

**DEPARTMENT OF WATER AFFAIRS
PRICING, ECONOMIC REGULATION REFORMS (PERR) PROJECT**

**(Pricing Strategy Review, Development of Infrastructure Funding Model and the Establishment of
Economic Regulation)**

Minutes of a meeting of the Funding Model Work Stream

Date: 22 June 2012
Time: 11:00–13:25
Venue: Centurion Lake Hotel, Centurion

Present:

Department of Water Affairs

Bofilatos, E
Korommbi, K
Lemekwane, R
Machedi, NS
Mbele, N
Morodi, C
Moshidi, MSN
Mqina, T
Sekgothe, P
Sigwaza, DP (Chairperson)
Van Zyl, F

Stakeholder representatives

Stadler, O	Bloem Water
Mofakeng, PA	Department of Agriculture, Forestry and Fisheries (DAFF)
Senefeng, HT	Magalies Water
Chimuti, S	National Treasury
Matji, P	National Treasury
Mugeru, ANS	National Treasury
Ngobeni, V	National Treasury
Ncobela, L	Rand Water
Nyembe, M	Rand Water
Nyandoro, T	Rand Water
Moraka, W	South African Local Government Association (SALGA)
Botha, M	South African National Biodiversity Institute (SANBI)
Motsamai, MI	Sedibeng Water
Nteo, T	Sedibeng Water
Kristiah, A	Umgeni Water
Singh, K	Umgeni Water

Professional service providers (PSPs)

Hayat, T	Pegasys
Koch, P	Pegasys
Madinginye, TDS	Pegasys
Mtsweni, A	Pegasys
Pegram, G	Pegasys
Schreiner, B	Pegasys
Arnold, R	Write Connection (Scribe)

Apologies:

Mathe, Z
Gabriel, M-J DAFF

1. OPENING, WELCOME AND PURPOSE OF THE MEETING

Ms Sigwaza had been delayed, and Mr Mqina chaired the meeting until Ms Sigwaza arrived. He welcomed everyone to the meeting. Ms Sigwaza chaired the rest of the meeting in place of Mr Helgard Muller, who was on leave.

Ms Sigwaza informed the work stream that the PERR project had been launched. The high-level Project Steering Committee (PSC) had met once and considered the broad terms of reference. The purpose of the work streams is to implement what was discussed at the PSC. The work stream members are intended to be strategic thinkers for the project. The agreement reached among the broad group of stakeholders represented in the work stream would be presented to the PSC. The work stream members had been selected because they are knowledgeable in their sectors, and their role is to serve the nation and guide the project so as not to repeat the mistakes of the past. The work stream did not have decision-making powers, but contributes to the discussion. Decision-making would take place at PSC level, and the Minister has ultimate responsibility for the project.

Ms Sigwaza presented the project governance arrangements. The DDG: Policy and Regulation (Helgard Muller) is the project champion. The PSC reports to the DG via the DDG: Policy and Regulation. There are three work streams under the PSC, namely:

- Funding Model, chaired by Ms Z Mathe (Acting DDG: Infrastructure) and supported by Rand Water
- Pricing Strategy, which would have been chaired by Mr F Ishmael (Acting CFO: Water Trading Entity), who had asked to be excused from this role in order to focus on his responsibilities at the Water Trading Entity. This work stream would be supported by the Department of Agriculture, Forestry and Fisheries (DAFF). Mary-Jean Gabriel would represent DAFF on the workstream, and Ms Mofakeng was standing in for her at the present meeting.
- Economic Regulation, chaired by Ms D Machotlhi and supported by SALGA.

The PERR project has links with the Water Sector Leadership Group (WSLG). Pegasys is providing technical support to the project. Ms Sigwaza reported that the PSC had emphasised that the project should not be led by the technical team, but that the technical team would assist in compiling the thoughts and ideas of the work stream.

DWA has several strategic flagship projects:

- Review of legislation (National Water Act, Water Services Act and Water Research Act)
- Review of the National Water Resource Strategy (NWRS) (driven by Fred van Zyl)
- Institutional reform and realignment, which was almost complete. The Minister had already taken decisions on the establishment of nine water management areas.
- Business Process Reengineering Committee, which advises the Minister and is represented on the PSC.

Mr van Zyl was given an opportunity to inform the work stream of progress with the review of the NWRS. After receiving many comments, the draft strategy had been revised and would be discussed with the Minister on 25 June 2012. The intention was to gazette the NWRS by mid-July 2012; there would then be extensive consultation and work sessions on the themes.

