Case Study

‘JOHANNESBURG WATER’ MANAGEMENT CONCESSION

Water Supply and Sewerage

CASE OVERVIEW

Country: South Africa

***ULB*:** Greater Johannesburg

Sector: Urban Basic Services ***Sub-Sector:*** Water Supply and Sewerage

Award Date: 2001

Type and Period of concession: Management Contract for 5 years

Stakeholders:

Contracting Authority	Johannesburg Water (JW), Public company setup as the Water Service Provider for Greater Johannesburg
Concessionaire	Johannesburg Water Management Company (JOWAM)
Oversight Arrangement	Independent Auditors contracted by JW to monitor performance of JOWAM Indirect Regulation through Change Management Unit (CMU) and Shareholder Unit (SHU) set up to monitor the service delivery and financial performance respectively of JW

Present Status of Project: The project was completed successfully in 2006 and operations were handed over to JW staff.

PROJECT TIMELINE:

1999	*Establishment of an Advisory Board of Specialists to help setup JW and to assist with the contract design and selection process for a private partner to manage the utility*
2000	*Constitution of JW as an autonomous Water Service Provider Company to be fully owned by the Municipal Administration of Greater Johannesburg*
2001	*Award of a five year management contract to JOWAM for managing JW*
2006	*Successful completion of the management contract*

1. PPP CONTEXT

1.1 ENABLING ENVIRONMENT

In the late 1990s Johannesburg undertook several administrative reforms in order to consolidate numerous separate administrations and restructure the city's approach to service provision. The following reforms undertaken during the period formed the background for the 'Johannesburg Water' Management Contract:

1. Adoption of the iGoli 2002 plan, which categorized all municipal functions into Utilities, Agencies and Corporate Departments (UACs), all entirely owned by the City Administration (CA) but set up as independent companies, accountable to the City Council through stipulated service delivery targets.

2. Creation of a Contract Management Unit (CMU) as an oversight body to monitor and evaluate performance of UACs and creation of a separate Shareholder Unit (SHU) to monitor the financial performance of the units.
3. Consolidation of seven separate water utilities serving different jurisdictions in the city into one autonomous company, Johannesburg Water (JW). In 2000, agreements were signed between the City of Johannesburg and the new company, transferring the city's water infrastructure assets and 2500 employees to the company and setting the service targets to be achieved.

1.2 SECTORAL CONTEXT

The following was the status of water supply and sanitation in Greater Johannesburg (3.2 million population approximately) during the inception of JW.

1. Inadequate coverage of water and sanitation facilities - at an aggregate level 9% lacked access to adequate water supply and 15% to adequate sanitation. The prevalent system also suffered from severe distributional inequities and the shortfall was very high in the informal settlements.
2. Very high Unaccounted-for-Water (UfW), estimated at 43% and a high incidence of non payment by users leading to heavy revenue losses.
3. Unacceptable levels of environmental non-compliance, especially at sludge handling facilities
4. Poor customer interface and customer relations management
5. Lack of capacity within the newly formed company - JW, to handle critical technical functions; an issue compounded by lack of robust sectoral data for effective management and monitoring

This formed the backdrop for initiating a management contract for operating the company in its nascent stage.

2. PROJECT DEVELOPMENT

2.1 PROJECT CONCEPTUALIZATION

As a part of the administrative reform process, there was an urgent need to infuse the newly formed UACs with an efficient work culture. In the case of JW, there was a need to increase the internal capacity of the staff, improve operational and financial performance and consolidate the integration of seven separate water utilities into a single efficiently managed autonomous unit. In order to achieve this it was opted to initiate a five year management contract, wherein the private party was expected to provide management expertise and support to the JW in critical areas and to transfer human resource competence to JW staff within the contract period.

