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BRIEFING TO THE PORTFOLIO COMMITTEE ON ENERGY

Thursday, 17th October 2013

For an Equitable Sharing of National Revenue

FOCUS OF THE PRESENTATION

I. Energy and the NDP
II. Past and current Financial and Fiscal Commission (FFC) research on energy-related issues, 2010 to 2013
III. Energy-related FFC recommendations, 2010 to 2013
IV. Additional issues for the Committee's attention
   - Asset Management Practice
   - Maintenance
   - Free Basic Services and Energy

NATIONAL DEVELOPMENT PLAN (NDP)

- NDP vision for 2030 entails SA energy sector that promotes:
  - Economic growth and development: through adequate investment in infrastructure
  - Social equity: through expanded access to energy services with affordable tariffs and well targeted subsidies for poor households
  - Environmental sustainability: through efforts to ↓ pollution and mitigate effects of climate change
  - Less use of coal to fulfil primary energy needs and greater emphasis on gas and renewable energy resources (wind, solar and imported hydroelectricity)
- Critical to balance supply security, affordability and climate change mitigation objectives
  - Moving to a lower carbon-intensive power generation mix is more expensive versus need to maintain competitiveness of electricity prices and security of supply so as to power economic growth and development

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II. Past and Current Energy Related Research, 2010 - 2013

Past FFC Research on Energy

2010

- Regionalising municipal services: the case of electricity distribution industry (EDI) in South Africa: The research assessed the case for transforming the municipal electricity distributors into six wall-to-wall regional distributors

2011

- Environmental sustainability and climate change in the local government sector: study undertaken as a result of Commission concern over the potential strain that climate change has on public finances due to the costs that climate change gives rise to
- Sustainable development of SA's built environment: research looked at financial and fiscal implications of urban land use patterns

2012

- Review of the local government fiscal framework: wide-ranging study undertaken in recognition of the various challenges plaguing the financing of municipalities
- Maintaining and rehabilitating water and electricity distribution infrastructure: raised issues around asset management at the local level particularly with respect to key basic services of electricity and water

CURRENT FFC RESEARCH ON ENERGY

- Relevant projects underway in 2013
  - Impact of electricity prices on municipalities
    - Two arguments – one that municipalities are being hard hit by significant electricity price ↑. On the other hand, municipalities have been using revenue earned from electricity to fund non-electricity expenditure. Study will focus on impact of electricity price increases on municipalities
  - Cost of Basic Services (multi year project)
    - Year 1 is focussed on electricity, water and sanitation

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III. PAST AND CURRENT ENERGY RELATED RECOMMENDATIONS, 2010-2013

FFC Energy-Related Recommendations

Submission	FFC Recommendation
Submission for the 2014/15 Division of Revenue	National Treasury in collaboration with relevant stakeholders (DCoG and SALGA) should develop local government-specific infrastructure asset management legislation, similar to GIAMA at the national and provincial level
	National Treasury devises local government infrastructure asset management guidelines. These guidelines should be positioned within the broader system of capacity development and performance oversight. Technical assistance should be provided to municipalities to prepare and implement credible infrastructure asset management plans
	Provincial and local authorities must increase scrutiny of the operating implications of capital funding so as to ensure that municipalities are able to adequately maintain and renew infrastructure

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FFC Energy-Related Recommendations [cont.]

Submission	FFC Recommendation
Final Report on the FFC's Public Hearings on the Review of the Local Government Fiscal Framework (2013)	It is recommended that government explicitly adopt a methodology to differentiate municipalities in the LGFF . Differentiation should: •Based on performance and context •Inform funding and capacity support
	Commission recommends a review of the funding for capital expenditure in local government given the identified vertical fiscal gap on municipal capital budgets, which is driven by increasing infrastructure needs and constraints on municipal capital revenues (operating surpluses and borrowing powers)
	Municipalities need to ensure that their tariffs are cost reflective and sensitive to the indigent profile of municipalities in order to minimise municipal consumer debt levels

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FFC Energy-Related Recommendations [cont.]

