

Our Ref: 2.1.2.3 DWS

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**THE MINISTER OF HUMAN SETTLEMENTS, WATER AND SANITATION
SEDIBENG BUILDING, 10TH FLOOR, ROOM 1029
185 SCHOEMAN STREET,
PRETORIA
0002**

ATT.: HONOURABLE MINISTER MS LINDIWE SISULU, MP

Via FEDEX Courier

Dear Sir

UMGENI WATER'S 2020/21 PROPOSED PRICING INCREASE FOR BULK WATER SALES

1. INTRODUCTION

Umgeni Water is a public entity established in terms of the Water Services Act (Act 108 of 1997) to provide water services to other water services institutions. The primary activities of Umgeni Water are to provide water services (water supply and sanitation services) to other water services institutions in its service area, as defined in Section 29 of the Water Services Act.

Whilst the rendering of bulk waste water services is within the ambit of the Water Boards mandate, the pricing thereof is not discussed in this document as Umgeni Water holds separate agreements with each customer concerned and consults individually on an annual basis in terms of those agreements.

1.1. Purpose of pricing document

The purpose of this document is:

- To set out the process followed for determining the pricing of Bulk water activities
- To make a proposal regarding the pricing of Bulk water sales; and
- To make a request that the proposed bulk water pricing increases for 2020/21 be tabled in Parliament.

UMGENI WATER

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The detailed input assumptions, financial analyses and risks to Umgeni Water in terms of the pricing proposed is contained in the "Annual Pricing Review 2020/21" document attached.

1.2. Applicable legislation, regulations and guidelines

The pricing of Umgeni Water's S29 activities is consistent with existing legislation, namely, the Water Services Act 108 of 1997 as amended by Water Services Amendment Act 30 of 2004, the Public Finance Management Act 1 of 1999, and the Municipal Finance Management Act number 56 of 2004 (MFMA).

1.3. Process followed for determination of the pricing for S29 activities

The process involves determining the proposed tariff to the customers and the benchmark tariff.

The proposed tariff differs from the benchmark tariff as the latter tariff for each scheme and category of schemes is a reference tariff only. The benchmark tariff includes a return on assets for economic schemes (but not for social schemes). The benchmark tariff is not a cash-flow based tariff that takes into account the repayment of debt and any direct spending on capital expenditure out of cash flows.

2. CONSULTATION PROCESS IN TERMS OF S42 OF THE MFMA

2.1. The steps to be followed in terms of Section 42 of the MFMA and Circular 23 issued by National Treasury.

Tariff setting process / activities	Date
DWS provides water resources tariffs for the following year/s to municipalities/ water boards	September 2019
Consultation with Municipalities	12 November 2019
Submission to National Treasury and SALGA	30 November 2019
Submission to the Minister of DWS	25 January 2020
Tabling in Parliament by Minister	15 March 2020
Implementation by municipality	1 July 2020

2.2. Feedback from consultation with Municipalities

The consultation meeting with the Municipalities as customers of Umgeni Water, in compliance with S42 of the Municipal Finance Management Act, was held on 12 November 2019. Representatives of DWS (Chief Directorate: Economic and Social Regulation), SALGA and National Treasury were also present.

TCTA consulted with the stakeholders on the 2021 increase for the capital unit charge ("CUC") for Mooi Mpofana Transfer Scheme 2 ("MMTS2") including the proposed surcharge to repay the debt associated with MMTS2 by 2023, ten years earlier than planned to make provision for the phasing in of the Mkomazi Water Supply Project capital unit charge by 2023.

The full attendance register is per **Annexure 3.1** to this report. The contents of the presentation highlighted the operational risks facing Umgeni Water and the financial impact thereof. The legislative framework governing the tariff computation was highlighted and discussed with the customers and the infrastructure plan to be funded from 2020 to 2024 was also presented.

The main issues raised by the customers (and responses thereto) were as follows:

Comment	Response
<p>1. eThekwini</p> <ul style="list-style-type: none"> • Sales volume – up to 1000ML/day from the Durban Heights WW – How will UW sustain the demand. • If the tariff increase was equal to CPI for 2021, what would that scenario look like and the impact on the Municipality? • With a tariff increase above inflation, how is the municipality expected to afford sustaining its investment into its own infrastructure? • Do not combine the MMTS2 tariff with the uMkomazi Tariff as this will blur the repayment of the debt associated with each initiative. • The 25% grant funding for uMkhomazi Water Project must still be factored into the sources of funding, as there will be a great need for grant funding. • If all the assumptions made are input into the long-term model used by EThekwini, the tariff increase could be lower than the 9.6% increase but maybe UW and eThekwini could meet soon to discuss the variables of tariff setting to foster greater understanding. 	<p>UW responded as follows:</p> <ul style="list-style-type: none"> • UW is bringing forward a number of projects to ensure that the demands can be met. • UW's planning team must ensure that demand projections are reflective of the current demand trends. However, it must be noted that in meetings with the customers, no customer has provided growth rates in excess of 3% and yet now it is mentioned that almost 1000ML/d is drawn from the Durban heights system. • In terms of a tariff increase of CPI, this will be communicated in writing to give the team a chance to determine the impact holistically. However, one must also be pragmatic – a tariff increase of CPI can be affordable if cuts in expenditure (more specifically capex) is done but that would catch up with the Municipality in the latter years for example the removal of the Umlaas Road water reuse project • The merging of the MMTS2 tariff with the overall bulk water tariff has been discussed at all meetings where the tariff for (Mkhomazi Water Project ("uMWP")) is discussed. However, the project team (which includes eThekwini) will discuss how the merging of the tariff can be implemented by mutual acceptance. Overall though we need to ensure that there are no significant increases in the next MTEF. • In terms of understanding the model inputs to the tariff, a meeting will be set up with the colleagues from eThekwini and Umgeni Water to understand the tariff setting dynamics. In addition it must be noted: <ul style="list-style-type: none"> ○ The tariff increase must be viewed in context of the R17bn investment in capex over the 5-year period to 2025. ○ Operating cashflows are not sufficient to cover each year's expenditure but is also still required