In response to a question from Mr Nyandoro (Rand Water) on the outcomes of the first PSC meeting, Ms Sigwaza responded that the main outcome had been that the Pricing Strategy should take the whole water value chain into account, as opposed to the current Pricing Strategy that focuses mainly on water resources. The Funding Model should also look at the entire value chain, including water resource management and water services. Similarly, Economic Regulation should also look at the entire water value chain. The technical team would assist with scoping in relation to taking the whole value chain into account, and Mr van Zyl would assist in resourcing these requirements of the project.

The PSC had also advised that the work streams should learn from international best practices. National Treasury had already conducted international studies, and the Water Research Commission had offered to analyse some of these. The World Bank had offered to contribute to the debate. The PERR project would pursue these ideas and avenues.

The PSC had emphasised that pricing should not be considered only in terms of financing, but sustainability should be taken into account, as well as the funding of 'soft elements'.

Mr Nyandoro (Rand Water) requested that work stream members receive the final draft of any documents before they were presented to the Minister to ensure that stakeholder comments were incorporated. Mr van Zyl responded that stakeholder comments had been incorporated as far as possible in the draft NWRS that had gone to the Minister. There would be a three-month period of detailed consultation once the strategy was gazetted, including consultation with clusters. The process of consultation that stakeholders had recommended would be adopted, as well as the process of negotiation and empowerment, and the development of an implementation action plan so that stakeholders would take ownership of the strategy.

Ms Nyembe (Rand Water) enquired whether the building blocks for the NWRS were water services across the entire water value chain, addressing all aspects, including sanitation and water infrastructure, or whether water resource management and water services were still segmented in the strategy.

Mr van Zyl responded that there had been work sessions between March and May 2012 not only on the NWRS but also on the Investment Framework and Strategy, which is comprehensive, involving three value chains: water resources, water services supply and waste stream, and including the activities of agriculture, industry and mining. DWA also invests in governance and better management. It had been recommended that the strategy take into account the complete value chain of the capital life cycle, including capital, operations and maintenance, and asset management. It had been proposed to the PSC that the Funding Model should accommodate this complete life cycle, although the contract was currently only for water resource management. The PSC had accepted that the PERR project should address the full value chain, but this had not yet been confirmed. Mr van Zyl commented that if the full value chain was not addressed in the PERR work streams, it would have to be addressed elsewhere.

Mr Matji (National Treasury) noted that there had been agreement at a previous meeting that the PERR project should address the whole value chain without fragmenting it, and National Treasury supported this approach.

Ms Sigwaza responded that this was DWA's understanding of the PERR project, and the contractual issues and related project funding would be discussed outside the meeting.

2. INTRODUCTIONS

Mr Mqina allowed a round of introductions.

3. COMMUNICATION

Ms Mbele, whose role is to coordinate communication on the PERR project, introduced the communication initiative. The objectives are to develop mechanisms for effective and timely communication; coordinate all levels and types of communication in relation to the project; encourage; support and sustain communication relationships with stakeholders; and provide a stakeholder engagement platform on the project developments and expedite convergence processes amongst all members.

The status of the communication initiative to date is that the Project Management Office (PMO) had been set up and IT Communication email addresses were in place:

- PERRPMO@dwa.gov.za deals with project/ technical issues and queries
- Perrprojectadmin@dwa.gov.za deals with administrative and logistic issues.

At work stream level, communication will be via SMS, MMS and Apps.

At Project Steering Committee level, the modes of engagement would be as follows:

Mode	Type of information	Frequency	Responsibility
Meetings	Key issues and project outputs	As per project implementation plan	Project Management Office (PSC Chairperson and Work stream Leaders)
Blog	Access and project outputs	Bi-weekly update per work stream	Project Manager (provide content)
E-mail	Submit final draft document for meeting preparations and review	As per the need / implementation plan	Project Management Office

At work stream level, the modes of engagement will be as follows:

Mode	Type of information	Frequency	Responsibility
Meetings	Obtain consensus on identified issues for each works streams	As per project implementation plan	Project Management Office (PSC Chairperson and Work stream Leaders)
Blog	Access to document details and provide inputs (continuation of discussions)	Bi-weekly update per work stream	Project Manager (provide content)
E-mail	Final draft for meeting preparations and review	As per the need / implementation plan	Project Management Office
SMS	Notify work stream members – urgent matters, new documents for comments, change of meeting dates	As per the need	Project Management Office

Due to the limited time for discussion during work stream meetings, a blog site would offer an extension for providing detailed information and comments on each of the PERR work streams, and the opportunity for two-way communication. Bi-weekly, the project officer would compile content on which work stream members would be invited to comment. The comments would be compiled and incorporated in project reports. The SMS facility would be used to notify work stream members of urgent matters or when material is uploaded to the blog. These means of communication would encourage work stream members to work on the project between meetings.

