Company Name	Vector
For Year Ended	31 March 2021

Schedule 14 Mandatory Explanatory Notes

(Guidance Note: This Microsoft Word version of Schedules 14, 14a and 15 is from the Electricity Distribution Information Disclosure Determination 2012 – as amended and consolidated 3 April 2018. Clause references in this template are to that determination)

1. This schedule requires EDBs to provide explanatory notes to information provided in accordance with clauses 2.3.1, 2.4.21, 2.4.22, and subclauses 2.5.1(1)(f),and 2.5.2(1)(e).

2. This schedule is mandatory—EDBs must provide the explanatory comment specified below, in accordance with clause 2.7.1. Information provided in boxes 1 to 11 of this schedule is part of the audited disclosure information, and so is subject to the assurance requirements specified in section 2.8.

3. Schedule 15 (Voluntary Explanatory Notes to Schedules) provides for EDBs to give additional explanation of disclosed information should they elect to do so.

Return on Investment (Schedule 2)

4. In the box below, comment on return on investment as disclosed in Schedule 2. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 1: Explanatory comment on return on investment

The return on investment (ROI) for Vector's Electricity Distribution Business (EDB) is 3.67%. This is lower than the 67th percentile vanilla WACC of 4.57%. The key factors depressing the returns are lower actual revaluation rate, lines revenues and loss on disposals relative to the DPP forecast.

Actual CPI for RY21 was 1.52% which was lower than the Commission's forecast of 1.90%. This reduces the ROI by 0.38%.

Net lines revenue is lower than forecast by $7.3m due to the volume reduction impact from COVID-19. Loss on disposals is $12.0m. Both of these amounts are recoverable in RY23 through the revenue wash-up.

Regulatory Profit (Schedule 3)

5. In the box below, comment on regulatory profit for the disclosure year as disclosed in Schedule 3. This comment must include-

   5.1 a description of material items included in other regulated income (other than gains / (losses) on asset disposals), as disclosed in 3(i) of Schedule 3

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5.2 information on reclassified items in accordance with subclause 2.7.1(2).

Box 2: Explanatory comment on regulatory profit
The value of "other regulated income (other than gains/ (losses) on asset disposals)" is nil.
There has been no re-classification of items in the disclosure year.

Merger and acquisition expenses (3(iv) of Schedule 3)

6. If the EDB incurred merger and acquisitions expenditure during the disclosure year, provide the following information in the box below-

   6.1 information on reclassified items in accordance with subclause 2.7.1(2)

   6.2 any other commentary on the benefits of the merger and acquisition expenditure to the EDB.

Box 3: Explanatory comment on merger and acquisition expenditure
No merger or acquisition expenditure has been incurred during the disclosure year.
There has been no re-classification of items in the disclosure year.

Value of the Regulatory Asset Base (Schedule 4)

7. In the box below, comment on the value of the regulatory asset base (rolled forward) in Schedule 4. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 4: Explanatory comment on the value of the regulatory asset based (rolled forward)
<u>Roll forward of regulatory asset base (RAB)</u>
The value of the RAB has been determined by rolling forward the initial RAB with allowances made for additions, disposals, depreciation and revaluation in accordance with the current IM determination.
<u>Reclassified items</u>
There has been no re-classification of items in the disclosure year.

Regulatory tax allowance: disclosure of permanent differences (5a(i) of Schedule 5a)

8. In the box below, provide descriptions and workings of the material items recorded in the following asterisked categories of 5a(i) of Schedule 5a-

   8.1 Income not included in regulatory profit / (loss) before tax but taxable;

8.2 Expenditure or loss in regulatory profit / (loss) before tax but not deductible;

8.3 Income included in regulatory profit / (loss) before tax but not taxable;

8.4 Expenditure or loss deductible but not in regulatory profit / (loss) before tax.

Box 5: Regulatory tax allowance: permanent differences

The RAB loss on disposal of assets after excluding amount in deferred tax is $9m. This relates to non-deductible unamortised initial differences of RAB assets disposed and the revaluation component of the disposal value (row 11 of schedule 5a).

Regulatory tax allowance: disclosure of temporary differences (5a(vi) of Schedule 5a)

9. In the box below, provide descriptions and workings of material items recorded in the asterisked category 'Tax effect of other temporary differences' in 5a(vi) of Schedule 5a.

Box 6: Tax effect of other temporary differences (current disclosure year)

There are no material items in the disclosure year.

