

Headline	With improved financials comes greater responsibility for water		
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With improved financials comes greater responsibility for water operators

BY KAMARUL AZHAR

The water tariff hikes across Peninsular Malaysia and Labuan, which have been approved by the National Water Services Commission (SPAN), come with specific key performance indicators (KPIs) that the state water operators will have to meet.

This is to ensure that the water supply service continues to be improved now that domestic users are required to pay more. And this time, SPAN, the regulator of the water services industry, is wielding its power as provided for under the Water Services Industry Act 2006 (WSIA).

"It is actually included under Section 10 of the WSIA that SPAN can impose KPIs on all water operators. These KPIs cover the technical and all other aspects that we want them to adhere to," SPAN CEO Datuk Ahmad Faizal Abdul Rahman told a media briefing on the water tariff hikes announced last week.

"There are a few penalties ... among them are that licences can be withdrawn and that there are also penalties and fines that can be imposed. So in short, there are ways that we can use to monitor the operators."

Section 10 of the WSIA refers to the requirement for the individual licensee to comply with the prescribed conditions of the individual licence and any special conditions imposed by the minister. These are spelt out in Subsection (1) of Section 10 of the WSIA.

Under Subsection (2) of Section 10, the WSIA reads that "an individual licensee who fails to comply with any condition of an individual licence under Subsection (1)

commits an offence and shall, on conviction, be liable to a fine not exceeding RM500,000 or to imprisonment for a term not exceeding five years or to both."

However, Faizal did not spell out in what situation or conditions SPAN would use its powers under Section 10 of the WSIA. Nevertheless, he stressed that the commission and the federal government are allowing the water operators room to improve their services.

"There is a process under the act [that allows] SPAN to appoint anyone to take over the operations of a water service operator. The operator will remain the same, but the people managing [it] will be appointed by SPAN."

"Say, an operator has its management and board, and when SPAN takes over, we have the right to replace all or where applicable. We have never done this in the past since it is a chicken and egg situation that has been holding back the water operators," said Faizal.

Water operators in many states have not had their tariffs for domestic consumption increased for years, which resulted in under-investment in the water supply infrastructure. However, arguably, some would ask why consumers should pay for poor services to start with?

Nevertheless, it is clear that water is not free and should not be taken for granted.

The state of water supply in Peninsular Malaysia



According to SPAN, the real cost of water supply in the country is RM1.75 per cu m. This includes the cost of leasing the water assets from Pengurusan Aset Air Bhd (PAAB).

Often, the capital investments required to develop water treatment and supply infrastructure are huge. Although most of these investments are done by the federal-funded PAAB, the water operators would still need to lease these assets.

As a case in point, the Sungai Rasau wa-

ter treatment plant (WTP) in Selangor requires investment of up to RM5.5 billion over two phases. Granted, the Sungai Rasau WTP will be the largest in Southeast Asia, with the capacity to produce 1,400 million litres per day (MLD) of water.

Even the development of the smaller Labohan Dagang WTP (Phase 2) in Kuala Langkat, with a capacity of 200 MLD, is estimated to cost RM480 million. The development of these assets will lead to a higher cost of supplying water to consumers in the state, Kuala Lumpur and Putrajaya.

For example, Pengurusan Air Selangor Sdn Bhd, the water service operator for Selangor, Kuala Lumpur and Putrajaya, spent RM732.29 million in 2022 on finance and leasing costs. This is the biggest operational cost item for Air Selangor, making up 28.6% of the total in 2022.

Therefore, many state water operators with limited financial resources find it hard to upgrade the water supply infrastructure. This has resulted in inadequate water supply, or low quality water being supplied, or even the loss of revenue through burst pipes and leaks.

When water operators do not have the financial capacity to maintain and upgrade the aged and ageing infrastructure, especially pipes, water leakage leads to high non-revenue water (NRW). This means the water operator does not get to "sell" as much treated water as it should have.

