



**Department of Water Affairs and Forestry
Republic of South Africa**

MUNICIPAL INDABA

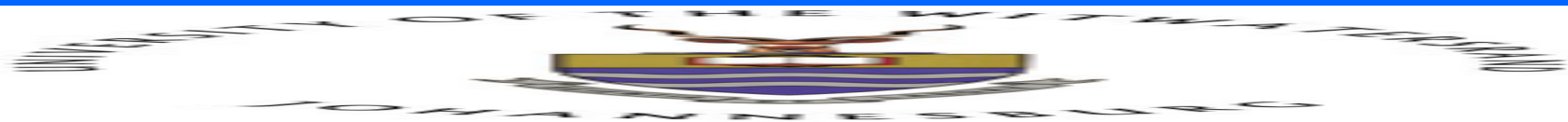
on

ENHANCING ACCESS TO FINANCE FOR WSS

East Rand, September 11, 2008

by

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1. INTRODUCTIONARY REMARKS

- . PREVIOUS SPEAKERS HIGHLIGHTED THE FOLLOWING:-
 - WATER IS A SCARCE RESOURCE
 - CLIMATE CHANGE AND MODELLING UNCERTAINTY
 - ENVIRONMENTAL CONSCIENCENESS
 - MIGRATION TO CITIES; POPULATION GROWTH
 - POLITICAL-ECONOMY OF POST COLONIAL CITIES
 - WASTE MANAGEMENT
 - ESCALATING COSTS & SKILLS SHORTAGE
 - HOUSING LOAN CRISIS, HOUSE PRICES, BANKS
 - UNITED NATIONS' MDGS IN RESPECT OF WSS
 - THE NEED FOR DOUBLING INVESTMENTS IN WSS

. IN SOUTH AFRICA:-

- A BIT OF GOOD NEWS:

.SA HAS ALREADY MET MDG IN RESPECT OF WSS
(MINISTER)

.INFRASTRUCTURE INVESTMENT; GAUTRAIN; 2010;

- THE CHALLENGE:-

.SA HAS NOT YET MET ITS OWN TARGETS

. “BACKLOGS” & POLITICIZATION OF BACKLOGS

. DEMAND FOR WSS OUTSTRIPS SUPPLY

. THE DEMAND FOR & THE SUPPLY OF CAPITAL

. INEQUILITY & APARTHIED LEGACY

- THE GREAT DECENTRALIZATION DEBATE:-

. DEVOLUTION OF “POWERS” TO REGIONS/TOWNS

. RESTRUCTURING

. DWAF’S DIRECT FUNDING OF MUNICIPALITIES

- THE KEY QUESTION FOR THIS INDABA :-

HOW CAN ONE “ENHANCE THE ACCESS TO FINANCE
FOR WSS” IDEALLY, AT MUNICIPALITY LEVEL?

TO ANSWER THIS QUESTION:-

- WE NEED TO REVIEW THE RELEVANT LITERATURE
- WE NEED TO LOOK AT COMMISSION REPORTS
- WE NEED TO LOOK AT THE EXPERIENCE OF OTHERS
- WE NEED TO DETERMINE DEMAND/SUPPLY
- WE NEED TO SHARE OUR (LOCAL) EXPERIENCE
- WE NEED TO EXAMINE OUR INSTITUTIONS:-
 - . LAWS, PROCEDURES
 - . OUR OWN MUNICIPALITIES
 - . UNDERSTAND BETTER FINANCIAL MARKETS
 - . WHO IS WHO IN THE ZOO?THE MAJOR ACTORS?
- EXAMINE THE EXISTING NATIONAL STRATEGY
- WE SHOULD THEN PROPOSE IDEAS AND DISCUSS THEM SO THAT WE HAVE PLANS AND PROCESSES.

SO A NATIONAL STRATEGY within an international paradigm.

In this respect Negash (2005:1) writes

“..the New Public Management (NPM) paradigm and recent discourse on Africa’s development challenges borrow many of their core concepts from corporate management literature. In practical-institutional terms, the postmodern State is expected to cut deficit spending, reduce the scope and cost of government and at the same time aim to provide effective and efficient services to the citizen. ‘The citizen’ is central to the NPM paradigm and the emerging literature rarely distinguishes between ‘the citizen’ and ‘the customer’. . . . The European public sector reform of the 1990s is slowly being introduced in the African public sector.”

“Decentralization is a word that has been used by different people to mean a good many different things.. Experiments with local governments that end with chaos and bankruptcy.. participation of local people but without money..