Cost allocation (Schedule 5d)

10. In the box below, comment on cost allocation as disclosed in Schedule 5d. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 7: Cost allocation
There has been no re-classification of items in relation to cost allocation in the disclosure year. The accounting-based allocation approach (ABAA) has been applied to allocate not directly attributable costs in the disclosure year in accordance with the IM determination. The "Property, Plant and Equipment (PPE)" asset and labour hours allocators are the key proxy allocators used to allocate not directly attributable corporate shared costs as causal factors are not available. A causal relationship cannot be established for the non-directly attributable costs because of the shared nature of these services. This means there is no single cost driver leading to a cost being incurred. <u>Labour hours</u> Vector has undertaken a survey of estimated time spent on regulatory activities for the purpose of regulatory cost allocation. Not all shared service functions are able to estimate time spent servicing each business due to their activities being ever changing or because activities are primarily provided on a group only basis. <u>PPE</u> A significant proportion of Vector's activities are focused on managing physical assets. Therefore, an assumption can be made that the greater the amount of physical assets a business has (measured by value) the greater share of corporate shared costs required to support that business. The rationale behind the use of each proxy allocation is based on a thoughtful analysis of each cost item.

Asset allocation (Schedule 5e)

11. In the box below, comment on asset allocation as disclosed in Schedule 5e. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 8: Commentary on asset allocation

Consistent with cost allocation, Vector applied ABAA to allocate non-directly attributable network asset values in the current disclosure year in accordance with the IM determination. Vector has determined and reported two allocators for shared network assets: a fair value ratio and a capacity ratio. The fair value ratio is determined by reference to an estimated fair value of the non-directly attributable portion of a shared network asset. The capacity ratio is an engineering-based ratio by reference to an asset's total service capacity. Determining which allocator to use involves an understanding of the nature of the shared network asset concerned and the substance of the non-electricity distribution services that the asset provides. These allocators are proxy allocators. A causal relationship sometimes cannot be established for the non-directly attributable network asset values because the shared nature of these assets means there is no single factor influencing the utilisation of the asset.

Determining the non-network fixed assets for the regulated and non-regulated businesses follows a similar process to operating cost allocation.

There have been no material changes in asset allocations in the disclosure year except for certain shared assets being removed from the electricity business due to a change in allocation.

Capital Expenditure for the Disclosure Year (Schedule 6a)

12. In the box below, comment on expenditure on assets for the disclosure year, as disclosed in Schedule 6a. This comment must include-

    12.1 a description of the materiality threshold applied to identify material projects and programmes described in Schedule 6a;

    12.2 information on reclassified items in accordance with subclause 2.7.1(2).

Box 9: Explanation of capital expenditure for the disclosure year

The materiality threshold applied to identify material projects is the level of audit materiality applied by Vector's regulatory auditors ($8m).

There were no material projects or programmes in the disclosure year.

There has been no re-classification of items in the disclosure year.

Operational Expenditure for the Disclosure Year (Schedule 6b)

13. In the box below, comment on operational expenditure for the disclosure year, as disclosed in Schedule 6b. This comment must include-

13.1 Commentary on assets replaced or renewed with asset replacement and renewal operational expenditure, as reported in 6b(i) of Schedule 6b;

13.2 Information on reclassified items in accordance with subclause 2.7.1(2);

13.3 Commentary on any material atypical expenditure included in operational expenditure disclosed in Schedule 6b, a including the value of the expenditure the purpose of the expenditure, and the operational expenditure categories the expenditure relates to.

Box 10: Explanation of operational expenditure for the disclosure year

Asset Replacement and renewal operational expenditure is largely incurred to rectify non-compliance with maintenance standards as identified from planned equipment inspections.

This expenditure includes the replacement of equipment components that do not extend the life of the asset. The major spend areas are maintenance on zone substations, subtransmission cables, and overhead lines.

Reclassified items

There has been no material re-classification of items in the disclosure year.

Atypical Expenditure

There was no atypical expenditure during the disclosure year which exceeded our materiality threshold, as described above.

Variance between forecast and actual expenditure (Schedule 7)

14. In the box below, comment on variance in actual to forecast expenditure for the disclosure year, as reported in Schedule 7. This comment must include information on reclassified items in accordance with subclause 2.7.1(2).

