



Record of Decision

2017/18

Tariff Application by the National Ports Authority for the Tariff Years 2017/18 - 2019/20

- ❖ On 1 August 2016, the National Ports Authority (the NPA) applied to the Ports Regulator of South Africa (the Ports Regulator) in terms of Section 72 of the National Ports Act, 12 of 2005 (the Act) for approval of the tariffs for services and facilities offered by the NPA for the period 1 April 2017 to 31 March 2018, together with indicative tariffs for the periods 1 April 2018 to 31 March 2019 and 1 April 2019 to 31 March 2020.
- ❖ After considering the application and the written and oral submissions by all stakeholders during the consultation period, and based on the latest available data, the Ports Regulator in considering the proposed average 8.02% tariff increase for the 2017/18 tariff year, decided that an appropriate overall increase in average tariffs for 2017/18 shall be 5.97%.
- ❖ The Ports Regulator further concludes that all cargo dues for 2017/18 are to increase by 6.0%, with the exception of marine services and related tariffs (Sections 1-8 of the Tariff Book, excluding Section 7 that deals with cargo dues) that are to increase by 7.9%, full container cargo dues which are to increase by 4.9%, and all RoRo tariffs which are to increase by 3.9%.
- ❖ In line with previous years' decision, all marine tariffs (Sections 1-8 of the Tariff Book, excluding Section 6 and 7 that deal with ship repair and cargo dues respectively) for existing commercial South African flagged cargo vessels as well as those registered in South Africa in 2016/17 will receive a 30% discount applicable year on year up to 31 March 2019. Those registered in South Africa in 2017/18 will receive a 20% discount up to 31 March 2019 and similarly those registered in 2018/19 will receive a 10% discount up to 31 March 2019. The discount will thereafter be reviewed.
- ❖ The above reductions will only apply to vessels registered as part of Chapter 4, Part 1 of the Ships Registration Act (58 of 1998) but excludes the following vessels:
 - ❖ All "small" vessels as defined in the Merchant Shipping Act;
 - ❖ All "fishing" vessels as defined in the Merchant Shipping Act; and
 - ❖ All non-cargo working vessels.
- ❖ In line with the Multi-Year Tariff Manual of August 2014, the Ports Regulator projects that the indicative overall average tariff adjustment for the 2018/19 and 2019/20 tariff years will be within the inflation target band.

1. The Tariff Application

The NPA requested a tariff increase of 8.02% for the 2017/18 tariff year. In addition, and in line with the Tariff Manual, the NPA has applied for an indicative tariff of 25.11% and 9.54% for 2018/19 and 2019/20 respectively. This follows an application for a 5.90% tariff increase for 2016/17 after which, considering updated information, the Regulator decided on a 0% average tariff increase.

Table 1: Overview of NPA Tariff Application and Previous Decisions

NPA Tariff Application Overview				
WACC	Previous Year	Current Tariff Application		
Year	Tariff Application	17/18	18/19	19/20
Risk-Free Rate (nominal)	8.26%	8.58%	8.58%	8.58%
Real Risk Free Rate	2.23%	2.05%	2.82%	3.02%
Market Risk Premium	5.40%	5.40%	5.40%	5.4%
Asset Beta	0.50	0.50	0.50	0.50
Equity Beta (using Hamada)	0.86	0.86	0.86	0.86
Gearing	0.5	0.5	0.5	0.5
Debt / Equity Ratio	100%	100%	100%	100%
Cost of Debt	9.86%	10.81%	10.91%	10.97%
Inflation Forecast	5.90%	6.40%	5.60%	5.40%
Tax Rate	28.00%	28.00%	28.00%	28.00%
Real Vanilla WACC	5.31%	5.42%	6.25%	6.47%
Revenue Requirements Calculation				
Return on Asset	3 902	4 037	5 101	5 817
Depreciation	1 928	2 015	2 199	2 414
OPEX	5 487	5 961	6 391	6 935
Tax	1 191	969	1 185	1 339
Total	12 508	12 982	14 876	16 505
Claw- back	-680	-774	11	-
ETIMC	67	-98	-	-
Allowable Revenue	11 895	12 110	14 887	16 505
Real Estate	-2 600	-2 798	-3 028	-3 282
Marine Business Income	9 295	9 312	11 859	13 224
Prior year's Revenue	8 571	8 469	9 312	11 859
Volume Increase	0.024	1.8%	1.8%	1.8%
Average Price Increase Required	5.90%	8.02%	25.11%	9.54%

2. The Ports Regulator's Mandate

In considering the Applicant's proposed tariffs, the Ports Regulator was guided by the National Ports Act, 12 of 2005, the Regulations issued in terms of Section 80(1) of the Act, together with the Directives¹ and the Regulatory Tariff Manual applicable to the period up to 2017/18 (the manual) (hereinafter jointly referred to as the 'Regulatory Framework').

Furthermore, the Ports Regulator is required to consider the submissions contained in the Application and all subsequent submissions, all written and oral comments received during the consultation process, including the responses thereto, as well as conduct its own information and research. The Regulator has adhered to this process.

