Record of Decision
2016/17

Tariff Application by the National Ports Authority for the Tariff Years 2016/17-2018/19

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1. **On 1 August 2015, 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 2016 to 31 March 2017, together with indicative tariffs for the periods 1 April 2017 to 31 March 2018 and 1 April 2018 to 31 March 2019.**

2. **After considering the application and the submissions by all stakeholders during the consultation period, and based on latest available data, the Ports Regulator declined the proposed average 5.9% tariff increase for the 2016/17 tariff year, concluding rather that an appropriate overall increase in average tariffs for the financial year 2016/17 is 0%.**

3. **The Ports Regulator further concluded that all cargo dues for 2016/17 are to remain at 2015/16 levels, i.e. a 0% increase, except marine services and related tariffs (Sections 1-8 of the Tariff Book, excluding Section 7 that deals with cargo dues) are to increase by 3.0% and full export container cargo dues are to decrease by 10%. Automotive tariffs will be adjusted as per item 4.**

4. **The Tariff Book will further be adjusted for the equalisation and therefore removal of the Automotive Volume Discount. All Original Equipment Manufacturers (OEM's) and other importers and exporters of vehicles, will receive the value of the maximum existing discount of 60% of total cargo dues irrespective of volumes from 1 April 2016 onwards, and the discount will fall away, being replaced by a single import tariff and a single export tariff.**

5. **In support of drought relief and its impact on food prices, maize cargo dues for the first 5 million tons in 2016/17 will be discounted by 50%.**

6. **All marine tariffs (Sections 1-8 of the Tariff Book, excluding Section 7 that deals with cargo dues) for existing commercial South African flagged vessels as well as commercial vessels registered in South Africa in 2016/17 will receive a 30% discount applicable year on year up to 31 March 2019. Vessels registered in South Africa in 2017/18 will receive a 20% discount up to 31 March 2019 and similarly a vessel registered in 2018/19 will receive a 10% discount up to 31 March 2019. The discount will thereafter be reviewed.**

7. **In line with the Multi-Year Tariff Manual of August 2014 the Ports Regulator projects that the indicative overall average tariff adjustment for the 2017/18 and 2018/19 tariff years will be within the inflation target band.**

ROD

1. The Tariff Application

The NPA requested a tariff increase of 5.9% for the 2016/17 tariff year. In addition, and in line with the Tariff Manual, the NPA applied for an indicative tariff of 12.74% and 7.63% for 2017/18 and 2018/19 respectively. This follows an application for 2015/16 of 9.47 after which the Regulator considering updated information granted a 4.8% average tariff increase.

Table 1: NPA Tariff Application and previous decisions

NPA Tariff Application overview					
WACC	Previous Year	15/16	Current Tariff Application		
Year	Tariff Application	ROD	16/17	17/18	18/19
Risk-free rate (nominal)	8.43%	8.43%	8.26%	8.17%	8.16%
Real risk free rate	2.58%	3.46%	2.23%	2.34%	2.33%
MRP	5.60%	5.40%	5.40%	5.40%	5.40%
Asset beta	0.50	0.50	0.50	0.50	0.50
Equity beta (using Hamada)	0.86	0.86	0.86	0.86	0.86
Gearing	0.5	0.5	0.5	0.5	0.5
Debt/equity ratio	100%	100%	100%	100%	100%
Cost of Debt	9.68%	9.68%	9.86%	10.07%	10.22%
Inflation forecast	5.70%	4.80%	5.90%	5.70%	5.70%
Tax rate	28.00%	28.00%	28.00%	28.00%	28.00%
Real Vanilla WACC	5.59%	6.38%	5.31%	5.56%	5.63%
Revenue requirements calculation					
Return on Asset	3745	4261	3902	4466	5022
Depreciation	1807	1791	1928	2117	2355
Opex	5020	5020	5487	5967	6503
Tax	964	768	1191	1072	1209
Total	11536	11840	12508	13622	15089
Clawback	-328	-581	-680	66	0
ETIMC		-150	67	0	0
Allowable Revenue	11208	11109	11895	13688	15089
Y/Y growth		-0.9%	7.1%	15.1%	10.2%
Real Estate	-2449	-2674	-2600	-2874	-3147
Marine Business Income	8759	8435	9295	10814	11942
Prior year's Revenue	7783	8759	8571	9295	10814
Volume Increase	0.028	0.043	0.024	0.032	0.026
	8001	9136	8777	9592	11095
Average Price Increase	9.47%	4.80%	5.90%	12.74%	7.63%

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 Directives[1] and the Regulatory Tariff Manual applicable to the period up to 2017/18 (the manual) (hereinafter jointly referred to as the 'Regulatory Framework').