Box 11: Explanatory comment on variance in actual to forecast expenditure

CAPEX

Overall actual expenditure was 10%, $33m below forecast at $296m with the key drivers being:

- Consumer Connections was 9% or $6.2m above forecast. This was predominantly due to residential subdivisions.
- System Growth was 7% or $3.1m below forecast. The primary driver was delays to future proofing dependent on third party works.
- Asset Replacement was 10% or $11.4m below forecast due to slowdown of activity in 2020 caused by the pandemic.
- Other Reliability, Safety and Environment was 12% or $3.2m below forecast due to the conductor renewal programme as fewer scopes were issued.
- Non network was 45% or $19.9m below forecast mainly due to property improvement deferred.

OPEX

Overall actual expenditure was 3% or $4m lower than forecast with key drivers being:

Network opex

$7.7m or 13% lower than forecast mainly due to lower spend on tree trimming activities in FY21 and delays in maintenance activities due to COVID 19 pandemic.

Non network opex:

$3.3m or 4% higher than forecast mainly due to a business re-organisation to move assets permanently and directly to a subsidiary entity.

Information relating to revenues and quantities for the disclosure year

15. In the box below provide-

15.1 a comparison of the target revenue disclosed before the start of the disclosure year, in accordance with clause 2.4.1 and subclause 2.4.3(3) to total billed line charge revenue for the disclosure year, as disclosed in Schedule 8; and

15.2 explanatory comment on reasons for any material differences between target revenue and total billed line charge revenue.

Box 12: Explanatory comment relating to revenue for the disclosure year

Vector's target revenue for the year ended on 31 March 2021, as included in our 2021 Electricity Pricing Methodology Disclosure pursuant to clause 2.4.1(1) and 2.4.3(3) of the electricity Distribution Information Disclosure Determination 2012, was $565m.

Total billed line charge revenue for the disclosure year ended on 31 March 2021 was $561m, as disclosed in schedule 8 of this disclosure. The variance between total billed line charges and target revenue of approximately $4m or (0.8%) is mainly due to lower than forecasted quantities.

Network Reliability for the Disclosure Year (Schedule 10)

16. In the box below, comment on network reliability for the disclosure year, as disclosed in Schedule 10.

Box 13: Commentary on network reliability for the disclosure year

There has been a decrease in the number of Planned Interruptions (SAIDI B) in RY21 by 17% on last year. This can be attributed to in some part due to the lockdown restrictions faced by the country due to Covid-19 pandemic.

Unplanned Interruptions (SAIDI C) were 22% lower than RY20, due to no major storm events occurring in RY21, but primarily due to significant initiatives to improve network resilience despite ongoing challenges caused by weather events, traffic congestion and vegetation.

Please refer to Schedule 15 for explanations of differences to the Electricity Compliance Statement.

Insurance cover

17. In the box below, provide details of any insurance cover for the assets used to provide electricity distribution services, including-

    17.1 The EDB's approaches and practices in regard to the insurance of assets used to provide electricity distribution services, including the level of insurance;

    17.2 In respect of any self insurance, the level of reserves, details of how reserves are managed and invested, and details of any reinsurance.

Box 14: Explanation of insurance cover

Vector Limited takes insurance cover for group assets. These policies cover material damage, business interruption and contract works insurance.

Insurance costs are allocated to the Electricity Distribution Business using the proportion these assets represent relative to Vector's overall insured assets.

In respect of the insurance cover the information reflects "insurance years" running from 1 September to 31 August each year and premium costs are allocated to the appropriate regulatory years to derive the premium values.

Amendments to previously disclosed information

18. In the box below, provide information about amendments to previously disclosed information disclosed in accordance with clause 2.12.1 in the last 7 years, including:

    18.1 a description of each error; and

    18.2 for each error, reference to the web address where the disclosure made in accordance with clause 2.12.1 is publicly disclosed.

Box 15: Disclosure of amendment to previously disclosed information

N/A

Company Name Vector

For Year Ended 31 March 2021

Schedule 15 Voluntary Explanatory Notes

(In this Schedule, clause references are to the Electricity Distribution Information Disclosure Determination 2012 – as amended and consolidated 3 April 2018.)

1. This schedule enables EDBs to provide, should they wish to-

   1.1 additional explanatory comment to reports prepared in accordance with clauses 2.3.1, 2.4.21, 2.4.22, 2.5.1 and 2.5.2;

   1.2 information on any substantial changes to information disclosed in relation to a prior disclosure year, as a result of final wash-ups.

2. Information in this schedule is not part of the audited disclosure information, and so is not subject to the assurance requirements specified in section 2.8.