Panday (2005:11)

In RSA the premises is:-

Realizing that water sector FINANCING WILL NOT INCREASE until reforms and capacity building measures are taken to create an enabling environment; one enabling mechanism is decentralization:-

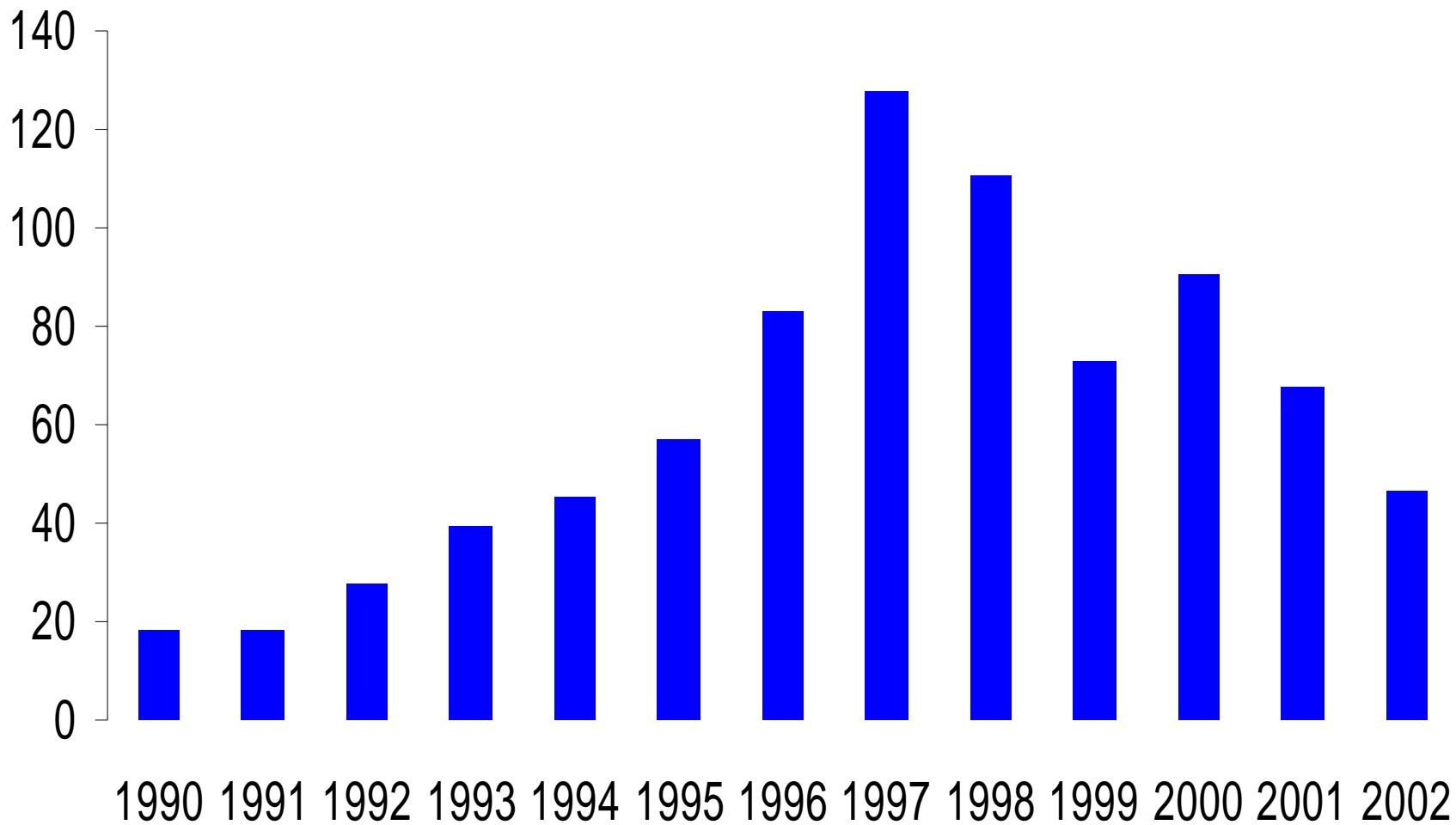
The POLICY with respect to the water services sector in South Africa suggests:-

“CONSOLIDATION OF NATIONAL GOVERNMENT’S FUNDING FOR WATER SERVICES THROUGH EQUITABLE SHARE OF THE REVENUE, A SINGLE MUNICIPAL INFRASTRUCTURE GRANT AND CAPACITY BUILDING GRANT DIRECTLY TO MUNICIPALITIES AND

ENSURE:

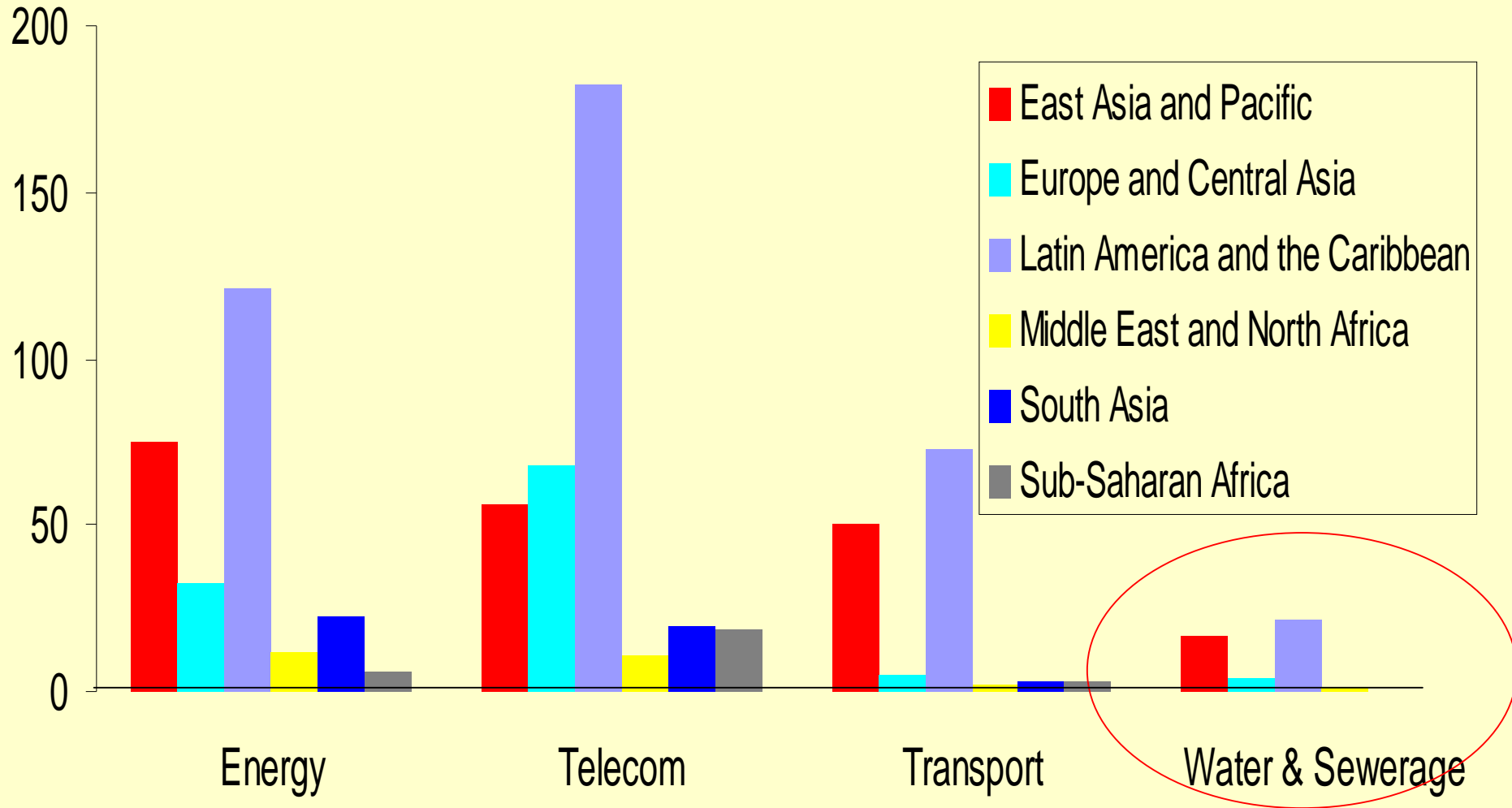
“SUSTAINABILITY, FINANCIAL VIABILITY & EFFICIENCY”

