

KOPANO YA METSI

# BARRIERS AND SOLUTIONS TO IMPLEMENTING MUNICIPAL WATER PPPs



SUPPORTED BY



**MINISTRY OF  
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# KOPANO YA METSI

“THE WATER AND SANITATION SECTOR IS CURRENTLY NOT FINANCIALLY SUSTAINABLE”  
National Water and Sanitation Master Plan, 2018<sup>1</sup>

## WATER MANAGEMENT IN SOUTH AFRICA REQUIRES URGENT ACTION

Drought and poor water service delivery is already constraining economic growth and hampering livelihoods. The water sector funding gap is R330 billion over the next ten years, with major infrastructure refurbishment and improved maintenance required. At least a third of the municipalities delivering water services are considered to be dysfunctional. Many water institutions are not credit-worthy and accumulated municipal water debt is now over R13 billion.

The National Water and Sanitation Master Plan states that a ‘turn-around towards financial sustainability is not optional’ and calls for enhanced revenues, cost reductions, an analysis of alternative service delivery models and increased private sector investment.

Kopano ya Metsi (‘meeting for water’ in Sesotho) was initiated in 2017 by the National Business Initiative (NBI) in partnership with the Confederation of Danish Industry (DI) and Voluntas Advisory, to understand how water investment can be unlocked in South Africa.

Kopano ya Metsi speaks directly to the need to investigate alternative delivery models and ways to improve the sector’s financial viability, as outlined in the National Water and Sanitation Master Plan.

## THROUGHOUT ITS DURATION KOPANO YA METSI HAS SOUGHT TO UNDERSTAND 4 ISSUES:

- **How can water finance be unlocked?**
- **What is the potential role of formal Public Private Partnerships?**
- **How can municipal water management be strengthened?**
- **How can we solve for a specific challenge, wastewater treatment?**

Over a period of 18 months, Kopano ya Metsi has engaged with hundreds of water experts in South Africa through 8 major roundtables, conferences and workshops held across 4 cities (Durban, Pretoria, Johannesburg and Cape Town), as well as a series of individual meetings. Participants have included civil society partners, national government, local government, industry bodies, local government associations, researchers, private sector implementers, development banks, commercial banks and investors. The findings of Kopano ya Metsi are a reflection of this consultation process.

[www.yametsi.co.za](http://www.yametsi.co.za)

[www.nbi.org.za](http://www.nbi.org.za)

<sup>1</sup> DWS (2018) *National Water and Sanitation Master Plan, Volume I: Call to Action*. Version 10.1, October 2018, p48

# KOPANO YA METSI REPORT SERIES

- 
- 01 UNLOCKING WATER INVESTMENT IN SOUTH AFRICA**  
Paper 1 summarises the main challenges to be addressed in the water sector from a financing and investment perspective, outlines key solutions and charts a course for the future.
- 
- 02 STRENGTHENING SOUTH AFRICA'S WATER SERVICES AUTHORITIES**  
Paper 2 provides recommendations on how municipal water management can be improved over time, with an emphasis on revenues, finance and institutional capacity.
- 
- 03 AN INTRODUCTION TO PPPs IN SOUTH AFRICA**  
Paper 3 provides a primer on formal PPPs, introducing their main characteristics, potential benefits, key success factors and governing legal framework.
- 
- 04 WATER PPP OPPORTUNITIES IN SOUTH AFRICA**  
Paper 4 assesses where the main opportunities for formal water PPPs are likely to be located at both a geographic and value chain level.
- 
- 05 PUBLIC PERCEPTION OF WATER PROVISION THROUGH PPPs**  
Paper 5 considers the findings of a public perception survey conducted among urban households in 2017, including the implications for a PPP approach to water provision.
- 
- 06 BARRIERS AND SOLUTIONS TO IMPLEMENTING MUNICIPAL WATER PPPs**  
Paper 6 identifies the key barriers to implementing water PPPs within local government and outlines relevant solutions to address these challenges.
- 
- 07 SOLVING FOR MUNICIPAL WASTEWATER TREATMENT**  
The final paper applies the findings of Kopano ya Metsi to improving the state of municipal wastewater treatment in South Africa.
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## EXECUTIVE SUMMARY

Despite opportunities for private sector involvement, formal Public Private Partnerships (PPPs) in the South African water sector are currently underrepresented, including within local government.

This paper unpacks the main impediments to water PPPs undertaken within municipalities, focusing on the barriers encountered in *setting up* a PPP, as well as the barriers encountered in *implementing* a PPP.