2.2 PROJECT DEVELOPMENT

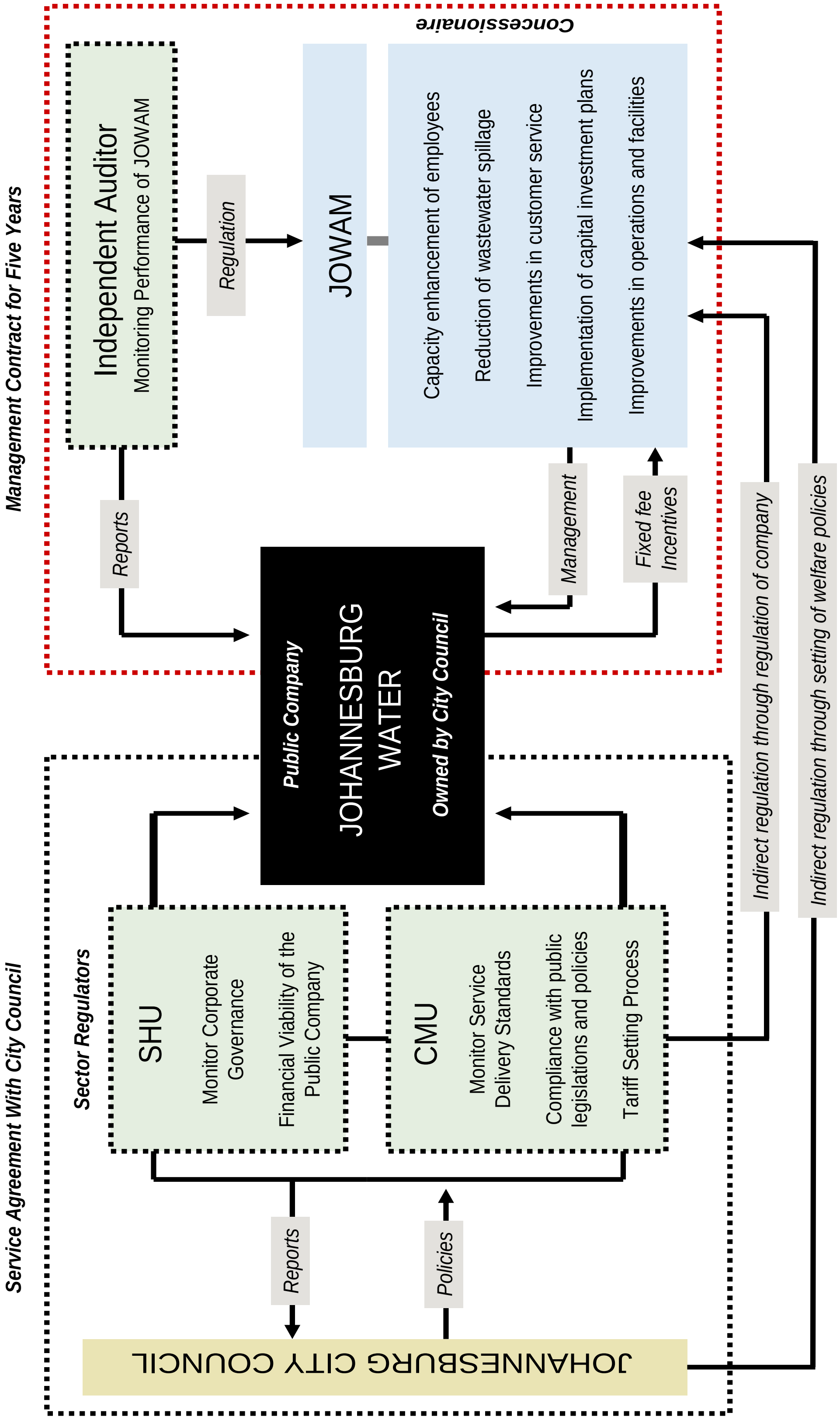
The Municipal Administration established an Advisory Board of Specialists in 1999 to help setup JW. The Board also assisted with the contract design and selection process for appointing a private partner to manage the new company.

2.3 PROCUREMENT PROCEDURE

In 2001, the management contract was awarded to the Johannesburg Water Management Company (JOWAM) through an international competitive bid. JOWAM was a Joint Venture between Ondeo (a water subsidy of Suez), Northumbrian Water and Water and Sanitation Services South Africa (a subsidiary of Ondeo). The award was based on their lowest bid for subsidy support from the Municipal Administration and lowest quote for incentive based payment (fixed proportion of annual revenues of JW). JOWAM also had a strong technical proposal including a strategy for building internal capacities and gradually reducing its staff over the contract period.

3. CONTRACTUAL ARRANGEMENTS

3.1 PROPOSED CONTRACTUAL STRUCTURE



3.2 OPERATOR OUTPUT OBLIGATIONS

The indicators for monitoring of JOWAM's performance were set out in the management contract. These included annual targets (reset every year in consultation with JOWAM) for:

1. Capacity Enhancement of JW employees and human resource development
2. Reduction in waste water spillage and overflow
3. Improvements in customer service and complaint redressal
4. Implementation of annual capital investment plans
5. Improvements in operations and facilities

JOWAM was expected to deploy 13 professionals (including at executive management levels) and phase them out over the period of the contract, after ensuring adequate skill transfer to JW staff. Operational decisions of JOWAM had to comply with policy decisions of the City Administration (single shareholder of JW).

3.3 REGULATORY AND MONITORING ARRANGEMENTS

The performance of JOWAM was directly linked to the performance of the managed entity (Johannesburg Water). Thus while JOWAM's performance was directly monitored by the JW Board through an Independent Auditor, in reality its performance was also regulated through the regulatory arrangements operating upon JW.

