

MSB III Mid-Term Review

**Key Outcome:
Alternative Financing Methods**

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Relevance

The agreement signed between the EU and RSA for the Masibambane III funding programme contains a number of outcomes. Outcome number six reads as follows:

Review of alternative financing mechanisms for sustainable delivery of water services and water resource management.

Government's financing support to the water sector has been central to the success of Masibambane to date. However, Treasury has indicated that the sector activities should seek alternative sources, and approaches involving a multiplicity of options and models. Different operations in the sector may well require different solutions, and so DWAF could play a pivotal role by reviewing and advising on alternative finance mechanisms, assisting water operators to establish and source finance, and advising sector stakeholders of the various mechanisms available.

Effectiveness and Efficiency

As far as the objective for the Masimambane programme to assist in the creation of alternative financing mechanisms for water services discussions with senior officials at DWAF, dplg, the DBSA and Treasury revealed little in the way of concrete results, or evidence of actual Masibambane funding for this purpose.

- The DBSA is aware of the incipient creation of a fund that will target the turnaround of non-revenue water in municipalities. This fund is to attract private sector participation in both the financing and implementation aspects of its operation, given the quick and sustainable returns that unaccounted for water loss management measures can offer. The driver for the fund's creation is a private sector initiative – Af-Cap. It claims to be attracting some funding from USAID and potential investment from the World Bank.
- The National Treasury pointed out that there is very little activity on the Public Private Partnership front. They would welcome some activity but lament that international water companies seem to have less appetite for pursuing PPPs than was initially the case. This is true – international water companies such as Vivendi, Suez, Thames Water, and Biwater are considerably less bullish and more risk averse than in the 1990s. This is largely as a result of adverse experiences of political and currency risk. The concessions signed in RSA in Nelspruit and the North Coast of KZN are, however, still operational. The Treasury officials agreed that, in addition to the above, the legislation for PPPs in RSA makes the conclusion of any deal extremely onerous.
- The dplg reports that it has allocated R30m of Masibambane funds to a programme that provides technical assistance and training to municipalities to help inter alia in accessing loan funding or secure a credit rating. This has been piloted in 7 municipalities. The main problem commercial lenders have is that investments have to generate a revenue stream at rates that are affordable to the consumers. The dplg has experienced cases where the water tariff required for loan payback is R28/kl. This is obviously unaffordable.

- The DBSA and the commercial banks do, however, regularly lend to municipalities. A component of this is for water and sanitation infrastructure. It is not apparent that there have been any new developments in devising alternative financial instruments.
- Direct consumer billing and debt collection is obviously the primary revenue stream for municipalities. This was not explored in this review.

Related matters arising from discussions

From the above it is apparent that there are a limited number of new initiatives in alternative financing mechanisms. Direct government grants will continue to be the mainstay of financing of the water sector for those municipalities whose cost recovery on billings is inadequate to cover the operating, overheads, and capex financing costs. A number of issues were discussed regarding the efficiency and effectiveness of the grants. These are reported below.

- Treasury has decided to be more transparent about the make up of the Equitable Share grants in the allocations. A municipal recipient will therefore know the separate amounts provided for electricity, water, sanitation, and refuse. The intention behind this is to empower departments within municipalities to “contest” for their allocations as opposed to the grant being absorbed in non service delivery overheads.
- Similarly, this greater transparency in the makeup of the allocations can help bulk providers such as Water Boards who sometimes struggle to obtain payment from municipalities.
- DWAF has looked into the possibility of making a part of the Equitable Share a “pass through” payment to, for example, a Water Board. This has not proceeded beyond the ideas phase and its legality is doubtful.
- Similarly, the option of making a portion of the grant conditional has been considered by the dplg. The main obstacle that presents to all the efforts to ensure that the Equitable Share is spent more on service delivery and less on overheads is the constitutional separation of the powers and functions of the different spheres of Government – National, Provincial, and Local.
- The effect of the separation of powers is that the link between funder (national government) and intended recipient is to a large extent severed. Local government is somewhat insulated from the consequences of poor service delivery as the revenue stream from the Equitable Share continues regardless. To the extent that this revenue stream is a material proportion of total revenue there is a degree of impunity with regard to the actual quality of service delivery.
- The net effect of the unconditional status of the Equitable Share grant is that the regulator – DWAF - is somewhat toothless in ensuring that the grant is used for the purposes intended.
- Treasury admitted that there is no real mechanism to ensure that the MIG and ES grants/transfers are used for the purposes intended. They rely mainly on the irregular updates to census data to gauge progress.

- As an aside it was stated that only the census data carry any weight with the dplg in determining transfer allocations. Municipalities spend money on garnering alternative statistics but these studies are ignored by dplg.

Recommendations

Firstly, there is a lack of co-ordination and integration in the planning for infrastructure as a whole. DWAF emphasized that the MIG grants cover retail basic infrastructure. South Africa is now at a point where bulk capacity is at a premium. The RBIG grant is designed to cover bulk infrastructure but it is inadequate in relation to the rollout of retail infrastructure. There is also a lack of integration. DBSA mentioned, by way of example, the case of Wolmaransstad (where very few of the residents can afford to pay for basic services) where water-borne sanitation was provided to 3512 homes in order to upgrade them from the bucket system. The bulk implications were not thought through and the water supply in the town proved inadequate for the new demand load. This led to the need for the construction of a R120m water augmentation supply pipe from Bothaville. It is also felt that the peri-urban needs of the cities are somewhat neglected in the whole planning process, whereas they are the major settlement problem. Further, there is insufficient planning co-ordination between the housing planners and the bulk infrastructure providers.

Secondly, there is an emphasis on capital expenditure whilst in general expenditure on operations and maintenance is neglected. This has been discussed to some extent above. The Equitable Share grant is intended for O & M but is often misused. The DBSA points out that in terms of life cycle costing O& M should have the largest share of costs – 44%. Financing attracts 37% whilst capital costs are only 17%. Effective planning, which need cost no more than 0.5%, is essential. The point they make is that the water services business is not only about new infrastructure.

Thirdly, and leading on from this, one wonders whether it is possible to create a link between the ES and MIG grants. There seems little value in building new infrastructure whilst existing systems are being neglected. It would be desirable to create a positive feedback between the judicious use of the ES transfer (i.e. it is used for operation and maintenance of basic services for the poor) and the attainment of further MIG grants. This suggestion will no doubt come up against the same constitutional barrier as mentioned earlier, but maybe these should be addressed. It will require audits of municipal budgets and expenditure to determine whether there has been judicious use of the monies available. Further grants should depend on some compliance with a good governance norm or target set.