

# Municipal Project Finance in the Municipality of Rustenburg (South Africa)

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## Summary Overview

**Location:** Rustenburg, South Africa

**Approach to Blended Finance:** To address vital wastewater infrastructure needs, the Municipality of Rustenburg created the Rustenburg Water Services Trust (RWST) to finance and upgrade infrastructure. The Trust secured revenues from municipal bulk water sales and an off-take agreement with two local mines. This revenue security, and the ring-fencing of the RWST as a special purpose vehicle (SPV), enabled commercial finance to be accessed in the form of a bank loan.

The establishment of a Trust, with revenues ring-fenced from the municipality and strong operating arrangements, provided comfort to the lenders and helped to soften lending terms. Revenues provided by the two mines for the purchase of effluent created a strong revenue stream for the Trust, and helped secure a commercial loan from ABSA bank. The public sector (including the Department of Water Affairs and Rustenburg Municipality) played a key role to help structure a transaction that addressed critical water resource needs for the municipal area.

## Context

In the Municipality of Rustenburg, South Africa, water supply has been constrained for a long time. The Rustenburg economy is heavily dependent on the mining industry, which accounts for roughly half of all formal employment in the municipality. The expansion of mining operations has spurred population growth in the region, which in turn increased water demand for domestic and industrial uses, and has put pressure on existing wastewater treatment facilities.



Under South African legislation, Rustenburg Municipality has been designated as the Water Services Authority, which means that it is responsible for ensuring access to water services in the municipal area. It receives water from two main suppliers, Rand Water and Magalies Water. By early 2000, stress on water supply in the municipality was intensified by the fact that the Rustenburg Wastewater Treatment Plant had reached full capacity and was releasing sub-standard effluent into the Hex River. This caused heightened pollution levels in the downstream Bospoort Dam, and led to system shut downs. Infrastructure upgrades were necessary, including refurbishment and expansion of the wastewater treatment plant, restoration and modifications of the water treatment plant, and repair of the pipeline infrastructure to improve the reliability of water service provision.

Rustenburg Municipality faced constraints in terms of institutional and financial capacity, which limited its ability to finance and upgrade infrastructure. For example,

its poor credit rating made it unable to raise finance. In an effort to address both water resource management constraints and improve infrastructure, the Municipality turned toward the private sector for a potential solution. At the same time, the mining sector offered to support the Municipality in its efforts to identify a way to address the urgent water and sewage treatment needs.

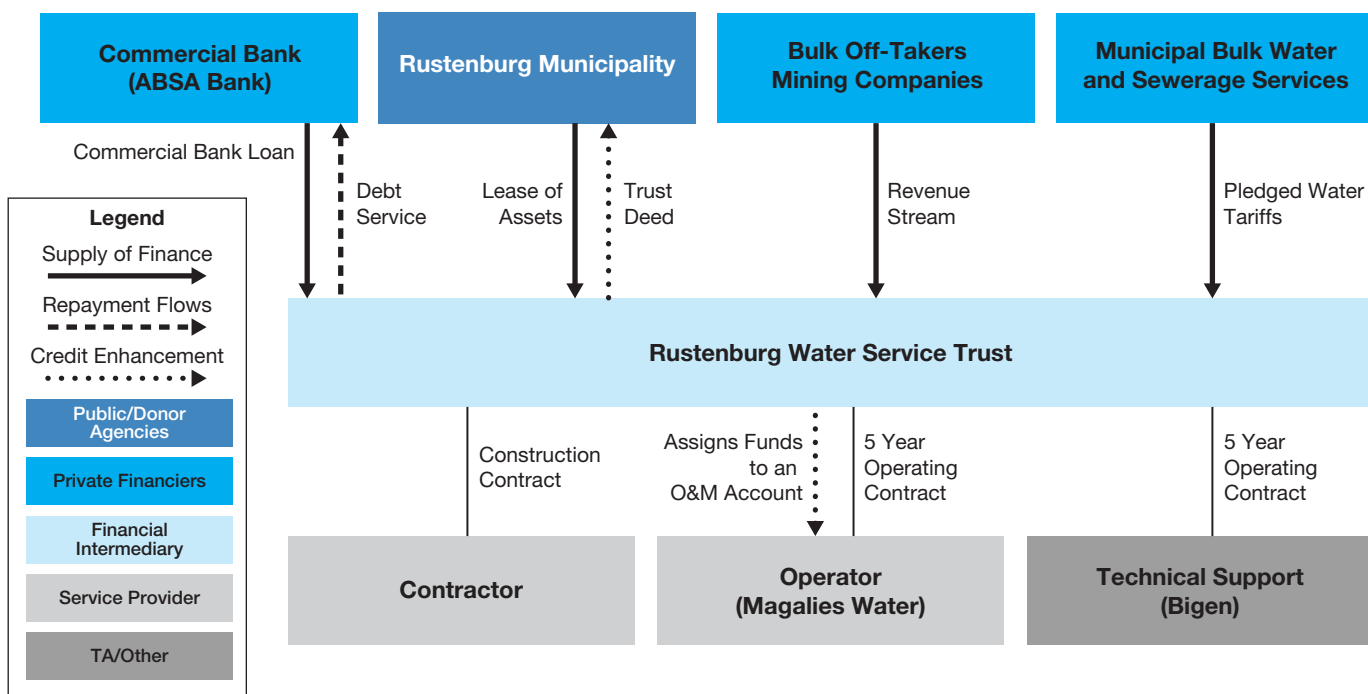
The result was the selection of a consortium consisting of Magalies Water (public partner), ABSA bank (financier) and Rustenburg Consulting (led by Bigen Africa), all of which joined forces, and in collaboration with the Municipality formed a special purpose vehicle (SPV), the Rustenburg Water Services Trust (RWST). The RWST signed a 25-year concession contract to finance, upgrade, and operate water infrastructure. The initiative was supported by two major platinum mines (Anglo Plat and Impala Plat), which agreed to purchase the non-potable treated wastewater produced. Financial close for the deal was achieved in December 2003, and construction began one month later.