<table>
<tr><th>Submission</th><th>FFC Recommendation</th></tr>
<tr><td rowspan="2">Final Report on the FFC’s Public Hearings on the Review of the Local Government Fiscal Framework (2013)</td><td>Municipalities are constitutionally assigned the electricity distribution function and are also legislatively entitled to apply a surcharge on the electricity tariff charged. In instances where Eskom is the service provider on behalf of the municipality, the municipality should be allowed to impose a surcharge on Eskom’s tariff</td></tr>
<tr><td>The transferring officers need to ensure that a comprehensive analysis of the outcomes of retrospective and current grant allocations is undertaken
•In accordance with the DoRA
•Accounting and tracking outcomes of conditional grants need to be improved
•Appropriate risk mitigation measures put in place to account for potential over or under-spending</td></tr>
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FFC Energy-Related Recommendations [cont.]

Submission	FFC Recommendation
Submission on the 2012/13 Division of Revenue	National government should specifically enforce the provisions set out in Section 74(2) of the Municipal Systems Act such that the basis of municipal tariffs accurately reflects the cost of providing the specific service, as well as conforms to National Treasury’s expenditure guidelines for repairing and maintaining municipal infrastructure

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FFC Energy-Related Recommendations [cont.]

Submission	FFC Recommendation
Submission on the 2012/13 Division of Revenue	Government should consider providing municipalities with a performance-based conditional grant, which rewards or incentivises actions that are environmentally efficient and responsive to the adaptation and mitigation challenges of climate change. The design of the proposed grant should pay attention to municipal-specific factors such as the area, topography coastal, vulnerability to climate change. Specific focus areas for this grant to include: •Efficient water management practices, including the minimisation of water losses, effective asset management or rehabilitation programmes and demand management •Efficient energy management practices, including the minimisation of electricity losses, the elimination of illegal connections and energy savings by household/industry •Implementation of green procurement policies

FFC Energy-Related Recommendations [cont.]

Submission	FFC Recommendation
Submission on the 2012/13 Division of Revenue	Government should actively and specifically pursue the development of a more spatially compact urban form for South African cities, by developing and adopting appropriate policies and financing instruments.
	Government should conduct a broad based review of the efficacy of current housing finance arrangements in meeting housing needs within the context of creating sustainable and more compact human settlements

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FFC Energy-Related Recommendations [cont.]

Submission	FFC Recommendation
Submission on the 2011/12 Division of Revenue	In the absence of an assessment of the specific performance challenges that the different municipalities face in implementing functions listed in Schedules 4B and 5B of the Constitution, the Commission recommends that approving a blanket regionalisation approach is not supported as current legislative provisions allow for alternative and creative service delivery arrangements
	Not all electricity distributors suffer from the challenges that the restructuring intends to overcome. As a result, the EDI restructuring process should consider a differentiated approach that allows for differences in performance