II THE LITERATURE AND COMMISSION REPORTS:-

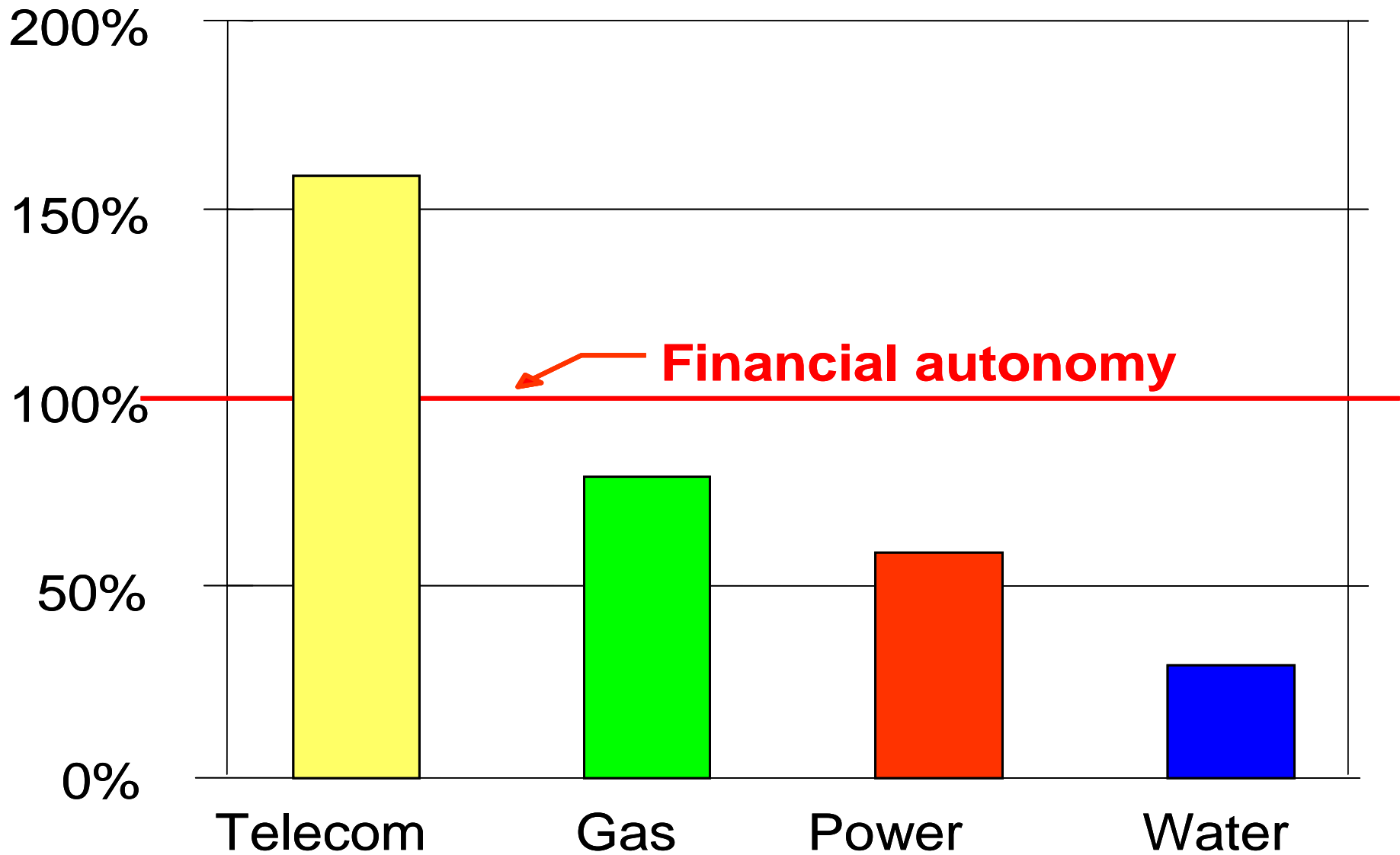


**Declining private infrastructure investments in developing countries,
Camdessus Commission (2003)**

Total Private Investment in Infrastructure in 1990-2002 by Sector and Region, US\$ billion



Specially, low in water and sanitation, Source: Camdessus Commission (2003)



What's the core structural problem?
Source: Camdessus Commission (2003)

ODA for water has marginally increased if at all and private sector investments have reduced dramatically due to both local political pressure on tariffs and the limited access to local currency financing.

IN RSA:- (DPLG, 2008).

CAPITAL EXPENDITURE SHOULD BE FINANCED BY:-

- 50% of municipal CAPITAL FINANCE covered by GRANTS
- 18% from EXTERNAL BORROWING
- 32% (remainder) CONTRIBUTIONS & INTERNAL sources

OPERATING EXPENDITURE SHOULD BE FINANCED BY:-

- 41% of operational expenditures are financed from tariffs,
- 17% property rates,
- 25% transfers including grants and subsidies and
- 17% from other sources

CONCEPT CHECK:- BORROWING FOR WHAT? CAPEX OR OPERATIONS? LTD Vs BRIDGING FINANCE?

During the 2004/05 financial year, CAPITAL FUNDS FOR WSS were for the first time allocated directly to municipalities through the municipal infrastructure grant (MIG) in RSA (AG, 2008a). BUT, WSS requires MORE INVESTMENT as ESTIMATED BELOW.

(Total capex – base scenario (MIIF5) Source: DPLG, MIIF (2008))

	Capex for year 2007/08 (R million)	
	MIIF4	MIIF5
Water supply	6,301	7,626
Sanitation	4,592	8,191
Electricity	5,296	9,337
Solid Waste	55	1,194
Roads	6,338	11,792
Sub-total for 'big 5' services	22,581	38,140
Public transport	404	2,791
Public services and places	2,046	4,446
Economic infra and buildings	989	2,218
Admin buildings and systems	2,015	1,929
Subtotal for public & other services	5,454	11,385
TOTAL	28,035	49,524

OUR MUNICIPALITIES (TAKING STOCK OF..)

-Variations in the SIZE, SHAPE & and financial STRENGTH:-

Municipalities have been divided into SIX GROUPS so that the figures can be analyzed (National Treasury, 2003):

- Metros (6 municipalities with 31 percent of households)
- B1: Secondary cities (top 21 local municipalities, with 18 percent of households)
- B2: Local municipalities with a medium-to-large town as core (31 municipalities with 9 percent of households)
- B3: Local municipalities with a small town or several small towns as core and with a relatively small rural population (119 municipalities, with 21 percent of households)
- B4: Largely rural municipalities (60 municipalities, with 23 percent of households)
- District municipalities (47)

(DPLG, 2008).