It must be noted that the information at the disposal of the Ports Regulator postdates the Application and as such some differences in calculations are due to the updated data and forecasts. However, the NPA's request to the Regulator for a decision by 01 December (as per Directive 22 (16)) does introduce a level of uncertainty in the tariff assessment and might result in increased volatility in tariff decisions due to the timing difference between the period under review and the time of the decision.

3. The Tariff Methodology/Tariff Manual

In order to continuously improve the level of transparency and consistency in the tariff setting process, the Ports Regulator has undertaken extensive consultations with all port stakeholders, including the NPA, through consultation hearings (road shows), meetings, and the receipt of submissions, on the NPA's proposed Tariff Methodology. An interim methodology was published on 13 August 2013 and was applicable only to the 2014/15 tariff year. Subsequently, a Multi-Year Tariff Methodology, applicable to the tariff period 2015/16-2017/18, was published in August 2014.

The guidelines within the multi-year Tariff Methodology were aimed at assisting the NPA with the submission of a tariff application containing a three-year horizon that would provide greater certainty in the ports sector. In addition, the Methodology has assisted stakeholders in formulating responses to tariff applications which in turn has assisted the Ports Regulator in the decision making process resulting in an overall increased level of regulatory certainty. This methodology, being in its final year of implementation, is currently under review and a revised Tariff Methodology is expected to be published by the end of the 2016/17 tariff year.

The current Methodology encapsulated by the Tariff Manual is based on the Revenue Required (RR) approach. The Ports Regulator, while attempting to increase regulatory certainty, must retain a degree of regulatory discretion to respond to unforeseen economic or other events, as well as corrections, anomalies and unintended consequences of a strict and autonomic application of the

¹ The Directives were promulgated in terms of Section 30(3) of the Act in Government Notice 825, Gazette No. 32480 dated 6 August 2009, and as amended in the Directives Amendment Notice, promulgated in Government Notice 37, Gazette No. 32898 on 29 January 2010.

methodology that may impact on the sustainability of the South African ports system. This has been captured in the guidelines and taken into consideration.

The NPA has utilised the Tariff Manual to calculate and submit the application which is set out below:

Revenue Requirement

$$\begin{aligned} &= \text{Regulatory Asset Base (RAB)} \\ &\quad \times \text{Weighted Average Cost of Capital (WACC)} + \text{Operating Costs} \\ &\quad + \text{Depreciation} + \text{Taxation Expense} \pm \text{Clawback} \\ &\quad \pm \text{Excessive Tariff Increase Margin Credit (ETIMC)} \end{aligned}$$

4. Compliance with the Directives, Regulations and National Ports Act

Although the Application achieved formal compliance with the Act, Regulations, Directives and the Tariff Manual, components of the Application do not yet fully comply as there has not been full disclosure. The data was adequate for purposes of calculating the over/under-recovery of the NPA. However, the requirement of the Ports Regulator, as articulated in the 2011/12 Record of Decision, is that full disclosure is required for all NPA business; that is, both marine and real estate business as well as a port by port differentiation of revenues and costs. The Ports Regulator's view on this matter has not changed. Although a higher level of compliance has been achieved compared to previous years, future applications must include disaggregated information on all elements of the NPA's business.

The Applicant submitted its Tariff Application based on the Rate of Return methodology, as outlined in the Tariff Manual (the 'Revenue Requirement' approach). The Ports Regulator therefore accepts the general methodology that has been used by the Applicant in this instance; however, the Ports Regulator differed from the Applicant in the interpretation and calculation of some of the parameters therein.

Directive 22 (3): Any submission to the Regulator in terms of sub-directives (1) or (2) above shall contain sufficient information for the Regulator to consider the submission; in particular, the Authority shall set out –

(a) the manner in which the tariffs have been calculated, and the model used by the Authority for determining and calculating tariffs;

Whilst the NPA has not fully adhered to this requirement in past applications, increased engagements have served to clarify uncertainties in the application. The NPA has, in the application for 2017/18, set out the manner in which their proposed tariffs have been calculated as well as the model that was used. The requirement has been met.

(b) all operating and capital costs, expenses and revenues, incurred or generated from the port service or port facility, as well as the value of the capital stock;

The application provided sufficient details regarding the operating expenditure, the capital costs, NPA's expenses and revenues generated, as well detailed information on the Regulatory Asset Base (capital stock). The requirement has been met.

The CAPEX programme information provided by the Applicant was sufficiently detailed to make an assessment. As the CAPEX information is the subject of further extensive processes that are to be engaged by the Ports Consultative Committees (PCC) and the National Ports Consultative Committee (NPCC), the Ports Regulator accepts the information provided for the purposes of this tariff application as an outcome of the PCC and NPCC processes, as well as a higher level of compliance by the Applicant. In this regard, continued information requirements, as set out in Item 8 of the 2015/16 ROD and Section 9 of this ROD, will continue to apply on a quarterly basis.