Future communication projects would include developing a stakeholder and communication plan, and extending invitations to key organisations as work stream members – including the dti, Forestry South Africa, organised agricultural unions (AgriSA, NAFU, TAU, AFASA), SAAFJUA and civil society organisations).

Once the Inception Report had been finalised, a national paper would be published to introduce the project to the South African community and inform the public of the objectives of the project. Announcements would be sent out to invite people per sector to participate in stakeholder engagements on all three work streams. Towards the end of each project, each topic would be gazetted for public comment.

Ms Schreiner offered a practical suggestion that a drop box be set up for the exchange of large documents. Mr Morodi undertook to investigate the possibility, including creating a link from the blog to a website where large documents could be accessed.

Action: Mr Morodi

4. WORK STREAM OPERATING RULES

Mr Sekgothe distributed copies of the Pricing and Economic Regulator Review (PERR) work-stream(s) conduct rules. These rules had been circulated before the meeting, but no comments had been received. Mr Mqina proposed that since most work stream members had not yet had the opportunity to study the document, the discussion and adoption of the rules be postponed until the next work stream meeting.

Mr van Zyl was concerned at the proposal that the rules commit members to strict confidentiality, in that they would not be allowed to disclose work stream matters without written consent. He commented that the work stream was not the only place where the issues were being debated and that it would therefore be difficult to keep the issues confidential. He requested that the rules should be more flexible.

Ms Sigwaza responded that the work stream would have a future opportunity to discuss the classification of documents and matters of confidentiality.

The work stream operating rules document was withdrawn and would be discussed at the next work stream meeting after work stream members had had an opportunity to comment on the document.

Action: Work stream members

Ms Nyembe enquired about the role of the work streams and the partners that would support each, as well as the issue of nominating additional members. Ms Sigwaza responded that the PSC had taken a principle decision that work streams would actively participate in the project, working closely with the technical team, in developing the Funding Model and revising the Pricing Strategy. The role of the work streams was mainly to discuss and debate matters of principle and technical issues, to provide strategic views, and to give direction on the Pricing Review and Funding Model. Ms Sigwaza emphasised that contractual issues should be separated from the work stream, as the work stream was not responsible for managing the technical resource.

Mr Mqina added that the intention of the work stream, as presented in the Communication presentation, is to provide support in reviewing the documents and discussing the issues. The outcome of the work streams would be fed back as guidance to enable the PSC to take decisions.

5. REVIEW OF FUNDING MODEL PROJECT SCOPE AND DELIVERABLES

Mr Mqina emphasised that work stream members should take leadership and ownership of the project, as it does not belong only to the DWA, but affects the entire water sector.

The Inception Report for the project would be delivered by the end of June, and would clarify the vision and scope of the work, the nature of activities to be undertaken, timeframes and deliverables, and the revised workplan. The PSC had advised that the Inception Report should include key fundamental operational principles, which would be reviewed as the project proceeds. The Inception Report should also include the international experience.

Work stream members would be informed by SMS and email when the Inception Report is loaded on the project website, with an indication of the timeframe for commenting on the document. Mr Mqina stressed the need to move rapidly as the project was long overdue.

Action: Project Management Office

Presentation: Task 2 – Infrastructure Funding Model project

Mr Mqina presented Task 2, the Infrastructure Funding Model, as described in the terms of reference. The purpose of the task is to identify, evaluate and recommend coherent and innovative financing models. These must resolve the challenges around water sector infrastructure. The task involves six activities, and the key deliverable will be a Funding Model Report. The six activities are as follows:

Activity 2.1 – Assessment of Infrastructure Financing

- Clarify the current situation associated with the trading account needs
- Compile a coherent and comprehensive infrastructure finance database, on:
 - Asset value, operational costs and tariff structure
 - At national, regional and local infrastructure level
- Synthesise projected financing requirements over the next 20 years

Activity 2.2 – Public Finance Principles & Models

- National Treasury would provide the principles, but a number of the principles would be included in the Inception Report

Deliverable: Infrastructure Financing Review Report

Activity 2.3 – Develop Funding Models

- The Funding Model will have various elements, including new infrastructure, betterment, refurbishment, and operations and maintenance.
- There is a need to distinguish between fiscal and off-budget sources of capital and operational funding, as well as the institutional mechanisms that enable this.
- The nature of the scheme must be reflected in the model. It will be necessary to distinguish between large national multi-purpose infrastructure and more local single purpose meso-infrastructure.
- Concepts of strategic asset maintenance also need to be brought into the financial models.
- Possible subsidy mechanisms will need to be included.
- The development of models is iterative, to be refined as different alternatives are evaluated and the implications assessed in the subsequent activities.