These included (i) the Change Management Unit (CMU) created in 2001 to monitor service delivery standards, compliance with local government and National legislation, and the tariff setting process of JW and (ii) the Shareholder Unit (SHU) created in 2003 to monitor corporate governance and financial viability of JW. Both the CMU and the SHU directly reported to the City Administration (CA) of Greater Johannesburg.

3.4 PROJECT FINANCIALS

1. The contractual commitments of JOWAM were restricted to management of JW and did not include any financial investments.
2. Compensation was structured through a fixed management fee which was to be paid by JW to JOWAM on a monthly basis, irrespective of the performance of JOWAM.
3. In addition to this JOWAM was entitled to two types of incentive payments. 'Incentive A' was determined by performance against the five parameters described in 3.2 earlier. 'Incentive B' referred to the fixed percentage (0.18% as per JOWAM bid) of the annual revenues of JW which were to accrue to JOWAM.

3.5 PROJECT RISKS AND ALLOCATION

Revenue Risk	The contract safeguarded JOWAM from revenue risks through a guarantee of fixed monthly management fees
Performance Risk	Borne by JOWAM since the incentive based payments were directly linked to operator performance and improvement of financial performance of JW

Policy Risk	Though not formally allocated as per contract, policy risk was borne by JOWAM since its performance was susceptible to policy decisions of the City Administration (CA), which was the single shareholder of the managed company, JW. No compensation was envisaged in case of changes in policy of the CA or default at their end in complying with their separate agreement with JW.

3.6 DISPUTES RESOLUTION MECHANISM

All disputes emanating from the contract were to be resolved through the CMU and the SHU.

4. PARTNERSHIP IN PRACTICE

In the five years of the contract period JOWAM successfully achieved its contractual targets including transfer of skills to the JW employees before withdrawing from the utility.

4.1 PROJECT OUTCOMES

OPERATIONS

1. Quality of water improved due to regular monitoring and testing (500 samples per month) resulting in 99% bacteriological compliance.
2. Treatment of Wastewater improved from 940 million to 1.01 billion litres per day and compliance with effluent standards increased from 82 to 98%. Wastewater overflow at treatment sites also improved from 646 to 138 spills per year by 2005.
3. UfW reduced from 43 to 35% and the percentage of water meters read by authorities increased from 50 to 94% by 2006. As a consequence revenue collection increased from 56% to over 105% (including arrears)
4. Other improvements included power and chemical savings, reduction in staff overtime and absenteeism.

FINANCIAL MANAGEMENT

5. Asset management improved through development of an asset register and a maintenance plan
6. Approximately 98% of the capital budgets were realized into actual expenditure and the company's credit rating improved from 'BBB+' at the start of the contract to 'A'.
7. JW, which was bankrupt at the start of the management contract, registered profits for the first time in 2005-06 (final year of the management contract)

USER INTERFACE

8. Citizen interface and grievance redressal improved, with 90% of all calls being answered in 30 seconds through the call centre set up for the purpose.
9. Response time also improved with 80% of network repairs getting completed within 48 hours of notice and 80% of blocked sewers attended within 24 hours.

TRANSFER OF SKILLS

10. Transfer of skills to JW employees and the gradual phasing out of JOWAM staff was achieved successfully as reported by CMU. This was achieved through active involvement of JW employees in all projects, delegation of responsibilities and periodic training and mentoring.

4.2 PROJECT SHORTCOMINGS

The management contract fulfilled its contractual targets to a large extent. However, since the CA played the dual role of being a public agency and the single shareholder of JW, this led to conflicts between the subsidy policies of the Administration and the efficiency objectives of the management agency.

4.3 LEGAL/CONTRACTUAL ISSUES

While the management contract largely fulfilled contractual expectations, the results were restricted on account of non compliance by the CA with certain transfer terms that were part of the its agreement with JW (during the constitution of JW). The agreement provided for transfer of all billing functions to JW. In effect however, only the top 14,000 consumers were transferred, giving JW control over only 30% of its revenues. It was only after three years of operation that 60% consumers were transferred to the company. The resultant lack of control of JW over a large proportion of its revenue base restricted the capacity of the management agency, JOWAM to address commercial losses and erroneous business processes in a comprehensive manner.

5. LESSONS LEARNT

1. The experience highlights the possibility of engaging the private sector for strengthening the capacities of public utilities (particularly newly constituted public companies where there is a need to inculcate an efficient work culture), and using management contracts as catalysts for developing efficient public companies.
2. Importance of ensuring the autonomy of management consultants in order to achieve expected efficiency gains from management contracts. In this case the extent of improvements was heavily restricted due to dependence of the management agency on both (i) the compliance of the CA with its commitments (separate agreement) to the managed company and (ii) the policy regime of the CA.
3. Need for ensuring phasing out of management consultants and transfer of adequate skills and capacities to the managed company so as to sustain the efficiencies produced through management contracts beyond the period of the project.