

Commission 1: Sector Financial sustainability

Draft 3. 19 February 2022

Summary Problem statement

Key water entities in the sector (Water Trading Entity, TCTA and water boards) are experiencing an unsustainable increase in creditor debt (money owed to these entities). As at the end of 2021, R37 billion was owed to the WTE and water boards. This is threatening the financial viability of these entities and compromising their ability to raise commercial debt finance from the capital markets. In some cases, entities (some water boards) are technically bankrupt.

The overall level of investment in the sector is insufficient in relation to the need. At the water resources level, this means that water insecurity is increasing because the pace and timing of investment is insufficient in relation to the need. Many of the metros are currently exposed to low rainfall events and have a lower level of assurance than the planning standard.

At the water services level, low levels of investment (particularly in infrastructure rehabilitation/replacement), combined with significant inefficiencies in how money is spent, exacerbated in many cases by poor governance and a lack of skills, is leading to a deterioration in water services. This is evident in reducing level of reliability of water supplies provided by municipalities in many parts of South Africa (“no water in the tap”). Many municipalities now have unreliable water supplies, and poor sewer collection and wastewater treatment. This leads to deteriorating services, higher losses and costs, more inconvenience to households and reduced willingness to pay. This, together with poor cash collection performance (customer debt management), results in insufficient cash to meet the costs of providing the service, creating a reinforcing cycle of decline.

Turning this cycle of decline around will require a multiprong effort that includes making better use of available grant finance, increasing the use of the private sector and commercial financing, improvement governance and management, and ensuring revenue sufficiency (attending to the tariff and to cash collection and debt management).

Main themes

Within the above context, the commission addressed the following key themes:

- Measures to protect and enhance the financial viability of key water entities (WTE, TCTA and water boards);
- Turning around municipal water businesses;
- Grant design;
- New models for engagement with the private sector; and
- Other interventions (not fitting into the above areas).

Measures to protect the financial viability of key water entities

Context

The **WTE**'s mandate is to develop, operate and maintain specific water resources infrastructure and the (financial) goals of achieving financial sustainability and independence to *reduce reliance on the fiscus*.

TCTA has the mandate to finance and implement bulk raw water infrastructure projects. It designs bankable projects and raises funding on capital markets, with the financial goal of being credit worthy and being able to access low-cost debt.

Water Boards' primary mandate is to provide bulk industrial and potable water services to municipalities and industries. They operate within their gazetted areas and can also implement grant-funded projects on behalf of municipalities. Their financial goals include being creditworthy and being able to raise low-cost debt finance for investment in infrastructure (in support of their primary mandate).

The goal

The ability of water entities to raise commercial finance needs to be protected and enhanced.

Findings

There was general agreement on the importance of the principle of financial viability of the key water entities, within an appropriate grant framework to support the development and operation of social infrastructure. (See grant design, below.)

Increasing commercial finance into the sector is important in the context of under-investment in the sector.

Recommendations

It is imperative to fix the municipal water services business which lies at the heart of sector financial sustainability challenges. (See separate section.)

Water pricing. Water pricing needs to be addressed in the context of the full value chain in the sector, recognizing interdependencies and knock-on effects. The sector will benefit with the creation of an independent economic regulator, with much greater transparency with respect to the principles, processes and results of tariff regulation. This will take some time to establish. In the short term, mechanisms are needed to improve transparency and increase the robustness of the current processes involving DWS, National Treasury, SALGA and water boards, including activities of the Portfolio Committee. Tariffs fund the operations of water boards, as well as the infrastructure program. Considering that the building and installation of water infrastructure take several years, the rejection of the tariff, unbalances the capital expenditure program for water boards and negatively impact financial performance.

Contracts. A view was expressed that existing contracts between entities and municipalities could be improved, particularly with respect to strengthening payment and debt collection enforcement mechanisms. Update, monitor and enforce Bulk Supply Contracts between Water Boards and Municipalities; implement repayment agreements.

Commitment by government and government entities to pay. There needs to be an initiative to ensure that government and government entities pay their water bills.

Other activities to address increasing debt levels in the sector: The commission also endorses the current efforts at the DWS (and by other stakeholders) to address the increasing levels debt to water entities, including the following:

- The activities of the **Multidisciplinary Revenue Committee** (MdRC) to assess the sustainability of the water services business within the top owing municipalities so that a diagnosis can be made with a set of recommendations to ensure a financially viable and sustainable by water services institutions. DWS is an active participant together with National Treasury, COGTA and SALGA.
- Deep dive assessment on top 12 owing municipalities to identify the structural and systemic issues underlying the debt.
- Initiatives to reduce the electricity and water debt crisis in municipalities – Installation of a prepaid solution ; Focus on assisting the top 20 defaulters with initiatives to resolve and pay monies owed by Department of Public Works and Infrastructure (National and Provincial);
- Responsible Citizenry Campaign.
- Address financial and service delivery failures through correct application S139 intervention process.

(These activities are not exhaustive.)

Municipal water business turnarounds

Key finding

The commission agreed that municipal water services financial and technical performance was a key systemic risk in the sector and had to be fixed in order to address water sector financial sustainability.

The goal

Within a well-defined grant framework (equitable share and capital grants), municipal water services need to be financially viable with cash revenue meeting the necessary costs to meet service obligations.

Possible ways to address municipal performance

Delegates asked if the direct municipal delivery model needed to be revisited, given that this way of providing water and sanitation services is not the norm internationally, it is more common for the service to be provided through a company (utility) structure.

There was a recommendation to ring-fence water revenues and expenses.