The barriers to the use of PPPs in the municipal sphere are not insurmountable and can be addressed through the solutions outlined in this paper.

**The key barriers and solutions to implementing municipal PPPs, as identified and prioritised through the Kopano ya Metsi consultation process, are summarised in Table 1 below.**

Please note that this list is not exhaustive and only the priority barriers have been included. A distinction is drawn between barriers in the PPP setup phase, and barriers encountered in a PPP's subsequent implementation.

TABLE 1: KEY BARRIERS AND SOLUTIONS FOR MUNICIPAL WATER PPPs

## SETUP PHASE



01

### LACK OF MUNICIPAL CAPACITY AND POLITICAL SUPPORT

- Clearly distinguish between the PPPs implemented in South Africa to date and privatisation, as the two are often incorrectly conflated. Emphasise that a range of PPP project types exist
- **Make use of the Government Technical Advisory Centre (GTAC) or NEPAD Business Foundation (NBF) supported PPP training courses**
- Make use of the [Municipal PPP Guidelines](#) developed by National Treasury
- Develop a standardised PPP readiness tool to assess a municipality's ability to undertake a water PPP procurement process
- Demonstrate how private operators can address service delivery challenges on a municipality's behalf, where the municipality has sufficient procurement capacity but is unable to manage its water infrastructure
- Ensure that the municipality has a sufficient budget to oversee the PPP procurement process and appoint a transaction advisor
- Establish and fund a pool of centralised transaction advisors that support municipal project development at risk



02

### LENGTHY PPP PROCESS

- **Undertake the requisite Municipal Systems Act and Municipal Finance Management Act consultations simultaneously, as recommended in the Municipal PPP Guidelines**
- Consider a legislative amendment to encourage the public sector to go the PPP route. Should the latter not be possible, work to shorten preparation time by:
  - Facilitating a quicker turn-around time for Treasury Views and Recommendations (TVR)
  - Ensuring project ownership at a political level within the host municipality



03

### HIGH INITIAL TRANSACTION COSTS

- **Make use of the project preparation grants provided by the Development Bank of Southern Africa (DBSA), International Finance Corporation (IFC) and National Treasury, amongst others**
- Consider bundling a number of water PPP projects in a municipality into one, in order for the transaction costs to be shared across multiple projects
- Develop and make available standardised Request for Qualifications (RfQ) and Request for Proposals (RfP) documents that specifically pertain to the water sector, as well as specific water projects



04

### SCEPTICISM FROM TRADE UNIONS

- **Consult with labour unions from the outset**
- Include private party performance metrics linked to improved working conditions

TABLE 1: KEY BARRIERS AND SOLUTIONS FOR MUNICIPAL WATER PPPs

## IMPLEMENTATION PHASE



05

### POOR PUBLIC SECTOR CONTRACT MANAGEMENT

- Ensure that a properly skilled Project Officer is in place
- **Strengthen internal municipal systems, procedures and protocols to facilitate improved project management capability**
- Consider outsourcing performance monitoring and contract management to an external firm



06

### REVENUE RISK FROM NON-PAYMENT AND ABSENCE OF COST-REFLECTIVE TARIFFS

- Improve billing systems, credit control and customer payment options
- **Increase collections and reduce non-revenue water to increase cash flows without raising tariffs**
- Implement cost-reflective tariffs for those who can afford to pay, coupled with a targeted subsidy for indigent customers
- Evaluate the use of water bonds or an escrow account to better ring-fence water revenues
- Investigate the use of risk underwriting facilities funded by Corporate Social Investment (CSI), international donors, Development Finance Institutions (DFIs) or climate finance



07

### CONTRACTING ASSUMPTIONS NOT HOLDING UP IN IMPLEMENTATION PHASE

- The private party to absorb this risk through the development of improved operational efficiencies
- **Prioritise data collection and sharing to create a better baseline on which to base project assumptions**
- Allow room for reasonable contract renegotiation and the involvement of an independent expert

# KEY BARRIERS AND SOLUTIONS IN SETUP PHASE



01

LACK OF MUNICIPAL CAPACITY & POLITICAL SUPPORT FOR PPPs AS A PROCUREMENT MECHANISM

## Overview of Barrier

This challenge often stems from a limited understanding of the PPP process by political leaders and municipal council members, leading to a lack of approval for projects that may have strong potential.