Therefore, the cycle continues — water tariffs kept lower than the cost of production leads to low revenue for water operators, which then leads to aged infrastructure not being upgraded, resulting in inefficient or low quality water supply.

In a statement announcing the increase in water tariff last Wednesday, SPAN says the average increase of 22 sen per cu m is still low, and still insufficient to cover the actual cost (or total, including capital expenditure [capex]) of water services, which averaged RM1.75 per cu m in 2022.

The average realised tariff in 2022 was RM1.43 per cu m, while the average operational cost was RM1.16 per cu m. While, on average, the tariff as at 2022 has covered operational costs, this does not reflect the actual situation in each state.

"They (the water operators) say that they can't afford to pay for their operational costs, let alone improve their service. So now that we have approved their requests for higher water tariffs, and once they have better financial standing, we expect them to improve."

"We understand [that] without financial sustainability, there is only so much they can do. But now, we allow them to have financial sustainability, at least to

TABLE 1

Water supply operators' performance in 2022							
STATE	MAIN KPI						
	SUPPLY COVERAGE		RESERVE MARGIN (%)	WATER PRESSURE (%)	NON-REVENUE WATER (NRW) (%)	COMPLAINTS	
	URBAN (%)	RURAL (%)				RESPONSE TO COMPLAINTS (%)	RESOLUTION OF COMPLAINTS (%)
Johor	100	99.9	11.5	99.8	26.3	99.6	99.6
Kedah	100	96.5	0.0	90.0	51.4	100	94.0
Kelantan	67.0	72.0	0.0	51.9	53.7	100	38.9
WP Labuan	100	100	21.5	100	36.8	100	99.0
Melaka	100	100	4.7	100	33.3	75.0	68.7
Negeri Sembilan	100	99.6	15.2	99.96	35.1	100	87.0
Pulau Pinang	100	99.8	26.35	98.6	26.3	99.97	97.08
Pahang	100	99.0	14.8	95.0	47.7	100	73.2
Perak	100	99.6	27.9	96.0	30.3	92.3	90.7
Perlis	100	99.0	8.4	74.0	62.4	100	100
Selangor	100	99.78	12.02	85.0	27.8	100	95.7
Terengganu	100	99.8	31.8	98.1	38.7	100	93.9

KPI	GOOD (%)	SATISFACTORY (%)	UNSATISFACTORY (%)
Supply coverage	90-100	60-89	0-59
Reserve margin	>15	5-14	<5
Water pressure	>80	50-79	<50
NRW	<15	15-40	>40
Complaints	>80	50-79	<50

SPAN monitors the performance of the water operator based on the set KPIs, through annual reports and periodic auditing

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TABLE 2

KPIs for water supply operators for 2023 and 2024

STATE	MAIN KPI TARGETS ¹												COMPLAINTS (%)			
	SUPPLY COVERAGE (%)				RESERVE MARGIN ² (%)		WATER PRESSURE (%)		NON-REVENUE WATER (NRW) ³ (%)				RESPONSE TO COMPLAINTS		RESOLUTION OF COMPLAINTS	
	2023	2024	2023	2024	2023	2024	2023	2024	2023	2024			2023	2024	2023	2024
Johor	100	100	99.5	99.5	10.0	15.0	99.0	99.0	25.5	25.0			99.5	96.5	99.3	70.0
Kedah	100	100	98.1	96.5	0	0	90	90	40	46.4			100	100	97.0	96.0
Kelantan	68.0	75.0	70.0	78.0	16.0	0	68.30	55.61	44.4	50.2			100	100.0	60.56	50.0
WP Labuan	100	100	100	100	16.8	25.0	100	100	33.0	30.0			100	100	98.0	98.0
Melaka	100	100	100	100	14.64	13.73	100	100	27.5	26.5			100	100	95.0	95.0
Negeri Sembilan	100	100	99.5	99.6	15.9	10	99.80	99.9	31.0	37.0			100	100	90.0	90.0
Pulau Pinang	100	100	99.8	99.8	20.0	20.0	95.0	95.0	22.9	22.7			95.0	95.0	95.0	95.0
Pahang	100	100	99.0	99.0	10.64	10.64	94.0	94.0	46.50	45.50			100	100	95.0	95.0
Perak	100	100	99.6	99.6	29.6	28.5	95.0	95.0	29.5	29.0			92.0	92.0	90.0	90.0
Perlis	100	99.7	100	99.7	21.7	21.8	86.5	87.0	63.5	63.0			100	100	100	100
Selangor	100	100	99.98	99.98	1.9	0	91	92	27.0	26.0			100	100	96.5	100
Terengganu	100	100	99.8	99.8	20.69	17.62	98.0	98.0	35.9	35.0			100	100	98.5	98.5