No.	Main findings	Percentage of municipalities achieving best practice indicator
1	Clear trail of supporting documentation that is easily available and provided timely	36%
2	Quality of financial statements and management information	17%
3	Timeliness of financial statements and management information	78%
4	Availability of key officials during audits	50%
5	Development and compliance with risk management and good internal control and governance practices	18%
6	Supervision / monitoring	34%

RELEVANT ACTS AND BYLAWS:-

HAVE WE OVER-REGULATED? HAVE WE TIRED OURSELVES WITH BAD RULES? ARE THEY CONSISTENT TO ONE ANOTHER?

- Water Services Act, 108 of 1997
- Public Finance Management Act 1 of 1999
- Division of Revenue Act (DORA) –each finance year
- Municipal Structures Act, 117 of 1998
- Municipal Systems Act, 32 of 2000
- Disaster Management Act, 57 of 2002
- Municipal Finance Management Act, 2003
- Employment Equity Act, 55 of 1998
- Preferential Procurement Framework Act, 22 of 2000
- White Paper on Municipal Services Partnerships,
(Notice 1689 of 2000)

Water Services Strategic Framework Targets

-  All people in South Africa have access to a functioning basic water supply facility by 2008.
 -  All people in South Africa have access to a functioning basic sanitation facility by 2010.
 -  All schools have adequate and safe water supply and sanitation services by 2005.
 -  All clinics have adequate and safe water supply and sanitation services by 2007.
 -  All bucket toilets are eradicated by 2006.
 -  Hygiene education and the wise use of water are taught in all schools by 2005.
 -  70% of households with access to at least a basic sanitation facility know how to practise safe sanitation by 2005 (and 100% by 2010).
-

Based on the RSA WSS targets above, the Minister of Water Affairs and Forestry (DWAF) Hon. Lindiwe Hendricks addressing with confidence the 18th annual water conference in Stockholm on the 20th of August 2008, stated the following:

“We (South Africa) have already achieved the Millennium Development Goals for halving the proportion of people without water and sanitation, and we are well ahead of our target to achieve the universal access by 2014”.

Investment in WSS HAS TO DOUBLE, and Governments, donors, consumers need to commit MORE resources to WSS

BUT WE KNOW THAT:-

INVESTMENT = FINANCE

ASSETS = DEBT + CAPITAL(EQUITIES)

AND.. DEBT CAN BE DANGEROUS; IT CAN LEAD TO BANKRUPTCY UNLESS MANAGED PROPERLY.

Search for firm level “optimal” cap structure must compare the costs & benefits of leverage: (Altman, Gitman De Angelo & Masulus)

$$V^L = V^U + [T_c(rD)/K_d - \text{Bankruptcy costs}]$$

The evidence in RSA:- Negash (2001/2)

Research question: Whether the NET GAIN from leverage is > 0

$$G_i = \sum_{t=1}^{t=T} \left[\frac{[T_c i_t](1-P(\text{bit}))}{(1+K_D)^t} - \frac{P(\text{bit})[L C_i + R C_i + D C_i]}{(1+WACC)^t} \right] > 0$$

TO IMPROVE “ACCESS TO FINANCE”, MEANS TO IMPROVE THE PROBABILITY OF FINANCING THE REQUIRED INVESTMENT BY THE USE OF A DEBT INSTRUMENT OF ONE FORM OR ANOTHER. THE SOURCE CAN BE DEBT MARKET, DEVELOPMENT INSTITUTIONS, NGOS OR GOVERNMENT CAN CREATE RING FENCED DEBT FUND.

THIS REQUIRES ACTIONS ON SEVERAL FRONTS:-

- (1) INCREASING THE CREDIT WORTHINESS OF LOCAL GOVERNMENTS (USE KEY FINANCIAL RATIOS, CASHFLOW INDICATORS & BANKRUPTCY TEST MODELS:- LEARN THE TRICKS OF THE BANKER!)
- (2) TRY TO BORROW IN LOCAL CURRENCY
- (3) ENSURE THAT THE NEW PROJECTS PASS FEASIBILITY TESTS (including social cost benefit analysis; securitization).
- (4) TRY TO GET GUARANTORS FOR YOUR DEBT (USAID, IMF, DBSA, ADB, EU, NATIONAL & PROVISIONAL GOVTS)

- (5) BUILD TECHNICAL CAPACITY (STAFFING)
- (6) SET REALISTICS AND ACHIEVABLE TARGETS,
USE RELIABLE DATA
- (7) HANDEL THE BEHAVIORAL AND POLITICAL ASPECTS OF
FINANCE (tariff setting, collection, “free water”, connecting
under-served and un-served areas, cross subsidization, etc.:- viz
subsidies, leads and lags). DOES THE POOR PAY? YES!
- (8) CREATE AN ENABLING LIGISLATION...