(c) the amounts to be invested and the revenues to be utilised in port development, safety, security and environmental protection;

Port development initiatives, investments, and revenues have been addressed. Safety, security, and environment protection costs / investment objectives have been satisfactorily addressed. The requirement has been met.

(i) the manner in which the tariffs will affect the cost of doing business in the ports;

The tariff book addresses this requirement as it sets out the manner in which the proposed tariffs will affect each sector in the port in terms of conducting business. The requirement has been met.

(ii) the proposed profit margin or rate of return, together with a motivation to show why this margin or return is commensurate with risk;

The application is in line with the Tariff Methodology in terms of its return and risk consideration. The requirement has been met.

(iii) The manner in which the factors set out in Directive 23 apply to the proposed tariffs.

Directive 22 (4): The Regulator may call on the Authority to provide any additional information which the Regulator required to consider the submission made in terms of sub directive 1 or 2 or to approve the proposed tariff.

The NPA was requested to provide additional information to the Regulator during the course of the assessment.

Directive 22 (5): The Authority may in a submission made in terms of sub directive (1) or (2), identify information which the Authority believes is confidential information. Any such submission shall be made and dealt with in the manner set out in Directive 25.

The Regulator provided an opportunity for the NPA (or any other party) to submit information on a confidential basis in terms of Section 30(3) of the Act and Section 25 of the Directives.

Directive 22 (6): The Authority shall maintain such financial and accounting systems as are necessary for the Regulator to verify the pricing principles and models used by the Authority to determine and calculate its tariffs.

The audited Annual Financial Statements of the NPA have been provided to the Regulator (on a confidential basis). The generalised corporate level of information, including audited financial statements, was adequate for the purposes of the analysis. Furthermore, the credibility of the information provided has continued to increase markedly over the tariff periods. Notwithstanding that the generalised corporate level information was adequate, greater breakdown of cost and revenue information on port and activity levels will be required in future for tariffs to be more accurately cost reflective.

However, some concerns are noted with respect to the cash management between the National Ports Authority and Transnet Group and the impact thereof on the short term vs long term debt utilisation by the Authority. Information on this and other areas of interest to the Regulator to be provided is set out in Section 9.

Directive 23 (1): In considering the proposed tariffs in terms of Directive 22, the Regulator must have regard to whether the proposed tariffs reflect and balance the following considerations: -

(a) A systematic tariff methodology that is applicable on a consistent and comparable basis;

The Applicant has submitted the Tariff Application based on the requirements set out in the Tariff Methodology/Manual.

(b) Fairness;

Whilst the tariff structure in the South African port system does not currently reflect international best practice with regards to the allocation of costs, The Tariff Strategy (as published on 31 July 2015) and the implementation thereof addresses all concerns related to 'fairness'. By the reductions and increases granted in this and previous tariff determinations, the Ports Regulator attempts to address some of the most glaring of these imperfections; however, the full implementation of the tariff strategy over its ten-year implementation period will give effect to Directive 23(1)(b) more comprehensively.

(c) The avoidance of discrimination, save where discrimination is in the public interest;

By the reductions and increases granted by the Ports Regulator in this ROD, as well as previous determinations, the Ports Regulator continues to address this. See comment on Directive 23(1)(b) above.

(d) Simplicity and Transparency;

The NPA have made significant strides in improving their levels of transparency. The requirement has been met.

(e) Predictability and stability;

The application matches previous forecasts in numerous aspects. This requirement has been met.

(f) the avoidance of cross-subsidisation save where cross subsidisation is in the public interest; and

The Tariff Strategy has set out the manner in which cross subsidisation will be addressed. The Regulator will continue to guide the NPA in this regard.

(g) The promotion of access to ports and efficient and effective management and operations in ports.

The PRSA has the following concerns, either stemming from previous applications or that have presented themselves for review in this assessment period; these concerns are set out below:

- i. The annual CAPEX projections of the NPA over the seven-year cycle must be better articulated and tied to demand and traffic forecasts as articulated in paragraph 5.1.2 and in line with Directive 22(3)(b) where applicable.
- ii. In past applications, the NPA has only included high level data concerning the real estate business. The data was adequate for purposes of calculating the tariff level. However, the requirement of the Regulator, as stated in the 2011/12 ROD, is that full disclosure is required for all NPA business – i.e. both the Marine and the Real Estate business. The Regulator has requested updated rental schedules for 2016/17 for South African terminal operators and will in due course request the Lease Register for all rentals received.

The information provided in the application was not sufficient to determine compliance with this provision. Although this is not clearly stated in the Application, the internal processes of the Applicant, including the Section 56 and 57 processes in terms of the Act and the processes that the Applicant is undergoing in the PCCs, address some, but not all, of the concerns that arise under this provision. The other issues that remain outstanding will be addressed in the disclosure components of the Regulatory Manual referred to above, as well as in the Ports Regulator's compliance and monitoring processes. In this regard, Item 9 outlines future information reporting requirements by the NPA to the Ports Regulator, specifically with regards to the Regulator's concern with the current pace of port reform with regards to representivity and access in the ports sector, with specific reference to B-BBEE and small and medium-sized enterprises owned by historically disadvantaged groups. As a result, necessary requirements to address this concern have been set out in Section 9.2.