NOTES:

KPIs are set based on:

1 – Previous year's performance as baseline

2 – Projected completion of new WTPs or upgrading of existing WTPs, as well as reduction in NRW

3 – Implementation of NRW-reduction programmes including pipe replacements

cover the opex (operating expenditure), so we want to see improvement. If still no improvements are being made, then, with the approval of the minister, we can take the drastic action [of revoking their licences]," said Faizal.

Even Air Selangor, which is the biggest water service operator in the country, has sometimes failed to meet SPAN's KPI. For example, in 2022, Air Selangor's NRW of 27.76% was short of the 27% target set by SPAN. The company's average water reserve margin of 12.02% in 2022 was also short of the targeted 18.11%.

What are the costs of a water supply operation?

It is clear that water is not free, even when a supplier is wholly owned by the state government. Water resources, which are controlled by each state, are one of their major sources of income. For example, in 2022, Air Selangor paid RM401.4 million to purchase water from the state, making up about 16% of its operational expenditure in 2022, slightly higher than 15.3% in 2021.

Another cost of water supply often overlooked is the cost of electricity. With tariffs being stagnant for so long — in the case of Pahang for 40 years — the electricity cost has been absorbed by the operators.

According to SPAN, between 2018 and 2023, electricity cost per unit increased at a compound annual growth rate of 10%, while the average tariff increased by just 2% during the same period. This means that the increase in electricity tariff has not been passed on to consumers.

Air Selangor's electricity costs amounted to RM276.32 million in 2022, compared with RM232.97 million in 2021, making up 10.8% of the company's operational cost in 2022.

Therefore, under the new tariff-setting mechanism, the government has also decided that the water tariff rates set by the water operator and SPAN include the energy surcharge charged by Tenaga Nasional Bhd on the operators for the previous year.

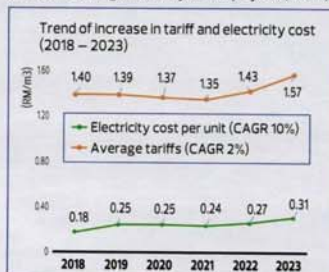
This is akin to Tenaga's imbalance cost pass-through mechanism, whereby a higher cost of fuel that the national electricity supply company is charged in the previous six months is passed through to consumers in the succeeding six-month period.

Repairs and maintenance is another ma-

Tariff hikes needed

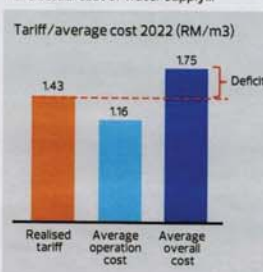
Average annual increase of 3.6% required to cover operational costs

Electricity cost increased by 10% (CAGR) compared with tariff setting which only went up by 2% (CAGR)



The calculation of the cost is based on the actual usage (billed) and actual and projected financials (2023)

The current tariffs do not cover the actual cost of water supply...



jor expenditure for water operators. In 2022, Air Selangor spent RM452.88 million on repairs and maintenance, making up 17.7% of the operator's total opex during that year.

Improvement projects being planned and KPIs

As mentioned, the increase in water tariff comes with specific infrastructure improvement projects to be implemented by the water operators. The progress of these projects will be closely monitored by SPAN to ensure that the additional cash flow will be used for the improvement of the service.

