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2023 BUDGET REVIEW

ESKOM DEBT RELIEF

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

ESKOM DEBT RELIEF

INTRODUCTION

Since last year, government has been considering measures to relieve a portion of Eskom's unsustainable R423 billion debt. The goal is to strengthen the utility's balance sheet, enabling it to restructure and undertake the investment and maintenance needed to support security of electricity supply. Following broad consultation, government proposes a debt-relief arrangement covering R254 billion of Eskom debt (about R168 billion in capital and R86 billion in interest) over the next three years, with strict conditions to safeguard public money.

This annexure outlines the proposed arrangement, which is being undertaken in the context of broader electricity reforms discussed in Chapter 2.

KEY CONSIDERATIONS IN STRENGTHENING THE BALANCE SHEET

In assessing Eskom's debt position, government considered several factors:

- The current approach of providing R230 billion over 10 years does not sufficiently address Eskom's underlying solvency or liquidity challenges.
- Eskom cannot reasonably service its debt from its own internally generated cash flows.
- The R350 billion of guaranteed debt, which is at risk of default, is a contingent liability, raising South Africa's risk premium and borrowing costs.
- Addressing the debt effectively will enable much-needed investment in critical transmission and other infrastructure, and proper maintenance of plant and equipment.

With these factors in mind, the National Treasury worked with Eskom and others to develop a debt-relief arrangement that is equitable and fair to all stakeholders, and which enables government to manage the resulting effect on the national finances.

Eskom and the National Treasury developed their own financial models covering various debt-relief scenarios. These models also examined the effect of a range of variables on Eskom's long-term financial position, including tariffs, operational efficiencies, disposal of non-core assets, capital investment and maintenance requirements. The results informed the proposed debt-relief quantum and the package of associated measures.

The modelling exercise included an assessment of financial benchmarks that would enable Eskom to operate sustainably, without continued transfers from the national budget. In developing these financial benchmarks, the National Treasury consulted World Bank studies examining similar utilities in other countries, and engaged with Eskom's finance team and external legal and financial advisors for their input.

DEBT-RELIEF ARRANGEMENT

Over the next three years, government will provide Eskom with debt relief amounting to R254 billion. This will take the form of advances of R78 billion in 2023/24, R66 billion in 2024/25 and R40 billion in 2025/26. These amounts represent Eskom's full debt settlement requirement over the next three years. They will be financed through the R66 billion mediumterm expenditure framework (MTEF) baseline provision announced in the 2019 Budget, and R118 billion in additional borrowing over the MTEF period. Additionally, in 2025/26, government will directly take over up to R70 billion of Eskom's loan portfolio.

Chapter 7 discusses the impact of this arrangement on government's gross borrowing requirement and funding strategy.

Key aspects of the debt-relief arrangement include the following:

- Funds will be advanced when Eskom's debt settlements (interest and redemptions) fall due on an annual basis.
- The advance of funds will take the form of an interest-free subordinated loan, to be settled in Eskom shares rather than cash, allowing Eskom to better manage its liquidity position. Loan advances from government to Eskom will be conditional on the repayment of pre-identified Eskom debt instruments.
- Strict conditions have been developed to safeguard public money. The Minister of Finance will enforce these conditions, and upon compliance, will allow the entity to convert the loan to government-owned equity.
- The debt-to-equity conversion will result in an immediate improvement in Eskom's balance sheet.
- Eskom will commit to adhering to conditions set by government within three years, commencing from the date of the first advance or 1 April 2023 (whichever comes earlier).
- Quarterly meetings between the National Treasury, the Department of Public Enterprises and Eskom will take place to discuss progress made in achieving conditions.
- A failure by Eskom to achieve and/or adhere to specific conditions will cause the loan amount from that quarter to be repaid to the National Revenue Fund at market rates. Prior to such repayment, government will meet with Eskom to determine the cause of and timing to rectify non-compliance.
- Government guarantees for Eskom debt will be reduced accordingly. Further terms and conditions of the loan will be published by the National Treasury by 31 March 2023.

CONDITIONS APPLICABLE TO DEBT RELIEF

In addition to the governing features and requirements set out above, the Department of Public Enterprises and the National Treasury have agreed various operational conditions that Eskom is required to implement. These will be included in Eskom's corporate plan, to be overseen by its board. Furthermore, Eskom is required to comply with the following proposed conditions on a quarterly basis:

- **Eskom's capital expenditure is restricted to transmission and distribution**. The only capital expenditure that may be undertaken for generation relates to minimum emissions standards, flue-gas desulfurisation and required maintenance. No other greenfield generation projects will be allowed during the debt-relief period.

- **Eskom may not use proceeds from the sale of non-core assets for capital and operating needs**. All proceeds from the sale of non-core assets, including the Eskom Finance Corporation and any property sales, will be used for the debt-relief arrangement.
- **No new borrowing will be allowed** from 1 April 2023 until the end of the debt-relief period, unless written permission is granted by the Minister of Finance.
- **Eskom's guarantee framework agreement** for the R350 billion facility (which expires at the end of March 2023) **will reduce** in line with National Treasury recommendations.
- **Positive equity balances in Eskom's derivative contracts** (swaps/hedges) **cannot be used to structure new debt or loan agreements** without the approval of the National Treasury. Nor can any such balance be used as "margin financing" for another derivative contract or derivative overlays.
- **The debt relief can only be used to settle debt and interest payments**.
- **Eskom may not implement remuneration adjustments that negatively affect** its overall **financial position** and sustainability.

TARIFFS AND MUNICIPAL DEBT

The National Treasury recognises that debt relief alone will not return the utility to financial sustainability.

A key assumption considered in the debt-relief determination is the implementation of the recent tariff increase approved by the regulator (18.65 per cent in 2023/24 and 12.74 per cent in 2024/25). Without these increases, the debt-relief arrangement is not sustainable.

Outstanding municipal debt, which has grown to R56.3 billion as at 31 December 2022, up from R44.8 billion in March 2022, is a systemic challenge to the electricity industry as a whole. The National Treasury is finalising a proposal to address this debt. The key elements under discussion are a conditional debt write-off, legal and regulatory changes to help Eskom resolve non-payment for services, the continuation of measures to prevent debt build-up (such as installation of prepaid meters), and national government initiatives to improve municipal revenue management.