5. The Application Specifics

The Application submitted is based on the Required Revenue requested by the NPA. The Ports Regulator assessed the Application on this basis, and used the methodology outlined in the Regulatory Manual, except where the Manual was incorrectly applied; or in the opinion of the Ports Regulator, a deviation was necessary.

In effect, the NPA used the following formula in its calculations for the Required Revenue:

$$\text{Revenue Requirement} = (\text{Weighted Average Cost of Capital} \times \text{Regulatory Asset Base (RAB)}) + \text{Operating Costs} + \text{Depreciation} + \text{Taxation expense} \pm \text{Claw-Back} \pm \text{ETIMC}$$

This approach accords with rate-of-return revenue requirement calculations by Regulators in South Africa and internationally (as modified in the ports regulatory practice over time) and has been used as the basis for assessments by the Ports Regulator in the preceding applications.

The standard exposition is:

$$RR = (v - d + w) r + D + E + T +/- C +/- ETIMC$$

Where:

<i>RR</i>	=	<i>Revenue Requirement</i>
<i>v</i>	=	<i>value of the assets used in the regulated services</i>
<i>d</i>	=	<i>accumulated depreciation on such assets</i>
<i>w</i>	=	<i>working capital</i>
<i>r</i>	=	<i>return on the capital reasonably expected</i>
<i>D</i>	=	<i>depreciation accounted for in the period of the tariff</i>
<i>E</i>	=	<i>operating expenses</i>
<i>T</i>	=	<i>taxation expense</i>
<i>C</i>	=	<i>Claw-back</i>
<i>ETIMC</i>	=	<i>Excessive Tariff Increase Margin Credit</i>
$(v - d + w)$	=	<i>Regulatory Asset Base</i>

6. The Regulated Asset Base (RAB)

The RAB submitted by the NPA was as follows:

Table 2: NPA Regulatory Asset Base Calculation

Transaction	Tariff Application	ROD	NPA Tariff Application	
	2016/17	2016/17	2017/18	2018/19
Opening RAB Value	71 342	71 411	73 846	80 737
Less: Transfer of Properties Outside of Port Limits	-489			
Adjusted RAB Value	70 853	71 411	77 249	85 625
RAB trended	75 033	76 235	78 572	82 258
Add Capex	4 144	3 055	4 050	6 358
Less Depreciation	-1 928	-1 948	-2 015	-2 414
Closing RAB value	77 249	78 134	80 737	97 511
Average Opening and Closing	74 296	74 773	77 291	93 061
Less Working Capital	-813	-927	-2 815	-3 188
RAB Final	73 483	73 846	74 477	89 872

6.1. RAB determined by the Ports Regulator

In the previous tariff determinations, the Ports Regulator accepted the Depreciated Optimised Replacement Cost (DORC) method used by the Applicant to determine a starting Regulatory Asset Base. The Ports Regulator maintains its previous position in that it retains a low level of confidence in the RAB value as determined by the 2008 DORC conducted by the NPA as the process gave rise to a steep increase in asset values. However, regulatory certainty was required in the absence of any alternative and the RAB was therefore accepted. The Ports Regulator has commenced a process to assess the application and appropriateness of these valuations for major assets in order to inform subsequent assessments of the RAB and will provide guidance in this regard with the publication of a revised Tariff Methodology.

The Ports Regulator has previously determined that the 2010/11 ROD value establishes the starting point for trending the RAB in future tariff determinations. Nonetheless, the Ports Regulator has applied a number of adjustments (correcting for the actual CAPEX resulted adjustments, correcting calculation errors contained in the application and inflation) for the subsequent years, to arrive at an opening balance for the 2017/18 year of R76 794 million.

The RAB value for the period under review was determined using the following formulas:

$$RAB = \frac{1}{2} [RAB_{c,y} + RAB_{o,y}] + w_y$$

$$RAB_{c,y} = RAB_{o,y}(1 + CPI_Y) + CWIP_Y - D_y$$

Where:

RAB_y = value of the RAB used to determine the returns for the period y ;

$RAB_{o,y}$ = opening value of RAB for the period y ;

$RAB_{c,y}$ = closing value of RAB for the period y ;

w_y = forecast average net working capital over the review period;

$CWIP_Y$ = value of expected capital investment over the review period;

D_y = depreciation allowance for assets over the review period;

CPI_Y = annual rate of general inflation expected over the review period

The calculation of depreciation resulted in a depreciation allowance of R2 030 million as opposed to the NPAs application of R2 015 million. Depreciation calculated by the Ports Regulator for the outer years total R2 221 and R2 441 million respectively, with the differences mainly due to the higher inflation forecast.