Further, the Ports Regulator considered the submissions contained in the Application and all subsequent submissions, written and oral comments, received in the consultation process, including the responses thereto, as well as its own information and research. It must be noted that the information at the disposal of the Ports Regulator postdates the Application and as such some differences in calculation are due to the updating of data and forecasts.

[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.

3. The Methodology

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

The guidelines within that document were aimed at assisting the NPA with submitting an application with a three year view that will provide greater certainty in the ports sector. In addition, it assisted stakeholders in formulating responses to the application which assisted the Ports Regulator in making a decision. The publication of the guidelines increased regulatory certainty.

The approach 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 methodology that may impact on the sustainability of the South African ports system. This has been captured in the guidelines and taken into consideration. Whilst this has resulted in a deviation from the previous manual, specifically with regards to the methodology for determining the Market Risk Premium as well as the calculation of Depreciation in the previous year, a more strict interpretation of the Tariff Manual has been implemented in this assessment of the NPAs Tariff Application.

The NPA used the Tariff Manual to calculate and submit the application as set out below:

Revenue Requirement = [cost of capital x Regulatory asset base (RAB)]

+ operating cost
+ depreciation
+ taxation expense
+/- claw-back
+/- ETIMC

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

Although the Application achieved formal compliance with the Act, Regulations, Directives and the 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. 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 NPAs business.

The Applicant submitted its Tariff Application based on the Rate of Return methodology, as outlined in the Manual (the 'Revenue Requirement' approach). The Ports Regulator therefore decided to accept, in this Application, the general methodology that has been used by the Applicant in this instance; however, in some of the parameters, the Ports Regulator differed from the Applicant with respect to either the methodology or its application.

Further important key areas include: -

Directive 22(3)(a) requires that the NPA shall set out the manner in which the tariffs have been calculated, and the model used by the NPA for determining and calculating the tariffs. This has been fully complied with in this Application.

Directive 22(3)(b) requires that all operating costs, expenses and revenues incurred or generated from a port service or port facility, as well as the value of the capital stock related to such services or facilities, are to be declared in the Application. Greater disclosure than in previous applications was apparent, including the submission of confidential data, allowing the Ports Regulator to conduct a more thorough assessment.

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 7 of this ROD, will continue to apply on a quarterly basis.

Directive 22(3)(c) requires that the amounts to be invested and revenues that are to be utilised in port development, safety, security and environmental protection, must be provided, as well as (i) the manner in which the tariffs will affect the cost of doing business in the ports; and (ii)

the proposed profit margin or rate of return, together with the motivation to show why this margin or return is commensurate with risk.
The safety, security and environmental expenditure submitted were more detailed than in past applications; the Application, in line with the methodology as set out in the Regulatory Manual, fully complied with 22(3)(c)(ii).

Directive 22(6) requires that the NPA shall maintain such accounting and financial systems necessary to provide the Ports Regulator with sufficient information to verify the pricing principles and models used by the NPA to calculate tariffs.
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.

Directive 23(1) requires the Ports Regulator to consider whether the requested tariffs reflect and balance a range of considerations:

- 23(1)(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 Regulatory Manual.

- 23(1)(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, it is the focus of the Tariff Strategy, published on the 31st of July 2015 with implementation to commence on 1 April 2017. 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 will give effect to Directive 23(1)(b) more comprehensively.

- 23(1)(c) - ***the avoidance of discrimination, save where such 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.

- 23(1)(f) - ***the avoidance of cross-subsidisation, save where it is in the public interest.*** The comments with respect to the Tariff Strategy, as set out in the comments on Directive 23(1)(b) above, have reference under this assessment.

- 23(1)(g) - ***promotion of access to ports and efficient and effective management and operation of ports***. 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 8 outlines future information reporting requirements by the NPA to the Ports Regulator.