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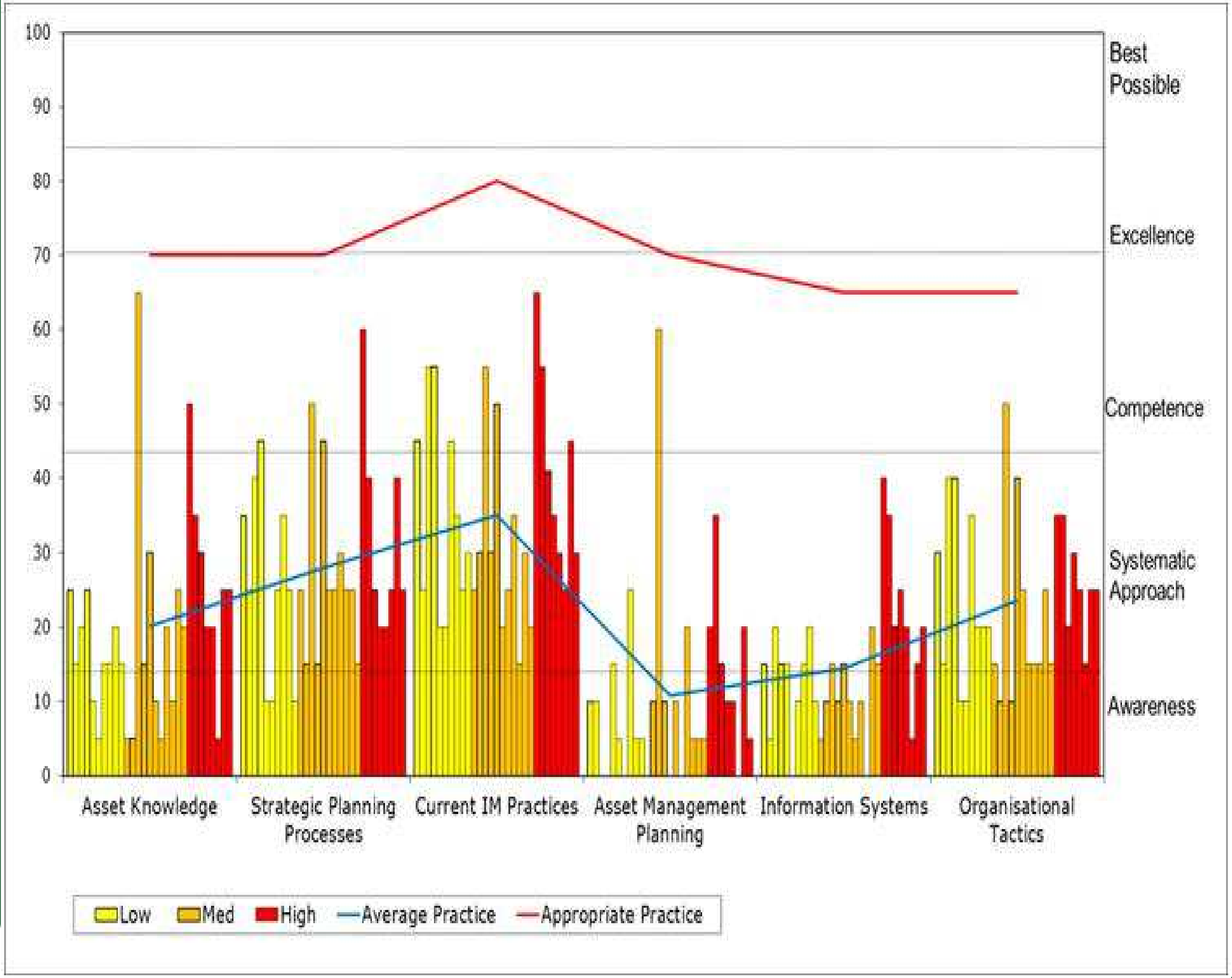
IV. Additional Issues for the Committee’s Attention

