The allure of investing in regulated energy assets

By Bopha Ly,
General Manager, Energy & Renewables at Dexus

The nature of returns from regulated energy assets in Australia and New Zealand, combined with the need for greater investment as both countries transition to renewable energy, is making the investment case for this core asset class even more compelling.

For an investor, the beauty of owning part of a regulated energy asset is the protection of earnings and the stable, predictable long-term cash flows they provide. Regulated utilities are typically the single or dominant operator in their service areas and provide essential services for which there is consistent and growing demand, through electrification, and economic downside protection.

Because of this, regulated utilities generally have a lower risk profile due to their essential nature and the regulatory framework that governs their operations. Regulated asset returns are also often linked to prevailing risk free rates at the time revenues are set and inflation, providing a potential hedge against borrowing costs and rising supply costs.

And, with the billions of dollars needed to be invested to support the sector on both sides of the Tasman, some regulated energy assets are poised to benefit from this growth through significantly higher regulated asset bases as the energy transition plays out.

A good example is Dexus's investment in Powerco, which is New Zealand's second largest electricity distribution business, and largest by network length and which has delivered consistently sound returns to investors in our infrastructure trust.

Dexus manages a 42% shareholding in Powerco, which owns and maintains the electricity distribution lines, substations and gas pipelines that deliver electricity and gas to more 900,000 customers across the country's North Island. Its electricity network comprises almost 30,000km of electricity distribution lines and is connected to around 360,000 homes and commercial and industrial customers.

As the future of the electricity market becomes more decentralised from behind-the-meter rooftop generation, batteries and a greater dispersion of generation and storage fleet, it will be the role of distributors like Powerco to connect these new sources of distributed generation and ensure networks can support multidirectional flow to maintain stability of the grid.

What excites me most about regulated energy utilities, is the potential to capture new unregulated revenue pools as a result of the energy transition. For instance, what we have seen in Australia are network companies providing infrastructure-as-a-service to connect renewables and batteries to the network. There is also opportunity for distributors to deploy more innovative storage solutions that delay or replace the need for grid augmentation, whilst at the same time capturing some of the energy value pools from the batteries.

The demand for electricity is forecast to grow and with increased investment and energy traffic across its network, Powerco's revenue


Powerco, New Zealand

base should also grow, steadily increasing the earnings for investors. And the amount of investment needed across the country is large.

A Boston Consulting Group (BCG) report estimated that decarbonising the broader energy sector, improving energy affordability, and increasing energy independence in New Zealand would require an investment of NZ$42 billion this decade.

More than half of this (NZ$22 billion) would be investments in distribution infrastructure to enable electrification and prepare networks for rapid electrification in the 2030s. Total investment needed in 2026–2030 is forecast to be 30% higher than 2021–2025.

Not only can Powerco grow through increased investment, energy flows and tapping unregulated revenue opportunities, but we also see strong potential for acquisitions.

We expect that there will be consolidation of the market. New Zealand currently has 29 electricity distribution businesses (EDB) and a population of just over five million. Compare this to New South Wales which has just three EDBs supporting its larger 8.5 million population.

In New Zealand EDBs are either council or trust-owned and many councils are having to fund expensive infrastructure upgrades, which we think will drive the need for these councils to divest over time.

We also see a significant investment opportunity in regulated utilities in Australia as the Australian Energy Market Operator (AEMO) estimates more than $200 billion in capital investment will be needed to fund the country's energy transition out to 2050. The AEMO also estimates electricity consumption from the grid will nearly double over that timeframe.

This needed funding will be for renewable generation to replace coal-fired power stations and battery energy storage systems and pumped hydro to maintain capacity when renewable generation dips. Significantly, a large proportion will be for transmission assets to strength interconnectivity between states and to connect new renewable energy zones to the grid.

With more than 30 years' experience investing in regulated utilities and the energy transition firmly underway and momentum building, we are excited about the opportunities that are ahead and look forward to partnering with our investors to unlock this potential.

Powerco, New Zealand