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:

Revenue Requirement = (cost of capital x Regulatory Asset Base (RAB) + operating costs + depreciation + taxation expense ± claw-back ±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:

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

5.1 The Regulated Asset Base (RAB)

The RAB submitted by the NPA was as follows:

Table 2: NPA Regulatory Asset Base calculation

	Tariff Application	ROD	NPA Tariff Application		
	2015/16	**2015/16**	**2016/17**	**2018/19**	**2019/20**
Opening RAB Value	**66 686**	**66 684**	**71 342**	**77 249**	**85 625**
Less: Transfer of Properties Outside of Port Limits			**-489**		
Adjusted RAB Value	66 686	66 684	70 853	77 249	85 625
RAB trended	**70 589**	**69 885**	**75 033**	**81 652**	**90 506**
Add Capex	3 584	3 485	4 144	6 090	7 377
Less Depreciation	**-1 807**	**-1 791**	**-1 928**	**-2 117**	**-2 355**
Closing RAB value	72 366	71 579	77 249	85 625	95 528
Average Opening and Closing	**69 526**	**69 132**	**74 296**	**81 437**	**90 577**
Less Working Capital	-2 526	-2 343	-813	-1 111	-1 374
RAB Final	**67 000**	**66 789**	**73 483**	**80 326**	**89 203**

5.2 RAB determined by the Ports Regulator

In the previous tariff determinations, the Ports Regulator accepted the Depreciated Optimised Replacement Cost method used by the Applicant to determine a starting Regulatory Asset Base. The Ports Regulator, in the past, has stated that it had a low level of confidence in the RAB determined through the 2008 Depreciated Original Replacement Cost (DORC) method, which gave rise to a steep increase in the asset values; however, regulatory certainty was required in the absence of any alternative. The Ports Regulator continues to hold this view, and has commenced a process to assess the application and appropriateness of these valuations for major assets, to inform subsequent assessments of RAB.

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 applied a number of adjustments (correcting the actual CAPEX resulted adjustments) for the subsequent years, to arrive at an opening balance for the 2016/17 year of R73 662 million.

In addition, the Ports Regulator has allowed the removal of R489 million in terms of land outside of port limits as applied for by the NPA, and a decision was taken not to effect the changes to the RAB retrospectively.

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

$$RAB_y = \frac{1}{2}\left[RAB_{c,y} + RAB_{o,y}\right] + w_y$$
$$RAB_{c,y} \;=\; RAB_{o.y}(1 + CPI_Y) + CWIP_Y - D_y$$

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 R1 942 million as opposed to the NPAs application of R1 928 million. Depreciation calculated by the Ports Regulator for the outer years total R2 126 and R2 331 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

FY 2016/17 R million	**RAB**
Opening Net Book Value (NBV)	71 411
Indexing	4 824
less: Depreciation	-1 948
add: Capex	3 055
closing NBV	78 134
Average Opening and Closing	74 773
Less: Working Capital	-927
RAB Final	**73 846**

5.3 Cost of Capital

The NPAs Application follows the Capital Asset Pricing Methodology (CAPM) to determine the cost of capital, as set out in the Regulatory Manual. The Applicant used the vanilla Weighted

Average Cost of Capital (WACC) approach. The Regulatory framework does not dictate or preclude this approach. The Application requested that the real vanilla WACC for the Applicant be assessed as being 5.31 % for 2016/17, and 5.56% and 5.63% respectively for the following years. Taking into account the higher inflation outlook, the Ports Regulator determined that the real vanilla WACC should be 4.64 %, when applying all its determinations on the elements below. The Ports Regulator also determined provisional WACC variables for the outer years as 5.04% and 5.40% respectively. The differences can mainly be ascribed to the lower inflation outlook.

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

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

Where:

k_d	=	pre-tax cost of debt
k_e	=	post tax cost of equity
g	=	gearing, which is debt over total capital

Cost of Equity

The requested real post-tax cost of equity in the Application was 6.87%. The Ports Regulator determined that the real post-tax cost of equity was 6.20%, which was determined using the subsidiary elements listed below. This resulted in a total calculated return on equity of R2 386 million available to the NPA as profit/maximum dividend.

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

$$\boldsymbol{k_e = R_f + \beta(MR - R_f)}$$

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

(i) Risk Free Rate

The 20 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 5 year period (from August 2009 to July 2014). The Risk Free Rate used in the assessment is therefore 8.26%.

(ii) Beta Co-efficient

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

(iii) Market Risk Premium

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

(iv) Gearing

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

(v) Cost of Debt

The Ports Regulator calculated the real cost of debt (Pre-tax) to be 3.36%.

(vi) Inflation

The National Treasury inflation forecast, as per the Budget Review February 2016 for the period, is 6.6% for 2015/16, 6.2% for 2016/17, and 5.9% for 2017/18.