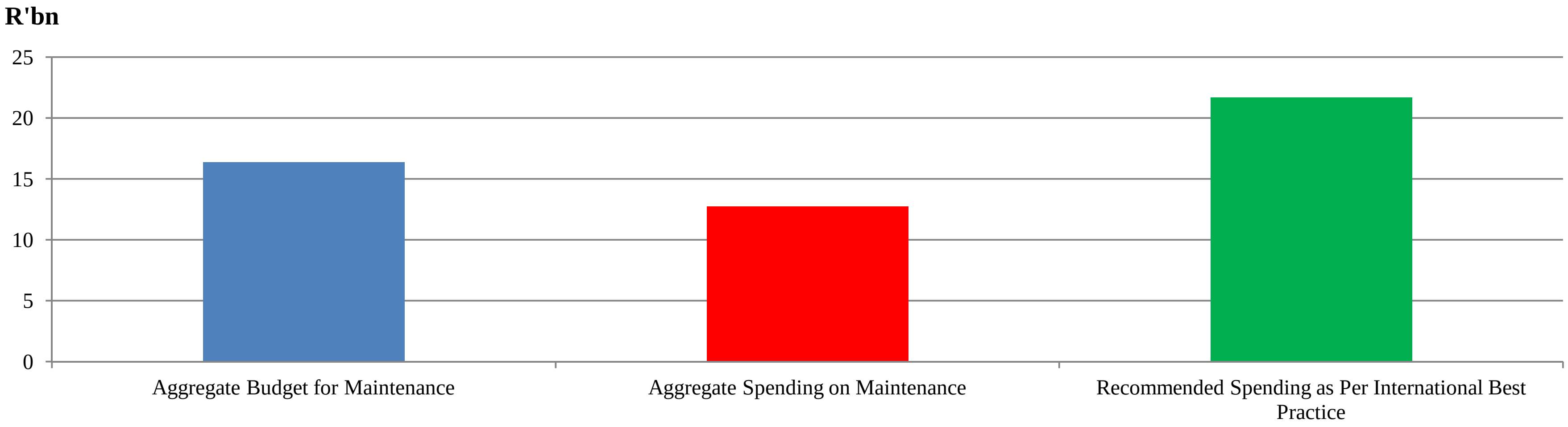
ASSET MANAGEMENT PRACTICE



In many cases, municipalities are uncertain of the extent, location, composition, physical attributes and asset-care needs of their infrastructure assets and, hence, are not in a position to plan and budget properly for asset maintenance and renewal

MAINTENANCE AND RENEWALS

Budgeted Versus Spending Versus Benchmark Allocation for Asset Maintenance as at 2011/12