Deliverable: Financial Model and User Manual

Activity 2.4 – Explore Alternative Sources of Funding

- The relative contribution of different sectors and user groups is to be unpacked. This will be based on social imperatives, economic affordability and water requirements. Funding infrastructure to support redress to emerging farmers must also be considered
- The concept of risk in innovative financing arrangements will have to be understood and reflected.
- Opportunities for innovative financing of non-conventional reconciliation measures should be included in the model, particularly small local schemes, such as desalination and effluent reuse, water conservation/demand management interventions. There should also be links to opportunities to include waste discharge mitigation infrastructure.
- Required capital and operational funding through various sources will be contrasted with current operational funding from user charges and transfers and already dedicated fiscal infrastructure budgets.

Deliverable: Sources of Funding Report

Activity 2.5 – Evaluation of Impacts of the Financing Model

- Infrastructure financing and water pricing have significant positive and negative impacts on the economy, society and environment.
- There is a need to determine the socio-economic consequence and distributional aspects of changing infrastructure funding regimes at a micro-economic scale on local water users:

- Five to eight representative catchments will be selected, with different hydrological, infrastructural and water user characteristics.
- The impacts of different funding models on the representative local users will be assessed, in terms of the cost of their water use as a portion of total input costs (where possible).
- Impacts on low income households, emerging farmers and agriculture will be specifically addressed, as well as consequence for both small and large urban areas.
- Likely short, medium and long term effects of potential income shortfalls will be qualitatively compared to impacts of potential tariff increases on the various user sectors.

Deliverable: Impacts Report

Activity 2.6 – Financial Arrangements

- The interim deliverables and financial model will be combined into an overarching summary report, which will combine the financial model, and financial and economic implications.
- The report will also address financial and institutional arrangements necessary to give effect to the financial model: notably the accounting treatment and disclosure of elements of the tariffs; the institutional vehicle/s required to enable the financial models; the consequences for the pricing strategy review; and the implications for economic regulation.

Discussion

Mr Madinginye (Pegasys) circulated a list of issues for the consideration of the work stream that had emerged from the first PSC meeting. The work stream should discuss these issues and provide guidance to the next PSC meeting on 13 July 2012. The discussion would contribute to the Inception Report. The issues for discussion were as follows:

- Clarify what Pegasys will be doing and what it will not be doing given the limitations of the budget
Mr Mqina pointed out that the scope of work had been extended to the whole value chain. The budget for the project would therefore have to be reviewed, as well as what the professional service provider could be expected to do.
- Create a clear and common view about what the professional service provider will be doing in this work stream
Mr Mqina noted that the work stream meetings would not be formal meetings but working sessions. Documents would be circulated in advance, so that work stream members were ready to provide comments and guidance to the technical team at work stream meetings. The technical team would develop tools for the Funding Model that sector members could use in order to plan and deliver. The work of the Funding Model work stream would also affect the Investment Framework. The work stream would work with Mr van Zyl and his PSPs on the Investment Framework project in order to ensure that there was no duplication in what the two projects would deliver.
- How far do the funding models go in terms of private sector financing – how much does/can the private sector get involved?
- Are we looking at funding models for all four types of water resource institutions – national, regional, municipal and water user association?
- Is this work-stream to look at funding in all four areas?
- Who decides whether the certain infrastructure gets built or not?
- Who will be involved in the project from the department's side to ensure that this project is effective beyond its lifespan and have people who can continue the work after the project closes – capacity building related issues?

Mr Nyandoro (Rand Water) enquired about the scope of work that had originally been agreed with Pegasys. Mr Mquina responded that Pegasys had originally undertaken to perform the six activities and produce the deliverables, as presented. However, there had subsequently been an instruction from the PSC to extend the scope of work. The Inception Report would clarify the work to be done by the technical team and the budget implications.

Ms Schreiner summarised the change in the scope. The original Funding Model and Pricing Strategy tasks had focused only on the water resources part of the value chain. The PSC had asked that the scope be extended to include water resources and water services. The Economic Regulator aspects of the project had always been intended to cover the entire water value chain.

