



## Fitch Affirms 5 TCTA Projects at 'AA+(zaf)'; Outlooks Stable

Fitch Ratings-London-05 December 2016: Fitch Ratings has affirmed Berg Water Project's, Vaal River Eastern Sub-System Augmentation Project's, Mooi-Mgeni Transfer Scheme phase 2's (MMTS-2), Komati Water Scheme Augmentation Project's and Mokolo Crocodile Water Augmentation Project Phase 1's National Long-Term ratings at 'AA+(zaf)', with Stable Outlooks. Fitch has also affirmed the National Short-Term ratings at 'F1+(zaf)'.

The ratings of the TCTA projects' instruments reflect the strong links with the Republic of South Africa's (RSA; BBB-/Negative) Issuer Default Rating (IDR). Through the Department of Water and Sanitation (DWS), the South African sovereign assumes most risks related to revenues, operations and maintenance (O&M) as well as debt service. The lack of an explicit guarantee coupled with political risks and execution risks position the long-term debt ratings one notch below RSA's IDR, at 'AA+(zaf)' and the short-term debt ratings at 'F1+'.

The Stable Outlooks are driven by Fitch's expectation that the links with RSA's IDR will remain the same.

### KEY RATING DRIVERS

#### Stable Revenues: Revenue Risk - Stronger

The DWS adjusts tariffs to ensure recovery of all costs in case of lower water demand. The DWS has the responsibility to ensure that the tariffs are paid to TCTA. It is also liable for all amounts billed and not received, as well as for the late receipt of revenue. Moreover if the raw water supply agreements between the DWS and the users were terminated, and no further payments were received, the DWS would continue to pay the tariffs until the project costs were repaid in full.

#### No Operational and Lifecycle Risks: Operation Risk - Stronger and Infrastructure Renewal and Development - Stronger

The DWS undertakes O&M as well as major maintenance works. Therefore all related operational risks are removed from the five projects. Fitch expects the economic life of the assets to exceed the maturity of the debt.

#### Limited Exposure to Floating Interest Rates: Debt Structure - Midrange

The long-term debt is senior, fully amortising and ranks pari-passu between the different lenders. It is denominated in South African rand, like the revenue. The DWS will adjust the tariffs to repay the debt over a targeted 20 years after completion. In terms of TCTA's policy, at least 70% of the debt must be fixed rate, depending on market conditions, after construction. This leaves some exposure to floating interest rates.

#### Tariffs Set for Full-Cost Recovery: Debt Service

The DWS sets the tariffs to cover operating costs and debt service. The projects can postpone the principal repayments to a later period if needed. This agreement with the government covers the entire life of the debt.

There is no residual risk that is not captured directly by the government or by the flexible tariff mechanism. However, to mitigate the residual risk that tariffs are not amended in a timely manner, TCTA uses two instruments: liquidity and regular demand planning.

Over the short term, the projects' liquidity facilities as well as TCTA's global facility mitigate the discrepancies that might affect debt service. Over the medium term, demand planning allows settlements of tariffs on a forward-looking and regular basis, covering the risk of discrepancies between the initial business plan and the actual developments.

### Peers

The Industrial Development Corporation of South Africa, Umgeni Water and Rand Water all follow a top-down approach. Similar to the five TCTA projects, they are rated one notch below the South African sovereign rating, at 'AA+(zaf)'. This reflects strong support and ties to the government but lack of an explicit guarantee.

### RATING SENSITIVITIES

An upgrade at this point appears unlikely.

A failure of the DWS or the South African government to execute their contractual obligations could trigger a downgrade.

A depletion of the projects' liquidity facilities with loss of access to alternative sources of funding, in particular TCTA's global facility, could also trigger a downgrade.

### CREDIT UPDATE

TCTA reported that MMTS-2 reached completion over the period covered by the review. As a result, the five projects that Fitch rates are now operational.

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### Applicable Criteria

National Scale Ratings Criteria (pub. 30 Oct 2013) (<https://www.fitchratings.com/site/re/720082>)  
Rating Criteria for Infrastructure and Project Finance (pub. 08 Jul 2016) (<https://www.fitchratings.com/site/re/882594>)

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