### Financial Structure and Approach to Blended Finance

In 2003, the RWST was established as a financially independent municipal entity under the Municipal Services Act, and the infrastructure project was effectively ring-fenced under the Trust to protect assets. A Board of Trustees was setup for RWST, with four representatives from the Municipality, and three from the consortium (Magalies Water, ABSA bank and Bigen Africa). The Municipality is the majority stakeholder and sole beneficiary of the Trust. The structuring of the project ensured that the municipality maintains full control over the Trust, in accordance with South African legal requirements. However, the Trust’s constitution regulates the transfer of funds between the Trust and the Municipality, thereby reducing the risk of municipal interference.

The RWST obtained a limited recourse loan from ABSA to finance the water and wastewater infrastructure upgrades and expansion. The loan was for R280 million (equivalent to US\$37 million at historical exchange rates), with a 20-year term. The key to securing commercial

**FIGURE 1** Municipal Project Finance in Rustenburg, South Africa: Financial Structure



finance from ABSA bank was the long-term off-take agreement between the RWST and the two local mines. The sale of treated effluent to the mines constitutes 50 percent of the SPV's revenue, and created a reliable revenue stream, important for investor confidence. The remaining 50 percent of RWST revenues come from the Municipality, which pays RWST for the supply of bulk water and provision of sewerage services from the collection of water and sewerage tariffs at the household level. The pricing for bulk water was benchmarked against that of a large well-known bulk water operator, Rand Water, to guarantee that the price of water being produced in the project was not higher. Revenue from these income streams help service the debt, and pay for maintenance and operations by the water service operator. The overall financial structure is shown in Figure 1.

A strong governance structure, with a ring-fenced Trust, and experienced trustees has ensured sustainable operations and management. During the transaction design stage, the importance of having a strong operator in place was highlighted. Institutional and technical capacity at the SPV level provided comfort to the commercial lenders. The presence of engineering specialists as trustees, and the procurement of an experienced Operator to manage the facility added to ABSA bank's confidence in the investment. A contractual provision for automatic review and re-bidding of the Operator after a specified period of time was also included in the overall structure, to ensure that strong performance would be maintained over time. Furthermore, the risk of operations and maintenance reserves being drawn on significantly for municipal activities outside of specific project purposes has been limited.

## Results

The innovative use of private, commercial, and public financing provided the basis for much needed investment and upgrading of water and wastewater infrastructure in the Municipality, and allowed the Rustenburg mines to shift from using imported freshwater to using locally treated wastewater. The infrastructure has been successfully operated since, and all debt commitments and obligations have been met. A financially sustainable bulk water and sewerage system was established with cash reserves of US\$12 million after seven years of operation.

## Lessons Learned

**The Rustenburg case proves that relatively small and financially weak municipalities can raise significant funding through well-structured projects with strong revenue streams from private sources.** The revenues received from the mines as part of the off-take agreement helped with the establishment of a creditworthy body (the RWST), and involved mixing revenues from two private sources—the mines and households (through tariff collection)—to secure commercial finance. Public funds were used mainly to help structure the transaction. The Trust was allowed to ring-fence the project, provide O&M capacity, and ensure continued legal compliance. The public sector, through the Municipality of Rustenburg and the Department of Water Affairs, played an essential role in initiating and driving this transaction forward through close.

**Granting SPV authority to a public sector entity helped mitigate concerns related to the handing over of public resources to the private sector.**

Rustenburg Municipality was named the beneficiary of the RWST (this followed a requirement in the South African Municipal Systems Act), thereby avoiding political issues typically encountered over public-private partnerships.

**Benchmarking bulk water tariff pricing allowed overcoming of political challenges.** The Trust was responsible for providing bulk water and sewerage services to the Municipality, which was then in charge of distribution and bill collection. Potential issues over setting bulk water tariffs were overcome by benchmarking the tariffs against those charged by another large government parastatal.

**There is high potential for replication in areas where industry has a stake in improving outcomes.**

Private sector companies can provide reliable revenue streams and can pledge such revenues in exchange for increased security of supply. A prerequisite for reproducing this model would be to identify private companies that have a high demand for water and steady revenue streams.

## References

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This case study is part of a series prepared by the World Bank's Water Global Practice to highlight existing blended finance experiences in the water sector.

Blended finance refers to "the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets," as per the OECD definition (WEF OECD, 2015). Concessional funds can be used in a catalytic manner to open up new opportunities for commercial financing, by providing technical assistance to borrowers and lenders to help them become more familiar with each other, help structure transactions, provide credit enhancement mechanisms, etc.

Private capital flows can help with meeting immediate financing needs for investment in the water sector but ultimately need to be repaid. Repayable financing from private sources to the water sector can come in various forms, including as commercial bank loans, bonds or equity. To obtain such financing, water-sector actors need to be able to repay the borrowed amounts and the associated funding costs, which means that they need to be deemed "creditworthy" by providers of finance.

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