Comment	Response
	<p>to enable the servicing of debt which allows for the investment in infrastructure, whereas other organisation which do not have a strong balance sheet are not able to raise the required funding and rely on the annual operating cashflow to guide the investment in infrastructure.</p> <ul style="list-style-type: none"> ○ UW will also submit a pack to the MM's office at each municipality which will explain in detail the cost drivers for the tariff increase. <p>National Treasury responded on the concern for grant funding for the uMWP as follows:</p> <ul style="list-style-type: none"> • Part of the reason why NT attends such forums as the consultation process as well as the project strategy meeting for the uMWP is to understand the funding requirements for the projects and the pressure on customers as well as UW. • Whilst there is currently pressure on the fiscus, the Raw water Pricing Strategy does make allowance for water resources infrastructure to be funded partly through grant funding and NT has not denied this. • DWS will need to make a submission to NT to start the initiative to obtain grant funding formally.
<p>2. Msunduzi</p> <ul style="list-style-type: none"> • Stephen Dlamini Dam BWS <ul style="list-style-type: none"> ○ Was that not part of the previous tariff capex? ○ Will it be ring-fenced? ○ Impact to customers for the implementation of this Dam? • There may be more drought restriction's in the future – how will that impact on the UW revenue? 	<p>UW responded as follows:</p> <ul style="list-style-type: none"> • UW is being proactive in addressing the need for the Stephen Dlamini Dam (Bulwer BWSS) as the uMkhomazi Water Project will be implemented but the community residing close to the uMkhomazi Water project will not be able to get access to the water produced by this plant – this could be a serious impediment in construction of the uMWP • In terms of the impact of the drought restrictions, if any, this will constrain revenues as water demand will be restricted. This will have an impact on the next year's tariff if the impact is significant.

Comment	Response
3. DWS (Regional Office) <ul style="list-style-type: none"> Sales volume – capacity to ensure the growth projections of 3% per annum as well as capex to be implemented – will the yields of the water resources be sufficient to feed these schemes. 	UW responded as follows: <ul style="list-style-type: none"> A 3% increase in 2021 has been factored in, but the following years the growth is factored in at 1.5% per annum given the capacity and yield of the water resources.

No further written comments were received from the customers.

2.3. Feedback from consultation with National Treasury

Comments from National Treasury and responses by Umgeni Water have been included in the annexures to this letter. Refer to **Annexure 5**.

2.4. Feedback from SALGA

Comments from SALGA and responses by Umgeni Water have been included in the annexures to this letter. Refer to **Annexure 6**.

3. 2020/2021 BULK WATER TARIFF CONSULTATION

Below is a summary of the bulk water tariffs 2020/21

TARIFF REVIEW	2020	2021
Bulk Water Tariff	R/kl	R/kl
- Bulk Tariff 1		
- Base Tariff	7.057	7.734
- Tariff Increase	0.677	0.742
- New Tariff - Umgeni Water	7.734	8.476
- % Increase - UW	9.6	9.6
Add Capital unit charge		
- Spring grove	1.498	1.893
- Mkomazi (Potable)	0.155	0.170
- Total Tariff	9.387	10.539
- % Increase -Total	21.1	12.3
- Bulk Tariff 2 - eThekweni		
- Base Tariff	6.918	7.582
- Tariff Increase	0.664	0.728
- New Tariff - Umgeni Water	7.582	8.310
- % Increase - UW	9.6	9.6
Add Capital unit charge		
- Spring grove	1.498	1.893
- Mkomazi (Potable)	0.152	0.166
- Total Tariff	9.232	10.369
- % Increase -Total	21.4	12.3
- Bulk Tariff 3 - Siza		
- Base Tariff	9.290	10.182
- Tariff Increase	0.892	0.977

TARIFF REVIEW	2020	2021
Bulk Water Tariff	R/kl	R/kl
- New Tariff - Umgeni Water	10.182	11.159
- % Increase - UW	9.6	9.6
Add Capital unit charge		
- Spring grove	1.498	1.893
- Mkomazi (Potable)	0.204	0.223
- Total Tariff	11.884	13.275
- % Increase -Total	18.5	11.7
WEIGHTED AVERAGE TARIFF		
Excluding the capital unit charge	7.642	8.378
- % Increase -Total	9.6	9.6
Including the Capital unit charge	9.293	10.438
- % Increase -Total	21.2	12.3

4. TARIFF INCREASE PROPOSAL 2020/21

The pricing increases proposed for 2020/21 will ensure that:

1. Umgeni Water continues to operate as a financially viable concern
2. No financial covenants to be breached
3. Strong operating cash flows continue to be generated to adequately service debt and maintain the credit rating of zaAAA (Long term) and zaA-1+ (short term).

Yours sincerely



TB HLONGWA CA(SA)

CHIEF EXECUTIVE

cc: Mr Humbulani Nevondo – DWS: Economic and Social Regulation

ANNEXURES:

1. Annual Pricing Review 2020/21 (document and associated annexures)
2. Consultation with Municipal Customers: Presentations to the Customers.
3. Consultation with Customers: Attendance registers and minutes of the Meeting
4. UW's Board Resolution taken at its Board Meeting on 22 January 2020 on UW's 2020/21 Tariff Proposal
5. Feedback from National Treasury and Umgeni Water response
6. Feedback from SALGA and Umgeni Water response