**Continuity with respect to municipal councillors can also be a challenge. New councillors may be reluctant to take up a PPP project that was initiated under a previous incumbent, and may either impede progress on a project or cancel it altogether.**

## Solution

The key identified ways to develop capacity and political support for PPPs are as follows:

- Demonstrate to public servants that a clear distinction can be made between the PPPs implemented in South Africa to date and privatisation, as the two are often incorrectly conflated. Emphasise that a range of PPP project types exist and that privatisation is 'off the table' and not needed
- Identify a PPP champion internally, who is able to drive the municipal PPP procurement process, as well as:
  - Demonstrate how private sector participation can increase customer service levels and improve revenue collection, thereby supporting municipal finances
  - Demonstrate how private operators can address water challenges on the municipality's behalf in cases where the municipality has limited capacity (e.g. wastewater treatment works)
- Make use of the Municipal PPP Guidelines developed by National Treasury
- Encourage municipal officials including CFOs and senior technical officials to attend either the GTAC or NBF supported PPP training courses
- Share success stories of existing water PPPs (such as the Mbombela and iLembe concessions, Durban Water Recycling Project and Johannesburg Water Management Contract) in order to demystify PPPs within local government
- Take political leaders through the PPP process and how it works, in order to help them understand and become comfortable with the process and to grant approval when necessary
- Develop a standardised PPP readiness tool to assess a municipality's ability to undertake a water PPP procurement process
- **Establish and fund a pool of centralised transaction advisors that support municipal project development at risk. These transaction advisers to work closely with municipalities that have adequate potential to develop PPP projects, with the municipality paying a nominal fee**





### Overview of Barrier

The PPP regulatory framework is highly developed in South Africa, but also considered complex and difficult to navigate by many procuring institutions. At a local government level this is amplified by the existing municipal legal framework, specifically the Municipal Systems Act (MSA) and Municipal Finance Management Act (MFMA).

It should be noted that the country's best-known water PPPs, the iLembe concession, Mbombela concession and Durban Water Recycling Project, were established *prior* to the introduction of South Africa's PPP legal framework.

Given the steps now required, a PPP project can take anywhere from three to six years to set up, by which time the private party may have moved on. The risk of new councillors entering during the PPP preparation phase is also increased given this lengthy time period.

### Solution

This barrier has partially been addressed by small improvements in the Municipal PPP Guidelines, which may not be widely known:

- Council can delegate the relevant decision-making/power of approval required within the MSA process for exploring external options to the Municipal Manager. This can be done to prevent unnecessary delays brought about by waiting for council to convene, and is allowed by the MSA
- **Certain activities that are not considered core to water and sanitation services and are considered a "supporting" activity are not subject to the MSA. This allows for a faster feasibility study process**

**Even with the above improvements there is still a strong perception amongst certain public and private institutions that legislative reform is needed if the municipal sector is to be encouraged into going the PPP contracts route. The length of time required to set up a water PPP has been stated as the key impediment by a number of experts.**

Nevertheless, it should be recognised that a process of legal reform would itself take many years, and thus should not be viewed as a short-term intervention. It is more pragmatic to provide ongoing support to municipalities in project preparation and the navigation of existing legal requirements.



### Overview of Barrier

Public servants wanting to explore the PPP route are not always aware of available project preparation grants and are therefore discouraged from using PPPs because of their high project development costs.

In addition, potential bidders are deterred because of strict tender requirements that specify credentials possessed by only a few market participants, as well as by the upfront costs required to put together a credible bid.

### Solution

- Where possible, such as in the case of projects that have provincial priority, obtain financial support from provincial government
- Make use of the project preparation grants provided by, for example, the DBSA and IFC. A number of grants are available to cover inception costs like hiring a transaction advisor. National Treasury also provides project preparation funding for priority projects, although these funds are limited
- Consider bundling a number of water PPP projects within a municipality into one, in order for economies of scale to be reached and for transaction costs to be shared across multiple projects
- **Develop standardised PPP procurement documents per main project type, such as standardised Requests for Qualifications (RfQs), Requests for Proposals (RfPs), standardised output specification/performance standards and standardised conditions of contract. These templates can then be amended and tailored, as required. Standardised procurement documents will also reduce tender submission costs for prospective bidders as they become familiar with the requirements of the various documents**
- Establish and fund a pool of centralised transaction advisors that support municipal project development at risk. These transaction advisers would work closely with municipalities that have adequate potential to develop PPP projects, with the municipality paying a nominal fee. Funding for such a centralised pool of advisors could be derived from a mixture of private sector, government, DFI and donor sources



## Overview of Barrier

Labour unions are often suspicious of PPPs, including viewing PPPs as privatisation that may eventually be accompanied by job losses. For example, experts have cited incidents where unions have boycotted attending public participation meetings with the hope that a PPP would be halted.