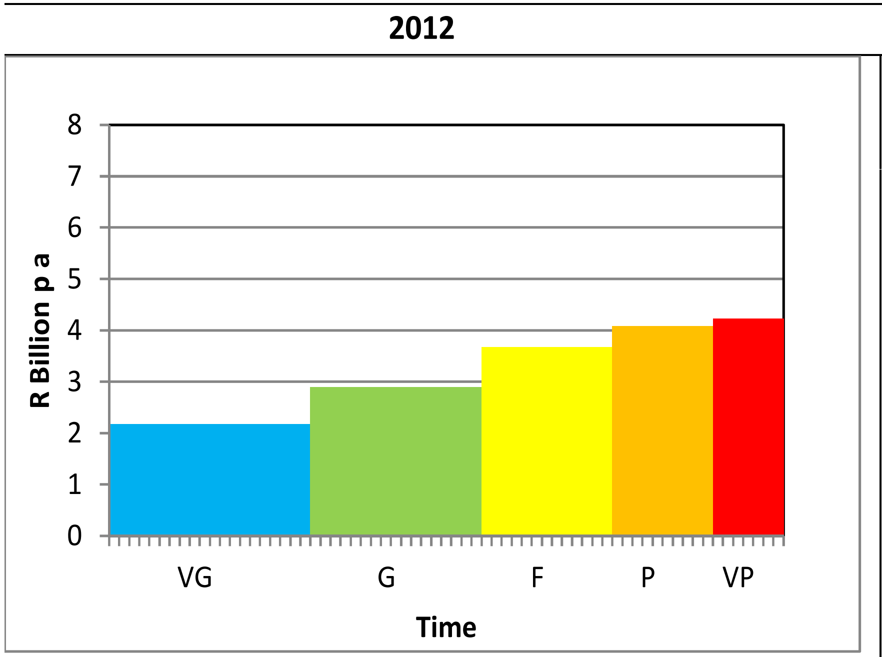


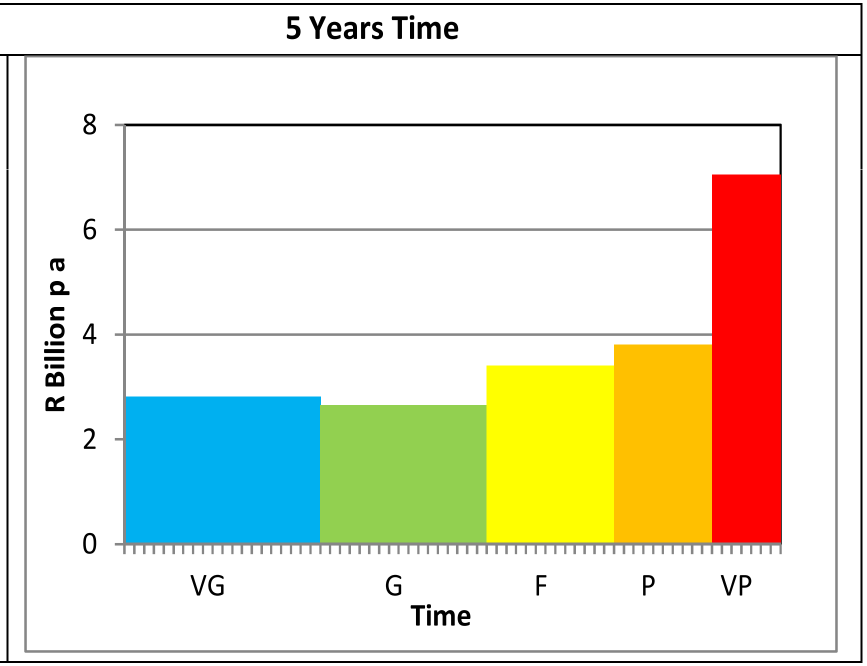
Summary of Estimated Renewals Backlog

Scenarios for quantifying backlogs against different standards	Water and Sanitation		Electricity	
	Amount	Years to Eradicate Backlog	Amount	Years to Eradicate Backlog
Optimum	R39 billion	10	R 41 billion	11
Sub-optimal	R19 billion	5	R 25 billion	7
Absolute Baseline	R4 billion	1	R 8 billion	2

Condition of Electricity Distribution Infrastructure in 2012 and in 5 Years Time

•Should current levels of investment continue, in 5 years time SA will see a severe deterioration of its electricity distribution infrastructure





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Developments With Respect to Funding Maintenance and Assisting Municipalities

- Revisions to local government equitable share (LGES) formula has made explicit provision for repairs and maintenance
  - The issue is the will to use such provisions for intended purposes
  - Big risk is impact on the national economy if significant investment are not made
- Approach to Distribution Asset Management (ADAM) = multi year initiative targeted at addressing maintenance, refurbishment and strengthening shortcomings in key electricity distribution infrastructure
  - Drafted in support of National Response Plan, following the 2008 energy crisis

Maintenance

- Contextualisation of ADAM - drafted within context of creation of regional electricity distributors (REDs),
  - Despite scrapping of REDs, ADAM strategy not adjusted for realignment
- Despite establishment of ADAM in 2008, funding (amounting to R320 million) only allocated in 2013 Division of Revenue Act
  - Given the extent of the maintenance challenge, pace of reform is slow

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FREE BASIC SERVICES

- Free Basic Electricity (FBE) and Free Basic Alternative Electricity (FBAE) funded through Local Government Equitable Share (LES) allocation:
  - Electricity component of the Basic Services (BS) component
- Revised LES formula implemented in 2013
  - Electricity component remained as part of BS
  - Improved accuracy and targeting of funding of FBE and FBAE
  - Greater support to rural municipalities to deliver FBE and FBAE
- Free basic services promotes gender equity and enhance lives of women and children: *frees time and resources for other services*

Free Basic Services

- R5.7 billion of total LES for FBE and FBAE in 2013/14
  - R56.29 per poor household per month
    - R50.66 for operational expenditure in FBE and FBAE delivery per poor household per month
    - R5.63 for maintenance of infrastructure

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Free Basic Services

- Poverty threshold in LES increased from R800 to R2300
  - Households earning less than R2300 per month receive funding for FBE
  - Covers 59% of total households in SA
- Increased funding for FBAE
  - Previous formula distinguished between household connected and not connected to services resulting in funding for FBAE being lower than FBE
  - Standard subsidy for FBE and FBAE in new formula