3. Provide additional explanatory comment in the box below.

Box 1: Voluntary explanatory comment on disclosed information

Reissued Disclosures

In March 2020 Vector's electricity business undertook certain sale and lease back related party transactions (the Transactions) relating to substation land, substation buildings and the Penrose to CBD tunnel. The Transactions were undertaken to separate Vector's land and buildings into separate subsidiaries, accountabilities and reporting lines, to commercialise, develop and realise additional revenue from these assets outside the regulated business, and to create opportunities for future capital raising to support our ongoing investment in Auckland growth and electrification to enable net zero 2050. Other infrastructure owners have recently undertaken similar transactions; for example, Telstra, Vodafone and Spark have all separated out the ownership of their passive infrastructure.

The Transactions were disclosed in the 2020 Information Disclosure published on 29 October 2020. Given the size and the complexity of the Transactions, extensive external legal and accounting advice was sought to ensure the Transactions were correctly treated in the Information Disclosures. Vector also brought the Transactions to the Commission's attention ahead of filing the 2020 Information Disclosures, and those original disclosures as filed clearly set out the impact of the Transactions. After the 2020 Information Disclosures were published, the Commerce Commission notified Vector that it considered its treatment of the Transactions to be inconsistent with the applicable input methodologies. Following extensive engagement by Vector with the Commission, Vector has agreed to amend the regulatory effects of the Transactions.

These restated and reissued Information Disclosures reflect the reversal of the regulatory effects of the Transactions. Neither the original treatment of the Transactions or the amended effects of the Transactions now reflected in these disclosures have had any impact on prices. As these transactions were undertaken between wholly owned Vector companies, they had no impact on our Group financial statements.

Vector initiated extensive engagement with the Commission on this matter, including proactively sharing expert legal and accounting advice supporting Vector's regulatory treatment of the Transactions, in an attempt to reconcile the difference in interpretation. Such expert advice was in addition to audited regulatory disclosures incorporating the Transactions having been filed with the Commission.

The opening deferred tax balance under clause 2.3.7(1)(c) of Electricity Distribution Services Input Methodologies Determination 2012 (IMs)

Vector provided the explanation last year for how the opening deferred tax balance under GAAP is treated for assets with no regulatory tax asset value.

The difference between the closing deferred tax balance reported in RY20 and the opening deferred tax balance in RY21 is the tax effect of 2020's ROU commissioned assets due to the adoption of NZ IFRS 16 Leases.

<u>"Net recoverable costs allowed under incremental rolling incentive scheme" under schedules 2</u>

The "net incremental rolling incentive scheme (IRIS)" as defined in the current IDs is the sum of previous years' incremental gain/loss from the 5 disclosure years preceding the current disclosure year. The IRIS disclosure in schedule 3 only applies to customised price-quality paths, and not default price-quality paths (DPP). At the time the IRIS was introduced, the Commission had not established an approach for setting expenditure baselines under DPP.

For EDBs under DPP, the Commission has implemented a new IRIS calculation under the IM's amendments for all disclosure years commencing after 1 April 2020. Since the Commission has not updated the Microsoft Excel template to reflect this change, Vector discloses its IRIS in the "Other financial incentives" under schedule 2 for disclosure year 2021.

<u>Zone Transformer Substation capacity in Schedule 9e</u>

In RY21 a number of zone substation transformers that had a cyclical rating were changed to nameplate values in the Northern network (nameplate values are always lower than cyclical values).

<u>Normalised SAIFI and SAIDI in Schedule 10</u>

The disclosed SAIDI and SAIFI values under the current ID requirements are not aligned with those presented in Vector's 2021 Compliance Statement, which is based on the Electricity Default Price-Quality Path Determination 2020 (DPP3). The methodologies and formulae for ID and DPP3 are not comparable. The SAIDI and SAIFI values under DPP3 can be found here on Vector's website https://www.vector.co.nz/about-us/regulatory/disclosures-electricity/price-quality-path.

<u>Energy efficiency and demand side management, reduction of energy losses (when known) in Schedules 6a and 6b</u>

Vector has improved the efficient provision of electricity line services by
(a) improving energy efficiency
(b) encouraging demand side management
(c) implementing initiatives that reduce electricity losses
(d) implementing initiatives that reduce reactive power flows in the network

However, the costs have been included under other categories which are the <u>primary driver</u> of Vector performing the work. Therefore, the values of "Energy efficiency and demand side management, reduction of energy losses" are nil in Schedules 6a (ii) and 6b(ii) as the data is not recorded in a way where it can be separately reported from our financial systems.