Mr van Zyl commented that addressing the total value chain would also involve social, environmental and economic issues in order to respond to the needs. He asked that the work stream agree to this principle. Water services includes industry, mining, agriculture, environmental and energy streams. The waste stream should also be addressed. Governance would have to be taken into account. Investing in infrastructure would also require investing in sustainable management and improved governance. This would entail a change of dimension.

Mr van Zyl believed that the outcome of the Funding Model project should not only be a report but also a practical model with guiding rules and principles. Over and above the financial issues, the dimension of the 'soft' issues would have to be considered (for example, cross-subsidisation for the impact on poor people and on the environment).

With reference to activity 2.4 to explore alternative sources of funding, Mr van Zyl commented that this should form part of the Funding Model, rather than being a separate activity from the development of the Funding Model (activity 2.3). Funding sources such as capital, own funding, grants, cross-subsidisation, loans and sponsorship should all form part of the Funding Model.

Mr van Zyl commented that a dimension that was missing from the activities was functionality and sustainability in managing operations and maintenance. The national, regional and municipal levels would also have to be taken into account. For example, municipal and regional supply might be cross-subsidised on a national scale, and the Funding Model might give rise to a new institutional model.

Mr van Zyl noted that once the options had been identified, these would have to be negotiated because of their possible impact on viability. He proposed that the first step should be to develop a conceptual design of the dimensions of the project within about three weeks and to compare this with the scope of work that had been agreed with the technical team. The work stream would then have to consider how to address any issues that were not included in the scope, for example, by increasing the budget or issuing another contract.

Mr Matji noted that National Treasury's approach was that the fiscal framework must respond to the value chain, and there should be a move away from fragmented projects. National Treasury wished to ensure that planning stretches across the value chain, and the activities of the project should therefore respond to the whole value chain, rather than a section of it. It would first be necessary to understand the value chain that the project would deal with. He enquired whether the international comparisons would be based on the same value chain as in South Africa. He suggested that it might be necessary to reallocate the budget between activities in order to ensure value for money from the project. He commented that a funding model report is not a deliverable, and that the deliverable should be a working model, which was tested and verified against similar models elsewhere. He suggested the need to refine the deliverables so that the technical team could be held accountable for what had been agreed upon.

Mr Moraka (SALGA) commented that members of the work stream might have different interpretations of what constitutes a model, and he suggested the need to reach common understanding on the definition of the model from the start.

Mr Moraka believed that it was quite clear that the project should address the entire value chain, as the PSC had requested, and that the ways in which the value chain could be segmented need not be debated in the work stream.

Mr Moraka suggested the need to investigate what other parties are doing in the work stream. SALGA is undertaking a number of studies that could be of value to the process (for example, a current study on the cost of service). He suggested that the Inception Report should highlight the interface with other related

projects. He emphasised that the Inception Report should show the linkages with the Investment Framework project so that the strategic direction is clear.

Mr Botha (SANBI) asked whether the work stream had a vision to include the ecological infrastructure as a component of the project, or whether there would be an opportunity to do so. Research shows that there is a superior return on investment from an ecosystem-based approach to certain water resource challenges, compared with built infrastructure models. It would be useful to include ecological assessment in the standard assessment of infrastructure.

Activity 2.4 includes “opportunities for innovative financing of non-conventional reconciliation measures” in the approach to alternative sources of funding. Mr Botha suggested that given the nature of the debate, this should be expanded beyond reconciliation measures to include, for example, extending the economic life of dams, or significantly reducing the treatment cost of water by maintaining or enhancing wetland function.

Mr van Zyl responded on the issue of whether to include ecological financing. He hoped that the Inception Report would start with motives and drivers (i.e. what drives the need for a financing strategy). The environment would be one of the core issues to be dealt with in implementing the National Water Resource Strategy, which would require investment. The multiple value streams would include the ecology and social aspects. The bigger water footprint entails the need to understand the cost versus the value of water, since the criteria used for prioritising and decision-making would ultimately be subjective. Financing is about finding solutions that are affordable.

Dr Pegram (Pegasys) commented that the discussion had been rich and the intent was clear. There would be a need for a discussion outside this meeting between the project managers and the Pegasys team on how to encapsulate the requirements. The initial terms of reference had focused on infrastructure financing and infrastructure funding, and creating appropriate financial institutional vehicles to raise the capital; the Pricing Strategy would determine how the funds would be repaid. The requirements were now moving along the value chain, which makes sense since it is necessary to understand at least the water supply value chain in order to understand the economic impacts. The agricultural value chain would also have to be taken into account. Ecological services would require a different set of infrastructure and costing mechanisms, and including it would make sense in the interests of integrated management. The initial project had focused on the requirement for capital; the operating costs and funding for infrastructure; creating innovative institutional mechanisms to raise capital on or off budget; social and economic impacts; and developing a model. Given the request to extend the project to the entire value chain, the initial requirements for the project would have to be extended into the other areas discussed.