## Solution

- Consult with labour unions from the outset, highlighting that privatisation and asset divestiture is not an option for South Africa
- Address labour union concerns by highlighting improved working conditions and increased union membership within current water PPP projects, based on existing South African examples. Facilitate dialogue with other union members that are involved in PPP projects, where necessary
- **Link the payment of the private party to specific performance metrics that pertain to employee working conditions**
- Consider the opportunities for additional employment within the municipal water sector, to deter fears over job losses. For example, the Municipal Benchmarking Initiative (MBI) proposes a benchmark of 4 water staff per 1000 water connections (SALGA and WRC, 2015). This is in line with global standards. However, in 2015 South Africa had only 3.4 water services staff per 1000 connections. **If South Africa were to move to 4 staff per 1000 connections (in line with the MBI benchmark) total employment by municipal water authorities would increase by almost 18%**



# KEY BARRIERS AND SOLUTIONS IN IMPLEMENTATION PHASE



05

POOR PUBLIC SECTOR CONTRACT MANAGEMENT

## Overview of Barrier

The successful implementation of a PPP contract requires a properly skilled contract manager, and many PPP contracts make financial provision for the hiring of a contract manager.

Nevertheless, many municipalities have insufficient people able to perform this role, with this concern further compounded by the high turn-over rate within local government. This can lead to a poorly managed contract where the private party is not held accountable for the required project outcomes.

## Solution

- Ideally, the best person for the role of contract manager is the project officer that is appointed to work on the project from its inception. This individual would have the requisite knowledge on the project from assisting in putting the contract together. The CFO and internal audit also have an important role to play in managing any PPP contract from a financial and legal perspective
- **Municipalities may, depending on budget, consider setting up an internal structure with sufficient skills to conduct contract management and the monitoring of PPPs. This has been done at eThekweni Municipality, for example. Arrangements like this will only be necessary where the municipality has many PPP contracts already running, or in the pipeline**
- In order to strengthen their project management capability, municipalities can focus on the strengthening of their internal municipal systems, procedures and protocols
- Municipalities could consider outsourcing performance monitoring and contract management to external firms to ensure quality contract management



### Overview of Barrier

**Concerns that the private party will struggle to recover tariffs from customers or the municipality itself is a major identified barrier.** At the same time, municipal billing systems may be inaccurate and customer service levels poor, which further reduces the incentive for customers to pay. In addition, water revenues may not be used by municipalities to ensure the adequate funding of water service provision.

Finally, water tariffs are often politicised, with councillors reluctant to approve tariff increases that allow water charges to reach cost-reflective levels.

### Solution

- Place customers at the heart of municipal water management, by focusing on improved communication methods, rapid response times, accurate billing and multiple payment methods. Employ a water utility diagnostics tool to identify key areas for improvement
- Implement welfare maximising tariffs for indigent households, such that the poor are not unduly affected by tariff increases. Continue to provide targeted free basic services to indigent customers
- Implement cost-reflective tariffs for the vast majority of water users and free basic water for the poor in tandem. Increase water tariffs gradually over time to achieve cost reflectivity for those who can afford to pay
- **Consider the use of performance-based private sector utility management contracts. Based on the signing of five-year management contracts, under this approach the private party would manage the water billing system, focus on improving customer service levels and enhancing collection rates (as in the case of the Joburg Water Management Contract), while honouring any free basic water requirements. This contractual arrangement sets the basis for increased private sector participation in the future**
- Evaluate the use of water bonds or an escrow account, in order to better ring-fence water-related municipal revenues
- Investigate the use of risk underwriting facilities, funded by CSI, international donors, DFIs or climate finance sources
- Commence initially with projects in the wastewater treatment arena, given these projects generally have a lower risk of non-payment and are able to access multiple revenue streams (treatment charge, water reuse for domestic, agricultural or industrial purposes, use of nutrients, and development of a biogas facility)



## 07

### CONTRACTING ASSUMPTIONS NOT HOLDING UP IN IMPLEMENTATION PHASE

#### Overview of Barrier

The most cited examples of this barrier are where the effluent quality received by a wastewater treatment plant is not of the anticipated quality (the quality being lower than assumed in the planning phase), or where discharge standards become more stringent over time. This context changes the treatment process and amounts of chemicals required, thus putting additional strain on the private party.