Based on previous tariff assessments and adjustments thereto, information in the Application and the Ports Regulator decisions for the current application as well as application of the above equations, the RAB is as per the Table below:

Table 3: Regulatory Assessment of the Regulatory Asset Base

Transaction FY 2017/18	RAB
Opening Net Book Value	76 794
Indexing	4 808
Less: Depreciation	2 030
Add: CAPEX	4 050
Closing NBV	83 621
Average Opening and Closing	80 208
Less: Working Capital	2 852
RAB Final	77 356

6.2. Cost of Capital

The NPA’s Application follows the Capital Asset Pricing Methodology (CAPM) in order to determine the cost of capital, as per the requirements of the Regulatory Manual. The Applicant has utilised the Vanilla Weighted Average Cost of Capital (WACC) approach and the Regulatory Framework does not dictate or preclude this approach. Furthermore, the Application requested the real vanilla WACC be assessed as being 5.42 % for 2017/18, and 6.25% and 6.47% respectively for the following years.

The Ports Regulator has determined the real vanilla WACC to be 5.71% when applying its determinations to the elements below. Furthermore, the Ports Regulator has determined provisional WACC variables for the outer years to be 5.84% and 5.64% respectively. The differences can mainly be ascribed to the lower inflation outlook.

The formula for calculating the WACC under the CAPM is as follows:

$$WACC_{vanilla} = k_d \cdot g + k_e(1 - g)$$

Where:

$$\begin{aligned}
 k_d &= \text{pre-tax cost of debt} \\
 k_e &= \text{post tax cost of equity} \\
 g &= \text{gearing, which is debt over total capital}
 \end{aligned}$$

6.2.1. Cost of Equity

The real post-tax cost of equity requested in the Application is 6.69%. The Ports Regulator has determined that the real post-tax cost of equity be 6.98%, which was then used to determine using the subsidiary elements listed below. This in turn has resulted in a total calculated return on equity of R 2 699 million available to the NPA as profit/maximum dividend.

The CAPM cost of equity methodology used by the Application is as follows:

$$k_e = R_f + \beta(MR - R_f)$$

Where:

k_e	=	Cost of Equity
R_f	=	Risk Free Rate
MR	=	Market Return
$(MR - R_f)$	=	Market Risk Premium calculated over long term
β	=	Beta Coefficient

6.2.2. Risk Free Rate

The twenty-year government bond is an appropriate measure of the Risk Free Rate, in particular the R186 bond instrument (yield), as it adequately reflects the market's perception of sovereign risk and inflation going forward. The average Risk Free Rate is calculated over a five-year period (from August 2009 to July 2014). The Risk Free Rate used in this assessment is 8.58%.

6.2.3. Beta Co-efficient

The Ports Regulator used an asset beta of 0.5, as set out in the Regulatory Manual, which equates to an equity beta of 0.86. The Hamada equation was used to re-lever the beta.

6.2.4. Market Risk Premium

The Ports Regulator, in line with regulatory consistency, and the medium-term tariff methodology, has calculated a market risk premium of 5.4%, as published in the latest available Dimson, Marsh and Staunton (DMS). It is an estimate of the geometric mean MRP for South Africa to determine an MRP for the NPA's cost of equity.

6.2.5. Gearing

As set out in the Regulatory Manual, the Ports Regulator in its assessment has used a Gearing of 0.5.

6.2.6. Cost of Debt

The Ports Regulator calculated the real Cost of Debt (Pre-tax) to be 4.44%.

In the absence of full disclosure of detailed long and short term debt information, the Regulator is concerned with the effectiveness of the debt structure and cash management of the Authority. The Regulator shall, in the new Tariff methodology applicable 2018/19 onward, set out the manner in which an appropriate debt structure is defined for the purposes of tariff assessments.

6.2.7. Inflation

The National Treasury inflation forecast, as per the Medium Term Budget Policy statement October 2016 for 2017 is, 6.1% for 2017/18, 5.9% for 2018/19, and 5.8% for 2019/20.

6.3. Operating Costs

The Ports Regulator accepted the operating cost estimate for 2017/18. However, the Ports Regulator wishes to express its concern regarding the impact of continued under spending of CAPEX on operational expenses. Whilst the underspending on maintenance has narrowed over the last few years to an estimated 13% in the current tariff year, the impact on efficiencies, capex requirements etc. remains a concern and a continuation. Whilst some of the underspending on operational expenditure is as a result of cost savings and higher operational and management efficiency, an outcome based assessment on operational expenditure will be followed in the next assessment. The Ports Regulator will further address any over allowance on operational expenses through the claw-back mechanism in the next tariff year.

The NPAs total operational cost amounts to R5 961 million, including Group overhead costs relating to the NPA. The split of costs into different operations of the NPAs business, such as marine costs and lighthouse costs per port, has not been provided. Whilst the Port Regulator analysed the operational expenditure of the NPA in detail, any under spending during the tariff period under consideration will, as per existing practice, be clawed back; whilst any over run on costs must be motivated in detail.

The Ports Regulator allowed the inclusion of the R509 million Group Costs in the total allowed expenses, subject to the conditions in the Manual. Whilst the Ports Regulator allows the Group cost component on the basis that the NPA, as a division of Transnet, will continue to depend on centralised services, the Ports Regulator will continue to monitor this allowance and claw back any under spending that may occur. The Regulator also sees the expected 22% reduction in the group cost allocation as positive.