Dr Pegram observed that the discussion had referred to two main uses of models: (1) a financial model, which is an ability to introduce expenditure and recover it through revenue (i.e. establish its impact on tariffs). An outcome of the project would be a financial model, based on the current situation plus projections, and it would be possible to consider different options for financing; (2) institutional models (or options for channelling money) for implementation, for example, a special purpose vehicle or trading account, or bonds in a municipality. The PSP would discuss with project management how to implement the intent, whether in the current project or through alignment with a different project.

Mr van Zyl suggested the need to understand the business as a precursor to scoping the project. Urban areas are classified in terms of socio-economic profile, and are more viable than rural areas. This would dictate certain models. Most municipalities do not have borrowing capacity and would depend on the fiscus for new capital investment. The private sector is not prepared to invest, as they require return on investment. Metros have exhausted their borrowing capacity and some have applied for special grants. Water boards are faced with the problem of cost recovery.

Ms Sigwaza summarised that the work stream had articulated statements of intent and made recommendations for the future. The technical team understood the intentions and would incorporate these in the Inception Report, which would be circulated to work stream members to ensure that the expected outcomes were understood and to make comments.

Mr van Zyl supported the suggestion made by Mr Moraka that the Inception Report should position this study within the bigger framework (for example, the costing model required to inform the Investment Framework).

Mr van Zyl referred to the question that Pegasys had posed, namely "Clarify what Pegasys will be doing and what it will not be doing given the limitations of the budget". Since the PSC required that the scope of the project be extended to the entire value chain, it could be anticipated that the project would cost more. His view was that the additional funding would have to be provided by DWA top management. The issue then would be whether to extend the contract or to add on additional actions. He identified this as an issue that would require solution at the next meeting.

Ms Sigwaza asked whether, in preparing the Inception Report, Pegasys had investigated other related studies. Ms Schreiner responded that Pegasys had not yet done so.

Mr Mqina stressed that the solutions should be relevant in addressing the South African situation. Ms Schreiner responded that study would focus on providing useful solutions for South Africa, and that the review would therefore consider the current South African context and look at other models that are relevant to the South African context (for example, other economic regulatory models in South Africa) and at other countries with similar status and challenges in sub-Saharan Africa, other developing countries and some of the developed world. The study would not provide a theoretical background that was not useful.

Mr Mqina highlighted the points that would be made in the report back from the work stream to the PSC:

Action: Management Project team

- There was agreement that the project would consider the entire value chain.
- The costing would have to provide detail on how much would be delivered in the entire value chain.
- The model would assist in addressing the realities of the current South African situation.
- There would be clear definition of what constitutes a funding model and a financial model.
- The Inception Report should make the conceptual model clear.
- The interface between the three PERR work streams should be made clear.
- The technical team should show how the concept of the ecological infrastructure should be incorporated.
- It would be important for the Inception Report to include not only the principles but also the key drivers.
- The institutional options and funding model should be made clear.
- The issue of viability throughout the entire value chain should take into account that a single solution would not succeed in addressing the different challenges and inequality across the country (i.e. a 'one size fits all' model would not work).
- The funding models would have to address the capital unit charge (CUC) for different solutions across the country.
- The Inception Report should profile the value chain, as the methodologies developed in the project would have to be guided by key principles, drivers and profiling of the value chain.

The work stream would have training sessions on the models developed.

Dr Pegram made a proposal in which he distinguished models from vehicles/options. Pegasys could look at the conceptual framework, which would link along the value chain with ecological services and infrastructure, as well as governance and management. In each of those spaces, the project should consider the most appropriate options for financing the requirements and repaying the capital (e.g. special vehicles for ecological service restoration and pricing mechanisms for recovering the costs). These would differ from the mechanisms required to fund the capital infrastructure, and there would be differences between national water resources and water services reticulation, for example). The conceptual models would have to be supported by numbers and risk analysis.