The tariff hikes will result in an increase in annual revenue of RM105 million for Air Selangor, RM86 million for Perbadanan Bekalan Air Pulau Pinang (PBAPP) and RM91.2 million for Ranhill SAJ Sdn Bhd — Johor's water operator.

In Selangor, the water tariff hike will allow Air Selangor to implement the development of the Sungai Rasau WTP project, which is expected to be completed by 2026, apart from the upgrading of pipes to reduce NRW.

In Penang, PBAPP, a subsidiary of Bursa-listed PBA Holdings Bhd, will repair the dissolved air flotation (DAF) system at its Sungai Dua WTP, which is expected to be completed this year, as well as replace pipes to reduce the state's NRW through 2028.

Ranhill SAJ — an 80:20 joint venture between Ranhill Utilities Bhd and Syarikat Air Johor Sdn Bhd — plans to use the additional financial capacity to solve the issue of reserve margin in the Johor Bahru district through the development of the Sultan Iskandar WTP, among others.

These are just some of the major infrastructure improvement projects that are planned by the bigger water operators. The smaller ones, such as Syarikat Air Darul Aman Sdn Bhd (SADA), the operator for Kedah, stands to gain an additional RM30 million in annual revenue from the tariff hike.

However, for the states where the water service industry is already quite dire — Kelantan, with its NRW at an eye-watering 53.7% as at 2022 and Kedah, with its reserve margin of 0% — the tariff hikes alone will not be able to help alleviate the situation.

The states will still need the support of the federal government through budget allocations, grants or loans to improve their water infrastructure. The federal government allocated RM1.1 billion this year for the improvement of water infrastructure, especially for Sabah, Labuan and Kelantan.

In his budget speech in parliament last October, Prime Minister Datuk Seri Anwar Ibrahim said that the first phase of the Machang WTP construction project in Kelantan, with a capacity of 250 MLD, will be

implemented under the special allocation.

It is not known whether this allocation has been taken into account as part of improvement projects planned along with higher water tariffs.

For the Kelantan government and politicians, this is far from enough to solve the state's water woes. The water situation in Kelantan has been used as political fodder on both sides of the aisle.

Politicians in Kelantan, including former deputy menteri besar Datuk Mohd Amar Nik Abdullah, said the water woes in the state are due to a lack of budget allocations to upgrade and repair infrastructure in the state.

In May last year, Nik Nazmi Nik Ahmad, the federal minister then responsible for water infrastructure and services, said that while allocation is an issue, inefficiencies in the management of Air Kelantan Sdn Bhd (AKSB) need to be improved.

In response, AKSB said that, based on the company's 10-year master plan for the improvement of water services in the state, it requires RM5.03 billion of capital expenditure. The plan includes RM1.7 billion to reduce NRW, RM2.1 billion to build off-river storage, and RM300 million to upgrade existing WTPs.

Then in August, Nik Nazmi said that the federal government does not discount the possibility of taking over the management of AKSB if the water situation in the state continues to show no improvement, or deteriorates.

In response, Datuk Seri Tuan Ibrahim Tuan Man, former minister of Environment and Water, said that the federal government should only assist AKSB, not take over the management or revamp it, to solve the state's water woes.

According to SPAN data, only 73.9% of the people in Kelantan are supplied with water by AKSB, the lowest level among the peninsular states and Labuan. Its reserve margin of 3.9% as at 2022 is also the second lowest after Kedah's 0%.

With the new tariffs, SPAN's KPI for AKSB to achieve supply coverage of 75% in urban areas in Kelantan, compared with 68% last year, while the coverage in rural areas should reach 78% this year, from last year's 70%. (See Table 2.)

As expected, there are murmurs of protest against the water tariff hike. The reality is this: the country's ambition to become a high-income economy will remain a pipe dream if the basic infrastructure of adequate water supply is not addressed by the government, both at the Federal and state levels. ■