Specifically, with regards to the Group cost component of the NPAs operational expenses, the Ports Regulator considered the following in allowing the request: Was the allocation from the NPA to Group in terms of the applicable policy? The Ports Regulator deemed it to comply with the policy as submitted to the Ports Regulator. Are the share allocations in the policy a fair reflection

of the services rendered by the Group to the NPA? Based on available information, the Ports Regulator is largely satisfied with the fairness of the share allocations in the policy.

However, the Ports Regulator will, in due course, address the applicability of some of the line items in the policy, finding that further assessment is necessary; this will be addressed in a set of regulatory accounts over the medium-term.

The Ports Regulator thus approves the Group cost allowance for 2017/18 and gives conditional approval for the 2018/19-2019/20 tariff years based on the conditions set out in Section 6.5 of the Regulatory Manual, which allow for future claw-back if deemed necessary.

6.4. Depreciation

The Regulator's assessment has resulted in an allowance of R 2 030 million as a depreciation allowance, as opposed to the applied for amount of R 2 015 million.

Estimated depreciation calculated by the Ports Regulator for the outer years totals R2 222 and R2 442 million respectively.

6.5. Taxation Expense

The Ports Regulator accepts the corporate tax rate of 28% for the 2017/18 Tariff Year. In line with the 2016/17 ROD, the Ports Regulator has determined that a simple pass-through tax calculated on the return on equity be implemented for the current, multi-year methodology period.

The resultant taxation expense for 2017/18 is R 1 050 million.

6.6. Volume adjustments

The Ports Regulator adjusted the volume forecast for the 2017/18 tariff year taking into account the latest estimates available, market assessments and intelligence. This resulted in a revised tariff book revenue forecast of R8 857 million for 2017/18. This, as in the past, has included the decision to exclude bilateral contracts in the calculation of revenue.

6.7. Claw-back

As the 2015/16 tariff year is now complete, the Ports Regulator can make the final adjustments to the impacts of any forecasts and recoveries for that year, resulting in a revised total claw-back of R691 million.

An interim claw-back (in favour of the NPA) was made in the 2016/17 tariff year (R -55 million), resulting in a residual claw-back of R746 million. The return on the residual claw-back in terms of the WACC rate for that period totals R47 million. The total residual claw-back for 2015/16 is therefore R793 million.

The expected claw-back calculated for the 2016/17 FY is R78 million. A provisional claw-back of R39 million, as well as the residual claw-back of R793 million for FY 2015/16, results in a total claw-back of R832 million in the 2017/18 tariff year. (Please note: Differences due to rounding).

Table 4: Claw-back Calculation

Transaction	R Million
Revised Total Claw Back 2015/16	-597
Interim Claw Back 2015/16 (Clawed Back in 2016/17)	-55
Total Claw Back for 2015/16 (including interim claw back)	-652
Estimated Claw Back 2016/17	26
50% Claw Back 2016/17	13
<i>2017/18 Claw Back calculation</i>	
Final Claw Back 2015/16	-652
Return on Claw Back 2015/16	-42
Provisional claw back 2016/17	13
Net Claw Back 2017/18	-681

Note: (-) indicates claw back to users (+) indicates claw back to NPA

6.8. ETIMC

The Ports Regulator regulates in the long-term interest of the industry. This requires that the Ports Regulator not only confine itself to the immediate tariff decision, but also consider ways to ease any future shocks or tariff spikes to the system which can be managed sustainably within the space that is available for such intervention. The Ports Regulator considers it prudent to utilise some of the Excessive Tariff Increase Margin Credit (ETIMC) through an adjustment to revenue allowed in the 2017/18 tariff year through a reduction in required revenue to offset against a calculated large, but justified, tariff increase in excess of inflation.

Table 5 below sets out the calculation of the ETIMC and the resultant value at the end of the tariff year.

Table 5: ETIMC Calculation

Transaction Type	R million
2012/13 ETIMC Retained	900
2012/13 WACC Return on ETIMC (average ETIMC across year)	20
2013/14 ETIMC Opening Total	920
2013/14 Estimated ETIMC Retained in 2013/14	1 378
2013/14 ETIMC Closing Total	2 298
2013/14 Average ETIMC	1 609
2013/14 WACC Return on Average ETIMC	60
2013/14 ETIMC Closing Balance	2 358
2014/15 Average ETIMC	2 358
2014/15 WACC Return on Average ETIMC	108.3
2014/15 ETIMC Closing Balance	2 466
2015/16 ETIMC Utilised	-150
2015/16 WACC Return on ETIMC	108.5
2016/17 WACC Return on ETIMC	112
2016/17 ETIMC Total	2 537
2017/18 WACC Return on ETIMC	111
2017/18 ETIMC Utilised	-593
2017/18 ETIMC Total	2 055

It is important to note that the expected tariff increase for the outer years may or may not require the use of the ETIMC facility through an adjustment of required revenue to ensure tariffs are in line with the below inflation trajectory as set out in the 2015/16 and 2016/17 Records of Decision. The ability of the NPA to implement their allowed CAPEX, maintenance and other operational expenses together with realised volumes may materially impact on the final tariffs and will be taken into consideration by the Ports Regulator in outer years.