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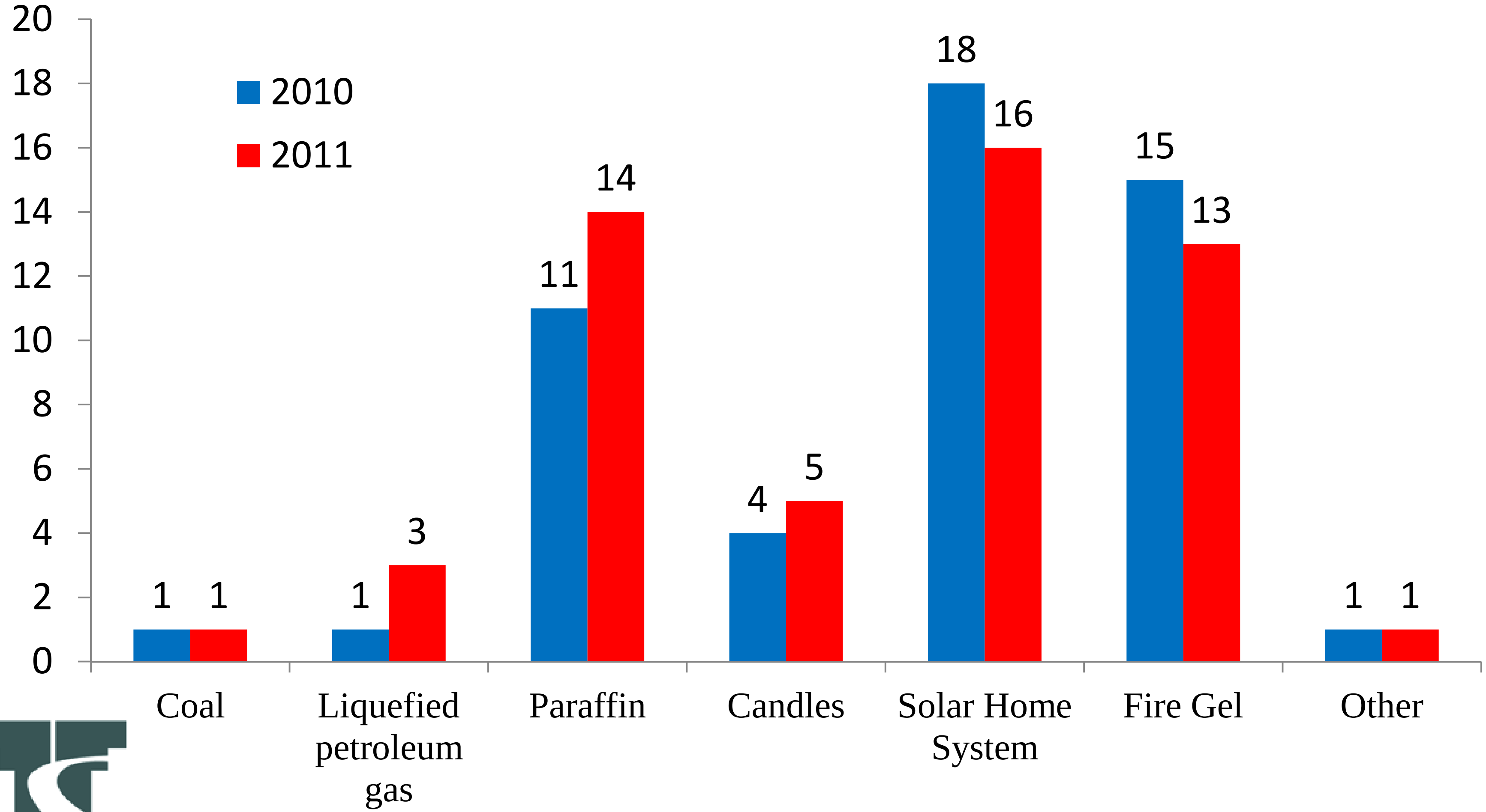
NUMBER OF MUNICIPALITIES PROVIDING ALTERNATIVE ENERGY 2010 AND 2011



