

## **Trans-Caledon Tunnel Authority (TCTA)**

WS05 (LHWP)	ZAG000018060
WSP3 (LHWP)	ZAG000019993
WSP4 (LHWP)	ZAG000020009
WSP5 (LHWP)	ZAG000020017

As established by Notice No 2631 in Government Gazette No 10545 of 12 December 1986, and revised by Notice No 277 in Government Gazette No 21017 of 24 March 2000.  
A Schedule 2 Public Finance Management Act no. 1 of 1999 entity.

### **FITCH AFFIRMS 5 TCTA PROJECTS AR 'AA+(ZAF)'; OUTLOOK STABLE**

Fitch Ratings announced on 27 November 2017 that it retains the South African National Scale ratings on 5 TCTA Projects at AA+(zaf) with National Short-Term ratings at 'F1+(zaf). Fitch sees the outlook on all the projects as "Stable".

#### **The projects are:**

- Berg Water Project (BWP);
- Vaal River Eastern Sub-System Augmentation Project (VRESAP);
- Mooi-Mgeni Transfer Scheme phase 2 (MMTS-2);
- Komati Water Scheme Augmentation Project (KWSAP); and
- Mokolo Crocodile Water Augmentation Project Phase 1 (MCWAP-1)

The projects are funded through long term loans with liquidity support from revolving credit facilities and unlisted Commercial Paper Programs.

Outstanding amounts on Commercial Paper at 31 October 2017 were:

- BWP: R nil of a R450 million Program;
- VRESAP: R302 million of a R400 million Program;
- MMTS-2: R250 million of a R400 million Program;
- KWSAP: R nil of a R500 million Program; and
- MCWAP-1: R nil or a R nil Program

*The Lesotho Highlands Water Project (LHWP) issues explicitly government guaranteed debt and is not rated.*

#### **Note on Impact of Fitch Deregistration**

As a consequence of the Financial Services Board's (FSB) deregistration of Fitch Ratings, TCTA is in the process of procuring the services of another Ratings Agency and investors will be updated with the results of that process.

In the interim: because the FSB has extended Fitch Ratings' exemption to rate South African SOEs and the sovereign to 31 December 2019 from 31 December 2017 as per their media release of 24 November 2017; the current ratings by Fitch will remain in force for 12 months or until a new ratings agency issues replacement ratings.

For further information please contact:

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*The Fitch statement is quoted below:*

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

Fitch Ratings-London-27 November 2017: Fitch Ratings has affirmed Berg Water Project's (BWP), Vaal River Eastern Sub-System Augmentation Project's (VRESAP), Mooi-Mgeni Transfer Scheme Phase 2's (MMTS-2), Komati Water Scheme Augmentation Project's (KWSAP) and Mokolo Crocodile Water Augmentation Project Phase 1's (MCWAP) National Long-Term Ratings at 'AA+(zaf)', with Stable Outlooks. Fitch has also affirmed the projects' National Short-Term Ratings at 'F1+(zaf)'.

The projects are water-storage and transport, predominantly dams and pipelines, in South Africa. The grantor is Trans-Caledon Tunnel Authority (TCTA), a state-owned entity specialising in water project development.

### **KEY RATING DRIVERS**

The ratings of the TCTA projects' instruments reflect the strong link with the Republic of South Africa's (RSA, BB+/Stable). Effectively, most risks including revenue, operations and maintenance (O&M) as well as debt service have been passed down to the South African sovereign through the Department of Water and Sanitation (DWS). The lack of an explicit guarantee, coupled with political and execution risks (a potential failure in water demand planning or in anticipation of financial mismatches), however, position the long-term debt ratings one notch below the RSA's IDR, at 'AA+(zaf)'. The short-term debt ratings are positioned at 'F1+(zaf)' as a result.

The Stable Outlooks are driven by the expectation that the link of the ratings with the RSA's IDR will remain the same.

#### **Tariffs Set for Full-Cost Recovery: 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 water supply agreements between the DWS and the users are terminated, and no further payments are received, the DWS would continue to pay the tariffs until the project costs are repaid in full, thereby removing counterparty exposure for the projects.

#### **Transfer of Operational and Lifecycle Responsibilities:**

##### **Operation Risk - Stronger**

##### **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 among the different lenders. It is denominated in South African rand, as is the revenue. TCTA targets to repay the debt over a 20-year period 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.

#### **Financial Profile**

The DWS sets the tariffs to cover operating costs and debt service. The projects can also postpone the principal repayments to a later period if needed. This agreement with the government covers the entire life of the debt. Under the currently prevailing tariffs TCTA maintains its objective of repaying the debt facilities over a period of 20 years post completion of construction.

There is little risk that is not captured directly by the DWS 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, provided by DBSA (Development Bank of Southern Africa), ABSA, Investec, and TCTA's global facility provided by FirstRand Bank, as well as TCTA's commercial paper programmes mitigate the discrepancies between the timing of the tariffs adjustment and the actual water demand 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 actual developments.

## **PEER GROUP**

Umgeni Water and Rand Water follow a top-down rating 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 the lack of an explicit guarantee.

## **RATING SENSITIVITIES**

### **Future Developments That May, Individually or Collectively, Lead to Negative Rating Action:**

- A failure of the DWS to carry out its contractual obligations;
- A failure of the government to carry out its obligations; and
- An exhaustion of liquidity, in combination with a loss of access to alternative sources of funding, in a context of severe disruption affecting the projects.

### **Future Developments That May, Individually or Collectively, Lead to Positive Rating Action:**

The one-notch difference with the rating of South Africa reflects the absence of explicit guarantee, making an upgrade unlikely.

## **CREDIT UPDATE**

### **Performance Update**

All five TCTA projects are operational after MMTS-2 reached completion in August 2016. TCTA reported significant drops in water demand projections in 2017; however, tariffs are adjusted accordingly at tariff consultations and Fitch believes that the funding schemes work as expected.

### **Asset Description**

TCTA has been mandated by the South African government to implement and fund the projects, which are ring-fenced projects within TCTA and managed by TCTA's staff. The O&M is carried out by the central government through the DWS.

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**Applicable Criteria**

National Scale Ratings Criteria (pub. 07 Mar 2017) (<https://www.fitchratings.com/site/re/895106>)  
Rating Criteria for Infrastructure and Project Finance (pub. 24 Aug 2017)  
(<https://www.fitchratings.com/site/re/902689>)

**Additional Disclosures**

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