AND OWNERSHIP STRUCTURE OPTIONS:-
CAN DEBT FINANCE BE COMBINED WITH PUBLIC PRIVATE
PARTNERSHIP PROGRAMMES? DOES IT WORK? HAS IT
WORKED?

EXAMPLES:

INTERNATIONAL

LOCAL

INTERNATIONAL:

Tamil Nadu Urban Development Fund of India which was established in 1996. The fund provides the necessary credibility to attract private capital flows into development projects.

Similar initiatives in Egypt, Senegal, Mexico, Argentina, Malaysia, the Baltic States.

LOCAL:

IFI Partial Guarantees create confidence in local capital markets

Municipal bond issues with a partial credit guarantee: Johannesburg case - The City of Johannesburg issued a R1billion (US\$153 million) bond in June 2004, IFC and the Development Bank of South Africa (DBSA) provided a partial credit guarantee Gurria Task Force (2006).

DBSA's other supports.

A Summary Terms and Conditions, JHB	
Amount	R1,000,000,000 (approximately US\$153mn)
Currency	South African Rand
Issue Date	June 23, 2004
Maturity	12 years
Series	1 Series
Interest Payment	11.90%, payable semiannually
Principal Payment	Six equal semiannual payments over the last 3 years
Rating	AA-.zaf by FitchRatings
Enhancement	Principal and interest for an amount up to 40% of principal outstanding, shared by IFC and DBSA on a several but not joint basis

THE SUPPLY SIDE:-

ODA:

- .RSA faces a different challenge as in most case it has met the UN requirements of the MDGs.
- . BUT ODA represents only a small part of the total funding, **INDIRECT HELP**

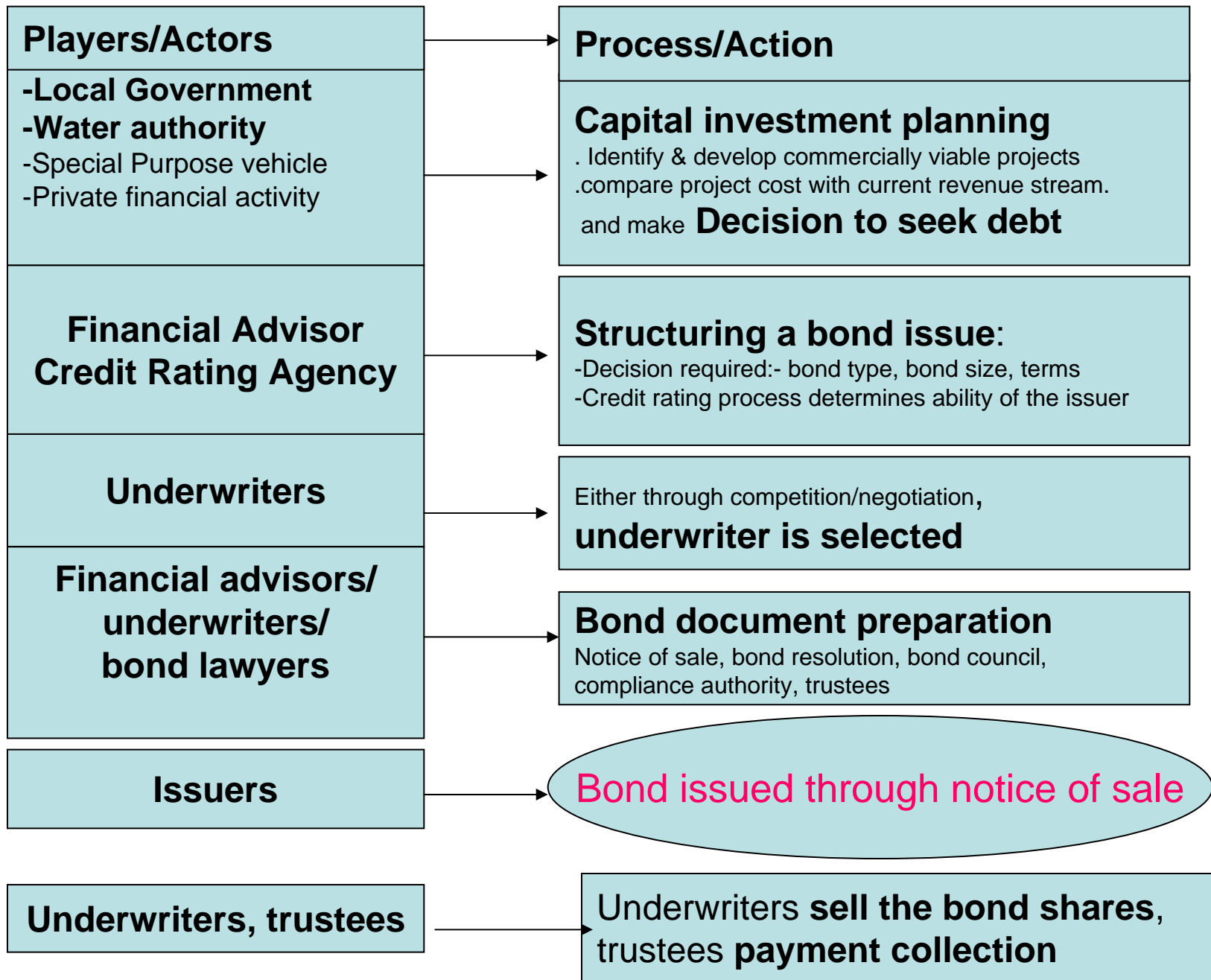
Local Actors:

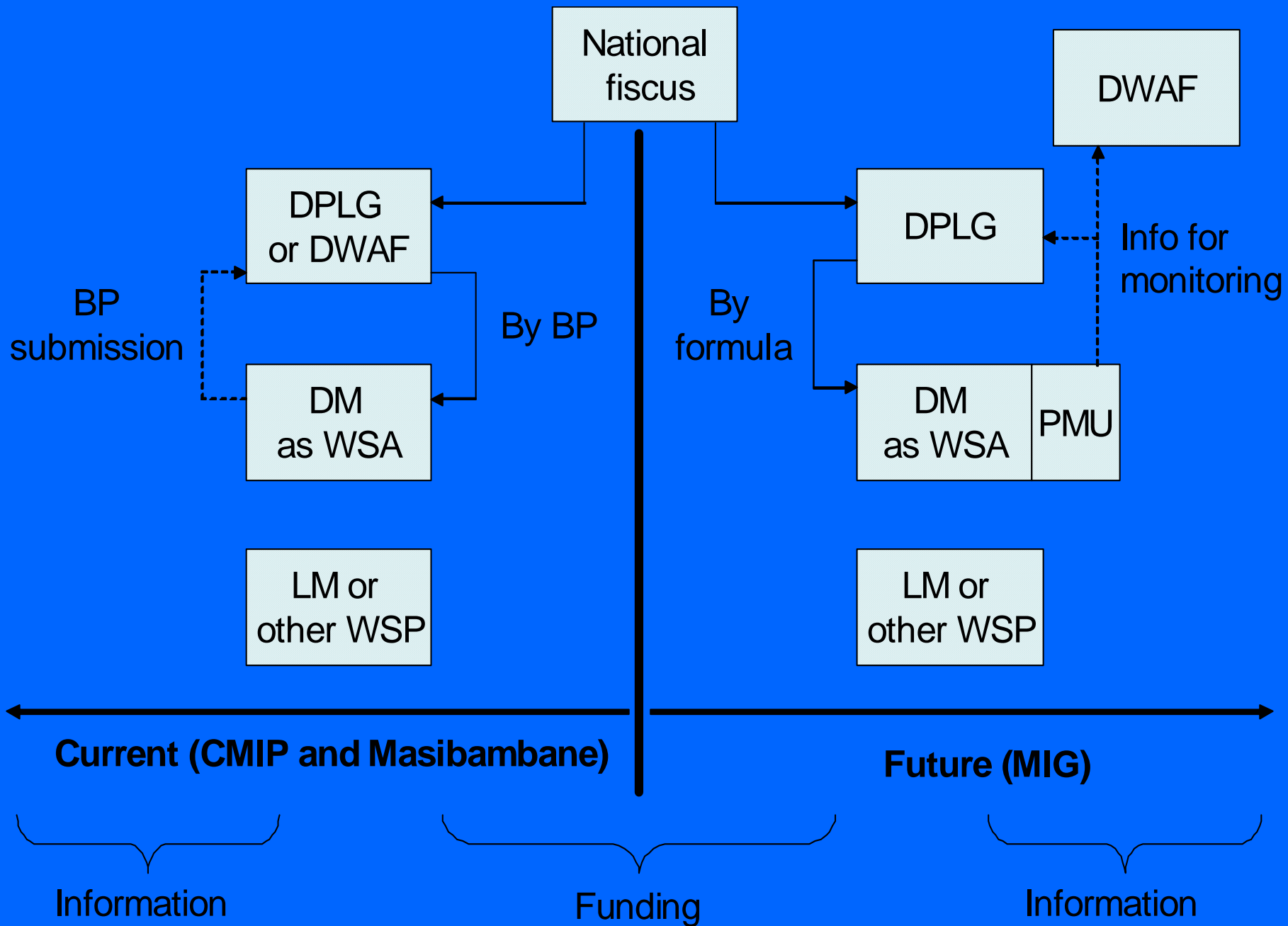
- . DBSA, Bond exchange of SA, Financial Service Board, National Treasury, Creation of ring fenced **DEBT FUND**.
Banks, Insurance, pensions funds, unit trusts, property fund managers, NGOS example (Mvula Trust).