Operating Costs

The Ports Regulator accepted the operating cost estimate for 2016/17. However, the Ports Regulator wishes to express its concern regarding the impact of continued under spending of CAPEX on operational expenses. 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 487 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 R650 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.

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 2016/17 and gives conditional approval for the 2017/18-2018/19 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.

Depreciation

The calculation of depreciation resulted in a depreciation allowance of R1 947 million, as opposed to the NPA application of R1 928 million. Estimated depreciation calculated by the Ports Regulator for the outer years totals R2 141 and R2 347 million respectively, with the differences mainly due to the higher inflation forecast.

Taxation Expense

The Ports Regulator accepted the corporate tax rate of 28% for the 2016/17 Tariff Year. As some uncertainty exists around the correct interpretation of the methodology related to the calculation of the tax allowance, the Ports Regulator used the pass-through tax approach, where the vanilla WACC was applied to the average RAB for the period under consideration, less the interest cost of debt. The corporate tax rate was used to determine the tax liability, which was treated as an expense in the RR calculation.
As the inclusion of ETIMC, claw-back and taxation allowances, as part of the Revenue Requirement in the tax calculation, may result in excessive volatility in future years, the Ports

Regulator determined that a simple pass-through tax calculated on the return on equity will be implemented up to the publication of a revised tariff methodology.
This resulted in a total taxation expense of R928 million for 2016/17, up from R748 million the previous year.

Volume adjustments

The Ports Regulator adjusted the volume forecast for the 2015/16 financial year taking into account the latest estimates available (including actual data for 11 of 12 months and latest estimates for the full year). This resulted in a revised tariff book revenue forecast of R8 551 million for 2015/16. This, as in the past, has included the decision to exclude all bilateral contracts in the calculation of revenue.

Claw-back

As the 2014/15 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 R533 million.

An interim claw-back (in favour of the NPA) was made in the 2015/16 tariff year (R -174 million), resulting in a residual claw-back of R707 million. The return on the residual claw-back in terms of the WACC rate for that period totals R28 million. The total residual claw-back for 2014/15 is therefore R735 million.

The expected claw-back calculated for the 2015/16 FY is R109 million. A provisional claw-back of R55 million, as well as the residual claw-back of R707million for FY 2014/15, results in a total claw-back of R680 million in the 2016/17 tariff year. (Please note: Differences due to rounding).

Table 4: Claw-back calculation

Transaction	R Million
Revised Total Claw Back 2014/15	-533
Interim Claw Back 2014/15 (Clawed Back in 2015/16)	-174
Total Claw Back for 2014/15 (including interim claw back)	-707
Estimated claw Back 2015/16	109
50% Claw Back 2015/16	55
2016/17 Claw Back calculation	
Final Claw Back 2014/15	-707
Return on Claw Back 2014/15	-28
Provisional claw back 2015/16	55
Net Claw Back 2016/17	**-680**

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

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 continue to retain the Excessive Tariff Increase Margin Credit (ETIMC) inside of the NPA through an adjustment to revenue allowed in the year it is either added to required revenue or through a reduction in required revenue to offset against future large, but justified, tariff increases resulting from the capital expenditure increases envisaged in the NPAs Long Term Port Planning Framework but not as yet articulated to a level of detail and phasing for accurate prediction.

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	2298
2013/14 Average ETIMC	1609
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	**2 536.5**

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 ROD. 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.

6. 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
Return on Capital	3420
Depreciation	1948
Operating Expenses	5487
Tax Expense	889
Claw Back	-680
ETIMC	0
NPA Required Revenue 2016/17	11064
Real Estate Business Income	2600
Marine Business Income	8457
Total Estimated Revenue	11057
Revenue (Shortfall)/Surplus 2016/17	-7

The forecast of a revenue shortfall of R7 million is partly due to an additional cost relating to the increase of the Automotive Industry Volume Discount for all OEMs, and other importers and exporters of vehicles, to 60% of total cargo due costs, i.e. the volume threshold to receive the maximum 60% volume discount will be removed from 1 April 2016.

The marine business income that is forecast above is the current tariff book marine revenue modelled for a weighted average volume growth rate of 1.7% for all cargo types and marine services for the period.