#### Solution

- **The private party to absorb this risk through the development of improved operational efficiencies**
- Prioritise data collection and sharing to support a more accurate baseline and set of assumptions when completing the feasibility study
- Allow room for reasonable contract renegotiation and the involvement of an independent expert, to quickly resolve issues regarding contractual assumptions that do not hold true



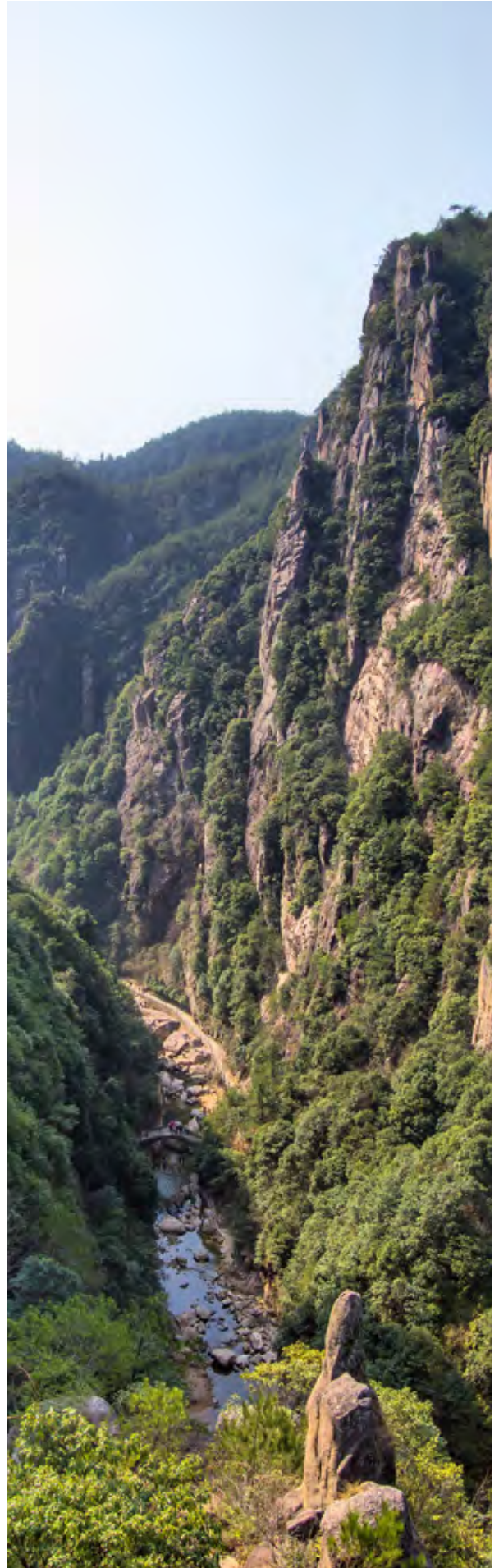
# CONCLUSION

Solutions exist to implement effective water PPPs in South Africa, provided that adequate time is allowed for project preparation. At the same time, private sector management contracts and other less complex PPP approaches can provide a valuable first step, support overall municipal functioning, and are easier to establish.

**In some cases a PPP is not a suitable mechanism, such as in a small municipality characterised by weak institutional capacity. An effective PPP requires sufficiently capable private and public sector counterparts.** In this instance it may be preferable for a municipality to first focus on strengthening their internal systems, processes and procurement capacity, before entering into a PPP.

An overview of the municipalities considered to have the highest potential for water PPPs is provided in Paper 4 of *Kopano ya Metsi: 'Water PPP Opportunities in South Africa'*. This paper provides a more detailed analysis of the types of municipalities where the underlying conditions required for a PPP are in place.

Overcoming the barriers to PPPs has the potential to unlock private sector investment and skills, narrow the water sector funding gap and support the improved functioning of municipal infrastructure. Implemented appropriately, PPPs are an important component in improving service delivery and enhancing national water security.



The National Business Initiative (NBI) is an independent and voluntary coalition of South African and multinational businesses launched in 1995 by former President Nelson Mandela. Today we have over 100 member companies that work together towards sustainable growth and development in South Africa.

## FOR MORE INFORMATION ON KOPANO YA METSI

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