balanced**.

Our empirical analysis suggests real, measurable effects of any change in approach, including more complexity for the regulatory regime.

We want to ensure all stakeholders clearly understand the issues and trade-offs and invite your feedback and further views before a final decision is made.

Submissions are invited by 5:00pm, 16 April 2026, with cross submissions due 6 May 2026.