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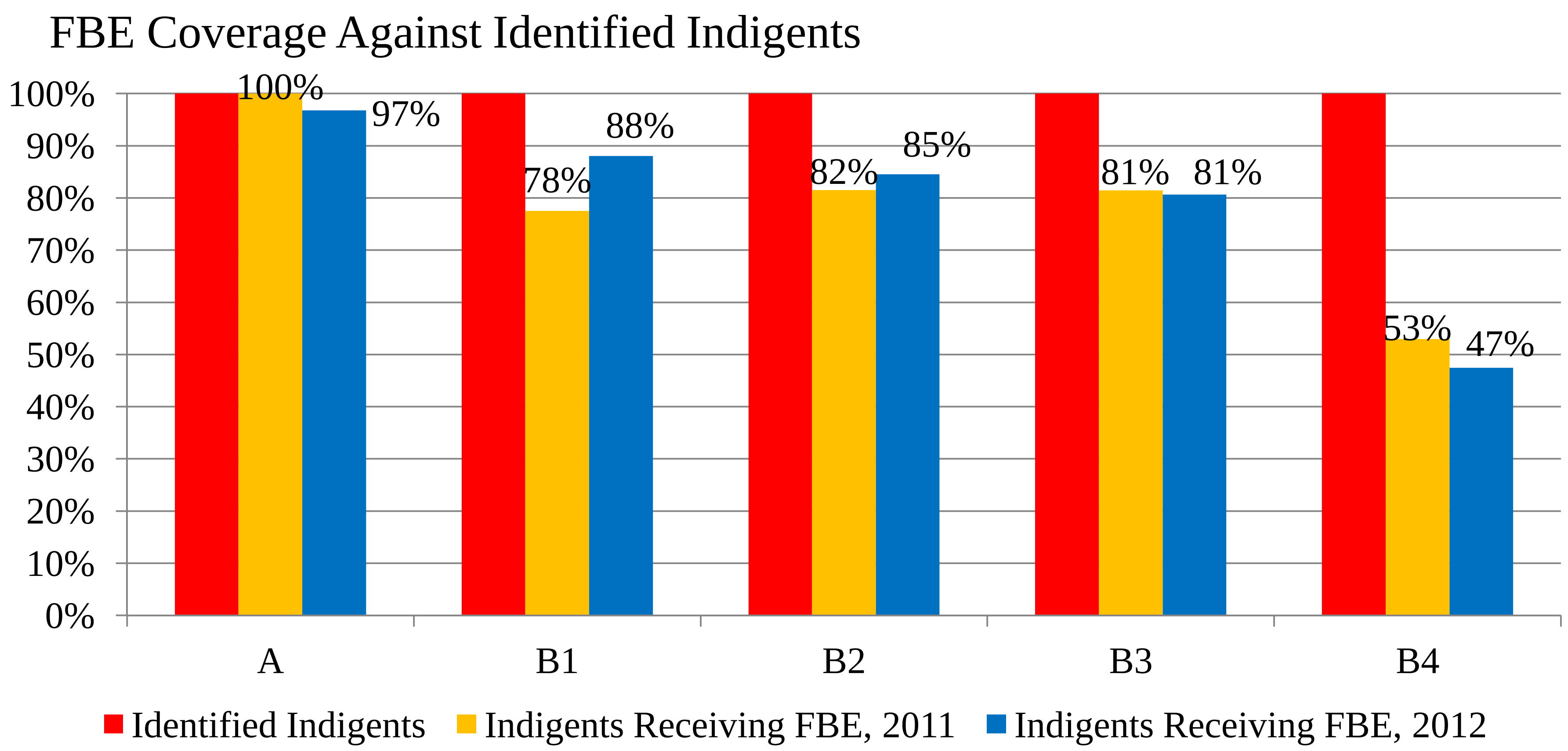
Indigents and Free Basic Electricity (FBE)

- There is need for proper targeting of FBE and correct use of indigent registers



THANK YOU.

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