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Fixed wireless, by-pass and affordability

NBN Co.'s fixed-wireless woes have made the TPG by-pass issue even bigger. And there is a 'time bomb' under affordability which needs to be addressed.

NBN Co.'s Review last week revealed that the fixed wireless and satellite programs will now cost $5.2 billion between 2011 and 2021(*Comms Wire,* 7 May 2014).

This raises the stakes in the issue of universal pricing and efficient by-pass. The issue of affordability also needs to be addressed.

Unforseen demand in country areas has increased fixed wireless capex by $1.7 billion and revenues by only $0.8 billion– increasing the size of the TPG (and others) by-pass issue by nearly $1 billion.

The poor demand forecasts were no surprise. The forecasting of AVC take-up and associated traffic was found to be flaky a year ago (see comments to the ACCC).

As explained last month in this column, geographically uniform access prices set by NBN Co. effectively combine a cost component and also a subsidy component to account for different costs in metro and country areas.

With last week's capex news, the metro to country subsidy just got $1 billion bigger; which will lead to inefficient by-pass of NBN Co., unless all providers of broadband access make a contribution to the subsidy. If that happens, efficient infrastructure competition is compatible with uniform pricing.

While an industry levy under a revised USO regime could be part of a solution to allow efficient by-pass, other complementary solutions were included in my submission to the Vertigan Panel. One is direct subsidy. Another which concerns the treatment of asset valuations in the Commonwealth's accounts suggests an opportunity to help solve for both infrastructure competition and affordability.

The Parliamentary Library paper on NBN finances and the budget statements says that the Department of Finance recommends using discounted cash flows for asset valuation. Or, if there are small cash flows and in the case of not-for-profit entities, it suggests using net assets (depreciated book value).

The Annual Report by the Department of Communications only uses discounted cash-flow

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for Australia Post.

[Incidentally, the Department's net asset value for NBN Co. at June 2013 is reported as $3.42 billion; which indicates how little has been built so far. By the end of the roll-out, it would be $41 billion less accumulated depreciation on this method of valuation].

Surely, NBN Co. assets should be valued by discounted cash-flows? The current NBN corporate plan of August 2012 has net cash flows to 2040 of just $5.2 billion discounted at 3% (and minus $11 billion discounted at 7%). It would take an unrealistic terminal value to get the 7.1% internal rate of return that Labor promised. Last week's news just makes this even worse.

When an asset does not generate enough revenues to generate a return on capital, it is normally written down - it is worth only the present value of cash flows. This situation obviously applies to the fixed wireless and satellite programme.

Note that an asset write-down has no impact on the budget deficit or surplus as it is below the line as part of other economic flows in the budget operating statement. This would reduce the size of the required cross-subsidy and help make the NBN more affordable for both city and country.

But a bigger issue for affordability - because all customers are affected - is the way NBN Co. intends to claw-back foregone revenues in future.

Have you ever wondered how NBN Co. can match existing market wholesale pricing despite having a $40 billion shiny new network? It is because NBN Co. got the ACCC to agree that the difference in revenues it is allowed to earn now and what the lower amount it actually earns now (because of artificially low prices) can be accumulated with interest in an Initial Cost Recovery Account (ICRA). This can be drawn down and added later to revenues allowed by the regulated return on assets.

It is this catch-up (not CVC pricing) which is the 'time bomb' leading to higher NBN ARPUs.

The ACCC rarely allows 'loss capitalisation' and then only as 'temporary' measure. NBN's ICRA goes to 2040 and beyond (see comments on ARPU and the ICRA).

The ICRA arrangement just delays the pain of admitting we have an expensive network. It hides the true cost of the NBN. Lowering the cost of completing the network is a good start, but we could also cop the pain now. If forecast revenues at the current low prices cannot generate a return on capital, an asset write-down would put NBN Co. on a more sustainable commercial footing and make it more affordable.

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