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The WRC operates in terms of the Water Research Act (Act 34 of 1971) and its mandate is to support water research and development as well as the building of a sustainable water research capacity in South Africa.

Exploring opportunities for local investment in water and sanitation services

A Water Research Commission (WRC) study sought to unpack the barriers and constraints of private sector investment flows to water services in South Africa.

Background



Water underpins socio-economic growth in a country. South Africa's highly unpredictable climate and the need for water-supply of high assurance has required investment into sophisticated water-supply schemes to ensure that the right volume of water is delivered at the right place when it is needed.

Many large-scale water infrastructure projects have been financed by the government over the years, including the Berg River Dam, which is a world-class facility. It is estimated that the current replacement value for existing bulk water infrastructure in South Africa is R139 billion. Further, the country requires investments around R1.4 billion annually to maintain its current bulk water infrastructure.

While bulk water infrastructure tends to attract private sector financing, the municipal water services sector has had

very little privileges to this resource. Insufficient financial transfers from the fiscus, is creating a backlog in service delivery, capital and O&M, that requires the deployment of innovative funding mechanisms, especially tapping the resources available through the private sector..

This WRC study sought to develop an understanding of the perceived challenges and constraints faced by the private sector, which prevents them from harnessing the opportunities of investing in the municipal water and sanitation services sector in South Africa. This is based on the premise that by unpacking these perceived challenges, a clearer picture of the investment/financing opportunities in the sector might be unveiled to make a business case for investments in the sector.

The study intended to inform key stakeholders in the water and sanitation sector in South Africa, including both the public and private sector, to bolster their engagement in the sector.

Key findings

The main outcome of this study reflects the fact that private sector involvement in the financing of water services infrastructure is still limited, with the public sector still bearing the large cost of infrastructure financing. In cases where the private sector is involved in the water sector, its bias is on the financing of large infrastructure programmes that have guarantees by Government.

Secondly, the lack of clarity in the regulatory framework in the financing of municipal water services infrastructure increases risk to the private sector and, as a result, their participation has been quite limited. The financial performance and status of many local municipalities has also

hindered them from effectively using market mechanisms for fundraising for their infrastructure programmes.

The key areas requiring attention are as follows:

- **There are significant investment opportunities:** The funding requirements for the South African water sector. Various studies have estimated that the total cost of funding requirements for the water sector in South Africa is in excess of R70 billion. Most of this funding will come from the national fiscus, but there is a major funding gap, which presents an excellent opportunity for the private sector.
- **There is too much focus on new water-related infrastructure:** Financiers are biased towards projects that focus on delivering new infrastructure projects. Such projects are perceived to be more profitable and less risky, as they are often ringfenced or guaranteed by the sector. This mismatch between the ease of raising funding for new projects, and the gap in funding for maintenance and operations is a major challenge for the water sector.
- **The private sector is too risk averse to effectively invest in the water sector:** The high level of private sector risk aversion in relation to water has hindered their effective participation in the sector. This risk aversion needs to improve if the private sector is to capitalise on the investment opportunities in the water sector. There is a need for better information channels to the private sector.
- **More innovative funding mechanisms are needed to unlock investments:** The traditional mechanisms for private sector participation in water management, such as private-public-partnerships in its various forms, have not yielded any effective outcomes in South Africa. There is an urgent need to explore more innovative funding mechanisms, such as impact investing and venture capitalism in addition to the known approaches.
- **Insufficient evolution in the political landscape in South Africa:** There is a strong perception in the investment community as a whole that to create a suitable investment climate, de-regulation is important.
- **The absence of an independent regulator is a barrier to unlocking private sector investments.** The potential establishment of an independent regulatory would be an extremely useful mechanism to

bolster private sector confidence in investing in water infrastructure.

Recommendations for unlocking private sector investments

The WRC study identified numerous barriers to private sector investment in South Africa. Several recommendations emanate from the project, particularly directed at local authorities seeking to expand their water and sanitation infrastructure.

From a regulatory perspective, municipalities are constrained in their ability to be able to borrow directly from the markets. To overcome this challenge may require revision of the regulatory mechanisms governing municipality financial management systems to expedite local authorities to effectively use market based mechanisms for financing water infrastructure.

It is also recommended that local municipalities that are poorly capacitated should develop better relationships with their well-established counterparts to build their capacity in order to improve their financial management and stand a better chance of raising funding for their infrastructure projects.

Municipalities also need to develop better relationships with private sector financiers, such as fund managers, to develop a clear understanding of their funding allocation priorities, and the kinds of project pipelines that they are interested in funding.

Finally, it is recommended that some of the funding allocated to local authorities for infrastructure development is ring-fenced for project development to increase the chances of securing external funding. This would help reduce the risk of projects, and make them more attractive to the private sector.

Further reading:

To obtain the final report, *Exploring opportunities for domestic-local investment in water and sanitation services. Challenges and constraints* (Report no. TT 725/17) contact publications at Tel: (012) 761-9300;

Email: orders@wrc.org.za or Visit: www.wrc.org.za.