The following assumptions are included in the tariff assessment:

- **Risk Free Rate** **8.26%**
- **Market Risk Premium** **5.4%**
- **Gearing** **0.5**
- **Beta Coefficient** **0.5**
- **Revenue Effect of Volume growth 2016/17** **1.7%**
- **Inflation** **6.6%**

Whilst the NPA did request specific tariff increases in addition to the general adjusted tariff increase of 5.9%, the application more specifically requested a 6.8% tariff increase in marine charges to shipping lines, 5.9% increase in bulk exports and 5.6% 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 decided to approve the following specific changes applicable to the tariffs as set out in the Tariff Book:

All cargo dues for 2016/17 are to remain at 2015/16 levels, i.e. a 0% increase, except for marine services and related tariffs (Sections 1-8 of the Tariff Book, excluding Section 7 that deals with cargo dues) are to increase by 3.0% and full export containers to be reduced by 10%.

The Tariff Book will further be adjusted for the equalisation and therefore removal of the Automotive Volume Discount. All Original Equipment Manufacturers (OEM's) and other importers and exporters of vehicles, will receive the value of the maximum existing discount of 60% of total cargo dues irrespective of volumes from 1 April 2016 onwards, and the discount will fall away, being replaced by a single import tariff and a single export tariff.

The tariff changes were informed by the ongoing research conducted by the Ports Regulator which benchmarks South African port prices with global samples. The relative movement of tariffs is similar to the changes effected in the 2013/14, 2014/15 and 2015/16 decisions. The adjustments do take a higher inflation, as well as the expected under recovery in 2015/16, into account and due to the expected subdued economic activity over the tariff period, the Ports Regulator will, if required, use the ETIMC to maintain overall average tariffs close to the inflation target band, as defined by the South African Reserve Bank mandate. Further, the effective removal of the automotive volume discount scheme, by allowing all imports and exports to qualify for the maximum discount, despite impacting negatively on the expected revenue for the 2016/17 tariff year, gives effect to the intention of the Tariff Strategy and the decision in the GMSA vs NPA Tribunal case.

Because of the ongoing Tariff Strategy implementation process and taking into consideration the various comments of stakeholders, the Ports Regulator determined that the specific changes for certain commodities will be implemented. It is the Ports Regulator's view that, in due course, the comprehensive restructuring through the full implementation of the ten year Tariff Strategy more accurately deals with the price anomalies evident in the tariff structure in order to further realign the Tariff Book.

7. Tariff Strategy Implementation

The Tariff Strategy is due to be implemented in the 2017/18 tariff year with methodological testing and simulations due to be 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, 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 R6.99 in today’s prices.

Tariff Strategy	**Unit**	**Updated Tariff Strategy “base rate” i.e target tariff to be achieved over ten year implementation**	**2016/17 ROD based NPA tariff book rate**	
Cargo Type			**Import**	**Export**
Break bulk	**Tons**	**R 36.22**	**29.72**	**29.72**
RoRo's	**Tons**	**R 50.34**	**225.83**	**89.1**
Liquid bulk	**Tons**	**R 16.59**	**29.08**	**29.08**
Dry bulk	**Tons**	**R 7.49**	**6.99**	**6.99**
Containers	**TEU**	**R 322.66**	**2046**	**673.7**

No distinction are 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.

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8. Information and reporting requirements

8.1. Quarterly Reporting

The Ports Regulator continues to expand its monitoring role and as such requires quarterly progress reports as per the Ports Regulator's templates, from the NPA on the following:

8.1.1. All CAPEX projects (infrastructure and capital acquisitions) underway (to include, but not limited to, information pertaining to project stage, tender specifics, construction progress etc.);

8.1.2. All acquisition of land and other capital assets (including motivation thereof);

8.1.3. All disposal/or removal of land and assets (including motivation thereof);

8.1.4. 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;

8.1.5. All applicable B-BBEE certificates for the abovementioned licences and agreements;

8.1.6. Data, results and progress applicable to the implementation and monitoring of operator performance standards, as per TOPS/ MOPS/ ROPS/ HOPS;

8.1.7. Key performance indicators relating to port capacity, port performance, volumes and maintenance programmes per port.

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 provision of the Act.

8.2. Historical Information required

8.2.1. All 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.

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 2016/17. The Regulator remains bound by the confidentiality provision of the National Ports Act.

8.3. Annual Financial Statements

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

Please note: All information as stipulated in section 8 must be provided to the Regulator in electronic format.

....   26/02/16.

Mr. Thaba Mufamadi   Date

Chairman of the Ports Regulator of South Africa