7. Required Revenue and Tariff Increase

The application of the above amendments and adjustments to the NPA 2016/17 Tariff Application has the following result:

Table 6: Assessment Results

Transaction Type (R Million)	2017/18
Return on Capital	4 417
Depreciation	2 031
Operating Expenses	5 961
Tax Expense	1 050
Claw Back	-681
ETIMC	-593
NPA Required Revenue 2017/18	12 185
Real Estate Business Income	2 798
Marine Business (Tariff Book) Income	8 857
Total Estimated Income	11 655
Revenue (Shortfall)/Surplus 2017/18	-530
Required Tariff Book Revenue	9 387

The forecast calculates a revenue shortfall of R 530 million.

The marine business income that is forecast above is the current tariff book marine revenue modelled for a weighted average volume growth rate of 2.97% for all cargo types and marine services for the period.

The following assumptions are included in the tariff assessment:

Risk Free Rate	8.58%
Market Risk Premium	5.4%
Gearing	0.5
Beta Coefficient	0.5
Revenue Effect of Volume growth 2016/17	2.97%
Inflation	6.1%

Whilst the NPA did request specific tariff increases in addition to the general adjusted tariff increase of 8.02%, the application more specifically requested a 13% tariff increase in marine charges to shipping lines, 8.3% increase in bulk exports and 5% on all other cargo dues. Based on the Ports Regulator's own research, which raised significant concerns about specific anomalies regarding tariff imbalances evident in the tariff book, as well as the cost levels facing other users, and the impact that the recent depreciation of the South African Rand has on costs, the Ports

Regulator approves the following specific changes applicable to the tariffs as set out in the Tariff Book:

All cargo dues for 2016/17 are to increase by 6.0%, except for marine services and related tariffs (Sections 1-8 of the Tariff Book, excluding Section 7 that deals with cargo dues) that are to increase by 7.9%, full container cargo dues are to increase by 4.9% and all RoRo tariffs are to increase by 3.9%. This differentiation in tariff increases are broadly in tandem with the prescripts of the Tariff Strategy, which seeks to address cross-subsidies over a ten-year period.

In line with previous years' decision, all marine tariffs (Sections 1-8 of the Tariff Book, excluding Section 6 and 7 that deal with ship repair and cargo dues respectively) for existing commercial South African flagged cargo vessels as well as those registered in South Africa in 2016/17 will receive a 30% discount applicable year on year up to 31 March 2019. Those registered in South Africa in 2017/18 will receive a 20% discount up to 31 March 2019 and similarly those registered in 2018/19 will receive a 10% discount up to 31 March 2019. The discount will thereafter be reviewed.

The above discounts will only apply to vessels registered as part of Chapter 4, Part 1 of the Ships Registration Act (58 of 1998) but excludes the following vessels:

- All "small" vessels as defined in the Merchant Shipping Act;
- All "fishing" vessels as defined in the Merchant Shipping Act; and
- All non-cargo working vessels.

Furthermore, in line with the Multi-Year Tariff Manual of August 2014, the Ports Regulator projects that the indicative overall average tariff adjustment for the 2018/19 and 2019/20 tariff years will be within the inflation target band. The tariff changes were informed by the ongoing research conducted by the Ports Regulator and based on the recommendations contained within the Tariff Strategy. The relative movement of tariffs is similar to the changes effected in the 2013/14 - 2016/17 decisions. Due to the expected subdued economic activity over the tariff period, the Ports Regulator will continue to, if required, use the ETIMC to maintain overall average tariffs close to the inflation target band, as defined by the South African Reserve Bank's mandate.

8. Tariff Strategy Implementation

The Tariff Strategy is due to be implemented in the 2017/18 tariff year with methodological testing and simulations conducted in the 2016/17 tariff year. The Tariff Strategy sets out guiding principles for setting the base tariff for different port users. These guiding principles aim to introduce a more flexible approach to facilitating pricing in the ports sector than what has been proposed earlier, in order to establish an appropriate level of tariffs that better reflects the underlying costs based on use and benefit. These principles are aimed at enforcing transparency and certainty.

The implementation of the Strategy and its principles are meant to bring real benefits to customers through charging cost reflective tariffs. On that basis, those customer categories currently over-charged would see tariffs reduced, whereas those categories that are currently subsidized (under charged) would see their tariffs rebased to a fair level. These principles must be taken into consideration during the gradual adjustment of the Tariff Book over the period up to and beyond 2026/27.

In order to provide a continuous update of the implementation of the Tariff Strategy and the changes to base tariffs due to changes in port structure, asset values and volume forecasts etc., the Ports Regulator will publish updated base rates for the coming financial year in every ROD. These tariffs provide an indication of the tariff trajectory during the estimated ten-year implementation period in current terms. Over the implementation period, tariffs will thus converge towards these annually updated base rates. For example, a dry bulk tariff above the dry bulk base rate will gradually, as conditions allow, converge towards the R5.54 in today’s prices.