Dr Pegram expressed concern at trying to include ecological service restoration, large augmentation schemes, desalination and bulk services, and reticulation for all municipalities in the country in a single financial model. He suggested that it might be necessary to be pragmatic about the level of resolution of the financial model, as well as the extent to which it was unified as opposed to modular. It would not be possible to develop a financial model for each individual municipality, but it would be possible to indicate on a system level the different types of customers (e.g. large metros, cities, towns, deep rural villages) and their particular profile in different parts of the country, and to quantify these. This would provide a manageable way of distinguishing different types of customers.

Mr Matji (National Treasury) suggested that a realistic approach would be for the Inception Report to prioritise what could be achieved in order to take immediate financial decisions. The project should produce outputs by July 2012, as National Treasury would be planning during August 2012 for the next three years, and any deliverables after that date would not assist in the planning cycle.

Mr Matji stressed the importance of considering creative solutions to sustainability. National Treasury is grappling with restructuring the financing of local government infrastructure, as it is not productive to invest in extending infrastructure that is not maintained or operated properly. He asked for clarity on the distinction between the funding model and financial models. National Treasury expected the project to develop a high-level model that could be used for decision-making at lower levels.

Mr van Zyl agreed with Mr Matji and commented that a high-level model is needed for changing perspective and focus. Reality must be taken into account. There are challenges in meeting basic services. The project focuses on sustainability and functionality, but South Africa does not invest in these. For example, water conservation/water demand management (WC/WDM) are considered to be important, but there is no funding for investing in WC/WDM; there is no funding for addressing acid mine drainage (AMD) (although the private sector would have to be involved). The planning decisions taken in August 2012 would influence water management for the next three years. Principle decisions were therefore required in the near future, although the details could be negotiated until November 2012.

Mr van Zyl commented on the distinction between the funding and financial models and noted that the concept of the financial model had been introduced because of the need for a costing model for financial management. Cost recovery is important, since revenue of about R11 billion per year is lost from local government.

Mr van Zyl stressed the importance of viability and commented that this should be considered broadly, not only in relation to schemes for poor people, but also in relation to catchment management agencies (CMAs), water boards, local government and large schemes. Money for large schemes such as the Lesotho Highlands could be borrowed on the open market, whereas the situation was very different for community schemes at the other end of the scale, where social issues assumed particular importance.

Mr Matji (National Treasury) stressed the importance of getting the principles right from the start, for example, the thinking on funding infrastructure at various levels. Another principle to consider was what position the state should take in responding to acid mine drainage. He did not believe that ordinary water users should be expected to pay to clean up the AMD situation created by business. Practical ways would have to be found to address the real issues on the ground.

6. TIMEFRAME

Mr Mqina referred to the proposed project timeframe, in terms of which the project was due for completion in February 2013.

Mr Ncobela (Rand Water) asked for clarity on the sequencing of activities and suggested that activity 2.4 should precede 2.3, since it would not make sense to explore alternatives after the funding model had already been developed. Mr Mqina responded that sequencing would be addressed in the Inception Report.

Mr Matji asked what outputs from the project National Treasury could expect by August 2012 that would influence policy decisions.

Dr Pegram (Pegasys) pointed out that the scope of the project was expanding and the timeframe was being contracted. The technical team had already done much of the international review in order to bring in principles used elsewhere and to review the principles adopted in South Africa, and the first draft of this work would be reflected in the Inception Report.

Dr Pegram explained that the reason why sources of finance and funding models were dealt with differently was that they were referred to in different ways in the terms of reference, and Pegasys had responded to both. In reality, sources of finance and funding models are both concerned with considering vehicles for raising and repaying capital and raising revenue.

Dr Pegram explained the next two key steps required to take the project forward, and noted that the Inception Report would make commitments in this regard:

- Obtain data required to develop the financial model and explore alternatives. Much work had already been done at various levels on the built infrastructure requirements, but not much on the ecological infrastructure aspects. More work was needed on how much revenue was actually being collected at different points.
- In parallel, the technical team would consider, on the basis of the principles, different and innovative ways of financing the various components, including AMD, desalination schemes, large augmentation schemes and bulk water services (all of which have different financing possibilities depending on the mandate and strength of the institutions that would be required to raise the capital). The technical team would develop draft conceptual models for discussion of the most suitable. Risk assessment would be done, including the potential for parties other than National Treasury to fund the various models.

Dr Pegram noted that the technical team could develop conceptual models in draft form by August 2012. At the same time, Pegasys would start to obtain information from DWA's financial system about current revenue. It was hoped that similar information for water services could be obtained from the considerable work already done by other parties. The technical team would synthesise the information obtained from the various sources. The final product would not be available by August, but advanced initial tools would be available by then to inform decision-making.