Participants asked if the financial model for municipalities (grant framework, size of equitable share) needed to be revisited.

Questions were asked on how the capacity of municipalities could be built and if the municipal demarcations were perhaps a contributing factor to low capacity in some municipalities, and if project preparation facilities could be used to support infrastructure investment.

The participants indicated that with the restructuring of water boards, excess staff could be moved to municipalities as a means of building capacity.

There was a proposal to forge partnerships to enhance skills development.

The servicing of tribal land and collection of revenue in these areas was raised as matters that needed to be addressed.

Recommendation

Create/strengthen high-level task team, that is adequately resourced, to reexamine the framework for providing water services in South Africa and to develop practical recommendations to effectively address the municipal water services performance crisis (“municipal water business turnarounds”).

The grant framework for supporting water services

Context

Comments were made as to the sufficiency of grants made available to municipalities and the viability of the existing municipal financial model and grant framework. It was also noted that economic conditions meant that national grants were limited and subject to competing needs; and also that grants were not “free money” to the country, as these needed to be paid for through taxes and that the tax base was reducing.

The sector receives over R40 billion in grants per annum but the results are not being seen.

Goal

It is essential that best use is made of available grants, and there is a stronger link between grants and outcomes.

Grant design

Various options were proposed for changes to the current grant framework. These included the following:

- Linking grants to outcomes through, for example, performance incentives;
- Grant consolidation (reducing the number of grants);
- Possible changes to the equitable share. Top slicing the equitable share (making the equitable share conditions, or reserving a share of the equitable share to pay for the basic water component of the water supplied by water boards). Allocating a share of capital grants to support maintenance. Relooking at formula for the vertical and horizontal distribution of the equitable share; and,
- Looking at other funding models.
- Review grant-making processes: Ensure strong business plans and prioritize water conservations and demand management projects.

Recommendation

Include considerations of grant design as part of the scope of work of the Working Group on the turnaround of municipal water service businesses, including engagement with National Treasury.

The role of private sector

Context

National Treasury has recently undertaken a review of the PPP framework. Proposals represented more of a refinement of the existing framework rather than substantial changes.

The Deputy-Minister for Water and Sanitation asked the Commission to make proposals for a bolder approach, that was more flexible but also beyond approach for the involvement of the private sector in the water sector.

An **infrastructure fund** has been established. Seeded with R100 billion over ten years by National Treasury. There is a Memorandum of Agreement with DBSA to establish a **Water Partnerships Office**. This will support the involvement of the private sector in the sector.

The goal

Increased and effective participation by the private sector in the sector, bringing finance, skills and efficiencies.

Options for private sector involvement

The following options of engagement of the private sector were discussed:

- **BOT type models for desalination, reuse and wastewater treatment.** It was noted that the private sector needs a return on investment and this has implications for water tariffs when using these models, although the private sector could bring scarce finance as well as cost efficiencies.
- **Co-investment in water projects** noting that businesses have an economic and financial interest in secure water and are willing to invest to achieve this. A challenge was how to manage commercial and social objectives in the same project.
- **Improved efficiencies could be obtained through co-design** (bringing private sector into the concept and project development phase).
- **Making use of off-take agreements** and learning from and **replicating the REIPPP concept** for the water sector.
- **Use of special purpose vehicles.**
- **Optimise (re) use of mine water** (acid mine drainage), in partnership with private sector.

Recommendation

Work with existing structures (Infrastructure Fund, Water Partnerships Office and others) and establish working groups (as needed) to look at specific water resource projects with high levels of economic value and private sector interest, including, for example:

- Tzaneen Dam
- Vaal-Gamagara (mining interests)
- Clanwilliam Dam (irrigation interests)

These could be modelled on the Olifants River Water Resources Development Project (ORWRDP). Involve private sector in project conceptualization and design.

Other interventions proposed by commission participants

Full value chain and environment:

- Declare strategic water areas
- improve the quality of water at catchment level in order to lower cost of water
- fast tracking the waste discharge charge system
- strengthen compliance monitoring.
- Consider the use of Plastic levy to assist in cleaning rivers
- Promote/support building of the smaller dams and water harvesting

Cash collection and managing customer debt

- Reduce cost of prepaid meters. Proposed for government to do bulk buying of prepaid meters,for municipalities to buy from government.
- Promote collection policies for informal settlements and low-cost housing.
- Restrict services to encourage payment
- Develop a Communication Strategy in order to create awareness to the public with regards to the importance of paying for Water Services.
- Automate metering systems

Governance

- Improve collaboration with all spheres of government and eliminate working in silos.
- Address gaps in the governance of the entire system from policy to implementation level; strengthen fight against corruption.
- Develop initiatives that promote and strengthen credit worthiness of entities and the municipal water business.

Making better use of the National Water Summit

Participants made the following recommendations:

- Better preparation with more time, involve private sector from the start, more time to prepare position papers.
- More continuity with previous summits & current work.
- Translate the recommendations into a programme of action.
- Start planning for next Summit now.

The commission

Chair: Dr Rolfe Eberhard, independent water finance expert

Facilitator: Percy Sechemane, CEO, TCTA.

Panelists:

- Masaccha Khulekelwe Mbonambi, Deputy-chair, Rand Water
- Dr Maxwell Mudhara, University of KwaZulu-Natal.
- Dr J MacKay, Acting Municipal Manager, Xhai! Gariiep Municipality
- Ms Khomotso Letsatsi: Chief Officer: Municipal Finance, Fiscal Policy and Economic Growth, Salga

Secretariate:

- Ms Sylvia Ndhlovu, Chief Director: Revenue Management, DWS