DATA FROM BOND EXCHANGE OF SA

MORE DETAILS ABOUT THE ACTORS AND PROCESSES

KW01	V	ZAG000016296	KOMATI RIVER BASIN AUTHORITY	RSA GUARANTEE	LISTED	N/A	N/A	N/A	N/A	N/A	
LB01	V	ZAG000006255	LAND AND AGRICULTURAL BANK	UNSECURED / RSA SHARE HOLD..	LISTED	AA-zaf	N/A	N/A	N/A	LAND AND AGRICULTURAL BANK	
LB107	V	ZAG000019639	LAND AND AGRICULTURAL BANK	UNSECURED / RSA SHARE HOLD..	LISTED	AA-zaf	N/A	N/A	N/A	LAND AND AGRICULTURAL BANK	
TSP29	CP	ZAG000034935	TRANSNET LIMITED	PAPER PROGRAMME	LISTED	N/A	N/A	Prime-1.za	N/A	N/A	
TSP30	CP	ZAG000034943	TRANSNET LIMITED	TRANSNET DOMESTIC SHORT TERM PAPER PROGRAMME	LISTED	N/A	N/A	Prime-1.za	N/A	N/A	
TSP31	CP	ZAG000035346	TRANSNET LIMITED	TRANSNET DOMESTIC SHORT TERM PAPER PROGRAMME	LISTED	N/A	N/A	Prime 1.za	N/A	N/A	
TSP32	CP	ZAG000035353	TRANSNET LIMITED	TRANSNET DOMESTIC SHORT TERM PAPER PROGRAMME	LISTED	N/A	N/A	Prime 1.za	N/A	N/A	
TSP33	CP	ZAG000035361	TRANSNET LIMITED	ABSA VEHICLE AND ASSET FINANCE/ABSA BANK LIMITED SECURITIZATION	LISTED	N/A	N/A	Prime 1.za	N/A	N/A	
UG65	V	ZAG000016288	UMGENI WATER	NO GUARANTEE	LISTED	AA zaf	N/A	N/A	N/A	N/A	
UTR01	V	ZAG000024779	UNITRANS SERVICES PTY. LTD.	UNITRANS LIMITED GROUP OF COMPANIES	LISTED	A zaf	N/A	N/A	N/A	RMB	
VAF1A2	AFRN	ZAG000026204	ACCELERATOR FUND 1 (PTY) LTD	SBSA SECURITIZATION	LISTED	AAA zaf	N/A	Aaa.za	N/A	N/A	
VAF1A3	FRN	ZAG000026212	ACCELERATOR FUND 1 (PTY) LTD	SBSA SECURITIZATION	LISTED	AAA zaf	N/A	Aaa.za	N/A	N/A	





Municipal finance mechanism, Ian Palmer's version

Current arrangement

- KEY FEATURES -

- Funds allocated to DWAF (for Masibambane) and DPLG (for CMIP) via national budget process
- DWAF and DPLG require funding motivation from the WSA for specific projects in the form of a BP
- Upon approval of the BP the funds are paid out to the WSA for the specific project
- WSA implements projects on behalf of WSPs and may delegate implementation to them
- DWAF and DPLG keep separate monitoring databases for their programmes

Future arrangement

- KEY FEATURES -

- Funds allocated to DPLG (for MIG) via national budget process
- DPLG makes annual funding allocations to WSAs by formula which is based on backlogs in each WSA
- Municipalities which are not WSAs will not get MIG funds for water services
- Districts and large LMs will be required to set up PMUs to implement MIG projects
- Where external WSPs are appointed (including LMs) the PMU will implement projects on their behalf
- DPLG, acting together with DWAF, will monitor performance
- Where WSAs under-perform, MIG funds will be reduced “in-year” or in the next year

Source: Ian Palmer, Palmer Development Group and Jean de la Harpe

CONCLUDING REMARKS AND DISCUSSION

To improve WSS and eliminate backlog in WSS, investment has to increase (double, triple...).

But Increased Investment = Increased Finance

Government's financial sources are limited

Moreover, decentralization and PPP are the trends.

Hence, borrowing from the local market might be an option; given that our municipalities are credit worthy and have feasible projects. Government can also create an internal capital market (ring-fenced DEBT FUND).

Major Issues DWAF wants CONSIDERED/RESOLVED

- (1) Who are the key local players in the finance sector re waster and sanitation
- (2) Types of financing available for this sector
- (3) How can municipalities especially the poor ones get access to financing?
- (4) The question as to whether municipalities can borrow and limitations in terms of current Statute.
- (5) The urgency of funds and time frames to meet targets need to be discussed
- (6) An action plan must be developed together with responsibilities.

DISCUSSION