Action: Technical team

Mr Matji (National Treasury) stressed that the Inception Report should define the value chain so that it was clear what the project would be dealing with. All the frameworks would then respond to different aspects of the value chain.

Mr van Zyl noted that the project design had been based on the contract, but the PSC had requested a change in the scope of the project. The reality was that DWA should be in a position to respond by August 2012 to the opportunity to influence budgeting for the next three years. The first-order output of the project should be to develop the concepts through strategic assessment, from which principles and core issues would emerge. Secondly, the project should profile the South African situation (including poverty and environmental issues). Thirdly, there should be a situation assessment of what is happening at the moment. For example, h Mr van Zyl commented that the municipal infrastructure grant (MIG) was initially meant for poverty alleviation, but municipalities now want to use it for all infrastructure purposes and are not prepared to consider other creative ways of cost recovery.

Mr Moraka (SALGA) suggested that the work stream should not pre-empt the Inception Report, but should comment within a given timeframe on the direction, commitments, deliverables and sequencing given in that report.

Dr Pegram commented that the initial undertaking had been to deliver the Inception Report by 29 June 2012, but due to the changes in the scope of the project, he requested that a more realistic timeframe of would be required to develop the conceptual model properly and make the linkages that had been

requested. Mr van Zyl asked for flexibility in the delivery date of the Inception Report in view of the expansion in the scope of the project.

Project Management Office would communicate with the technical team to tighten the scope of the project based on the request of the PSC and the requirements expressed by the work stream, and to agree on a date for the submission of the Inception Report.

Action: Project Management Office

Work stream members would then obtain the Inception Report for comment within a given timeframe.

Action: Project Management Office

Mr Moraka noted the supply chain risks associated with changing the scope of the project and the need to manage and mitigate such risk.

7. SCHEDULE OF MEETING DATES

Work stream members would be advised of the next meeting date after the outcome of the PSC meeting, which was scheduled for 13 July.

Action: Project Management Office

8. CLOSURE

The meeting closed at 13:25.

APPENDIX 1: LIST OF ACRONYMS

AFASA	African Farmers' Association of South Africa
AgriSA	Agri South Africa
AMD	Acid mine drainage
CFO	Chief Financial Officer
CMA	Catchment management agency
CUC	Capital unit charge
DAFF	Department of Agriculture, Forestry and Fisheries
DDG	Deputy Director General
DG	Director General
DWA	Department of Water Affairs
IT	Information technology
NAFU	National African Farmers' Union
NWRS	National Water Resource Strategy
PERR	Pricing, Economic Regulation Reforms
PMO	Project Management Office
PSC	Project Steering Committee
PSP	Professional service provider
SAAFWUA	South African Association for Water User Associations
SALGA	South African Local Government Association
SANBI	South African National Biodiversity Institute
TAU	Transvaal Agricultural Union
the dti	Department of Trade and Industry
WC/WDM	Water conservation/water demand management
WSLG	Water Sector Leadership Group

APPENDIX 2: ACTION ITEMS ARISING FROM THE PERR FUNDING MODEL MEETING OF 22 JUNE 2012

	Task	Responsible party	Due date (where indicated)
1	Mr Morodi would investigate the possibility of setting up a drop box for the exchange of large documents, as well as the possibility of creating a link from the blog to a website where large documents could be accessed.	Mr Morodi	
2	The work stream operating rules document would be discussed at the next work stream meeting after work stream members had had an opportunity to comment on the document.	Work stream members	Before next work stream meeting
3	The Project Management Office would communicate with the technical team to tighten the scope of the project based on the request of the PSC and the requirements expressed by the work stream, and to agree on a date for the submission of the Inception Report.	PMO	
4	The Inception Report would: <ul style="list-style-type: none"> • Take the entire water value chain into account • Start with motives and drivers (i.e. what drives the need for a financing strategy) • Include principles for the Funding Model • Highlight the interface with other related projects • Show the linkages with the Investment Framework project • Profile the water value chain • Clarify the conceptual model • Define what constitutes a funding model and a financial model • Clarify the work to be done by the Technical Team and the budget implications 	Technical Team	
5	The work stream would report back to the PSC	PMO	13 July 2012
6	The Technical Team would develop conceptual models in draft form for the National Treasury planning cycle starting in August 2012.	Technical Team	31 July 2012
7	Work stream members would be informed by SMS and email when the Inception Report is loaded on the project website, with an indication of the timeframe for commenting on the document.	PMO, work stream members	
8	Work stream members would be advised of the next meeting date after the outcome of the PSC.	PMO	After 13 July 2012