Table 7: Tariff Strategy Base Rates

Tariff Strategy		Updated Tariff Strategy “base rate”	2017/18 ROD based NPA tariff book rate	
Cargo Type	Unit	i.e. target tariff to be achieved over ten year implementation	Import	Export
Break bulk	Tons	R 21.88	31.50	31.50
RoRo's	Tons	R 30.23	234.63	98.58
Liquid bulk	Tons	R 12.27	30.83	30.83
Dry bulk	Tons	R 5.54	7.40	7.40
Containers	TEU	R 210.03	2146	706

Note: Table 7 only reflects cargo dues as marine charges are (at time of this decision) still being simulated as per the published Tariff Strategy tariff designs.

No distinction is made between import and export tariffs in the tariff strategy base rate as any deviation from the base rate should clearly indicate whether a tariff rate is subsidising other rates, i.e. above the base rate, or being subsidised, i.e. below the base rate.

Due to the possible impact of the implementation of the Tariff Strategy design methodology for marine tariffs on certain “purpose-of-call” categories, specific cost benefit analyses is required to determine the required cross-subsidies in those categories. The full implementation of the Tariff Strategy tariff design methodologies will be reflected in the 2018/19 tariff book.

9. Information and Reporting Requirements

9.1. Quarterly Reporting

The Ports Regulator continues to expand its monitoring role and as such requires quarterly progress reports from the NPA (as per the Ports Regulator's templates). Based on the provisions of Regulation 16, as well as Directive 22, the NPA is required to submit to the Regulator the following:

- 9.1.1. All CAPEX projects (infrastructure and capital acquisitions) underway (to include, but not limited to, information pertaining to project stage, tender specifics, construction progress, project estimates and expenditures, etc.);
- 9.1.2. All acquisition of land and other capital assets (including motivation thereof);
- 9.1.3. All disposal/or removal of land and assets (including motivation thereof);
- 9.1.4. Lease Register setting out all lease information;
 - 9.1.4.1. Copies of all new agreements and licences entered into or issued in the quarter, as well as the supporting documentation thereof, including Sections 79s, 72s, 56s, 57s, and lease agreements (inclusive of all annexures, including but not limited to updated rentals and terminal operator tariffs); and
 - 9.1.4.2. All applicable B-BBEE certificates for the abovementioned licences and agreements;
- 9.1.5. Data, results and progress applicable to the implementation and monitoring of operator performance standards, as per TOPS/ MOPS/ ROPS/ HOPS;
- 9.1.6. Key performance indicators relating to port capacity, port performance, volumes and maintenance programmes per port; and
- 9.1.7. Updated NPA relevant annual debt stock levels as well as annual debt redemption payments itemised, as well as the relevant debt instruments and applicable interest/coupon rates since the inception of regulation, including the *effective* interest rates on any internal or external cash management or short term debt facility.

All quarterly progress information must be submitted to the Ports Regulator by no later than the end of the month after the end of the applicable quarter, based on the reporting templates provided to the NPA by the Ports Regulator on the 16th March 2016. The Ports Regulator reserves the right to amend these on an ongoing basis.

The Ports Regulator remains bound by the confidentiality provisions of the Act.

9.2. Equity and B-BBEE

As an initiative towards enhancing the Equity and B-BBEE requirements set out in the Act and its Regulations, the NPA is required to hold discussions with the Regulator concerning B-BBEE by 28 February 2017; furthermore, the NPA is required to make written submissions to the Regulator by 31 May 2017 on the following:

- 9.2.1. A strategy to promote and incentivise B-BBEE participation in port terminal operations and other port services (leases and licenses) through the use of cross-subsidies (in the public interest), and within the current revenue trajectory;
- 9.2.2. A plan and schedule for new concessions and the re-concessioning of an appropriate portion of existing State and private sector terminal operations, to promote transformation and greater B-BBEE economic participation in the port sector; and
- 9.2.3. A detailed and scheduled plan for the implementation of the new B-BBEE sector codes.

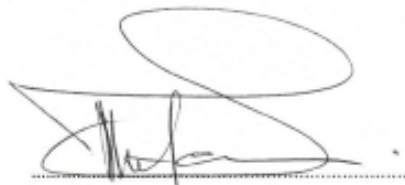
9.3. Historical Information required

All historical information referred to above, not yet submitted, must be submitted to the Regulator by no later than the end of the first quarter of 2017/18. The Regulator remains bound by the confidentiality provision of the Act.

9.4. Annual Financial Statements

As per current practice, a full set of audited annual financial statements must accompany all future tariff applications to the Regulator.

Please note: All information as stipulated in Section 9 must be provided to the Regulator in electronic format acceptable by the Regulator.



Mr. Thabadiwa Mufamadi
Chairperson: Ports Regulator of South Africa

30 November 2016