

PRINS ALBERT MUNICIPALITY

COST OF SUPPLY STUDY REPORT

2026/2027



1. INTRODUCTION

Prince Albert Municipality is responsible for the sustainable provision of basic municipal services to its community in a manner that is financially viable, equitable, and compliant with applicable legislation. In terms of the MFMA (Act No. 56 of 2003), the MSA (Act No. 32 of 2000), and the MBRR, municipalities are required to ensure that tariffs charged for services are informed by the actual cost of providing those services.

A critical first step in understanding the operational performance of an electricity distributor is to conduct a Cost of Service (COS) study, also sometimes referred to as a Cost to Serve (CTS) study. The objective of this study is to assist Prince Albert Municipality in setting cost-reflective tariffs that promote financial sustainability while remaining affordable to consumers. The study further supports informed decision-making, enhances compliance with relevant guidelines, and strengthens the municipality's ability to balance revenue generation with socio-economic considerations, including the provision of basic services to indigent households. To support this objective, the National Energy Regulator of South Africa (NERSA) has developed a COS Framework for all licensed electricity distributors ("licensees") in the country. This framework serves as a guideline for licensees when conducting their own COS studies. The COS study, using the 2024/2025 period as the base year, was conducted in accordance with and in compliance with the NERSA COS Framework.

2. STUDY AREA OVERVIEW

Prins Albert Municipality is a local municipality found in the South African province of Western Cape, and it has a population of 17 836. The total energy sales of the municipality were 7 868 823 kWh in the 2024/25 financial year. The composition of sales per category for the 2024/25 were as follow:

Consumer Classification	Sales (kWh)		Number of Consumers
	Actual 2024/25	% Sales	Actual 2024/2025
Domestic (pre-paid)	2 537 923.00	32.25	892
Domestic (conventional)	1 743 479.00	22.16	224
FBE	1 896 001.00	24.1	970
Commercial (conventional)	1 601 331.00	20.35	21
Commercial (pre-paid)	90 089.00	1.14	14
TOTAL	7 868 823.00	100	2121

Table 1 Municipal energy sales per customer category

3. COS STUDY METHODOLOGY

The Prince Albert Municipality's Cost of Supply (COS) study is a sophisticated analysis that fully incorporates all requirements of NERSA's current COS framework while also extending beyond it to accommodate electricity distribution businesses transitioning to a more infrastructure availability-based model.

The NERSA Cost-Plus methodology has been employed for both the wire and retail business revenue requirement determinations. The model includes the functionality to utilize either the allowable return on the regulated asset base or asset values annuitized at selected discount rates to calculate the revenue requirement of the wires business.

The COS study is designed as a multi-year model, spanning three years, with each year defined as follows:

- Year 0 (FY 2024/25): The input test year, based on the most recently audited AFS.
- Year 1 (FY 2025/26): The current year in which the study is being conducted.
- Year 2 (FY 2026/27): The subsequent year for which tariffs are being designed.

This multi-year approach introduces several complexities, particularly in the forecasting of costs across different years, but it also offers significant benefits to the overall analysis.

4. OVERVIEW OF COS STUDY KEY RESULTS

The following key results were noted from Prince Albert Municipality's Cost of Supply (COS) study:

Revenue Requirement:

- The revenue requirement for FY25/26 is estimated at R28 139 562 (excluding the impact of subsidies), up from R22 041 885 million in FY24/25.
- Network-related costs, including network repairs and maintenance, depreciation, cost of losses, and other OPEX costs, dominate the wires business expenses.
- For the retail business, energy purchases from Eskom represent the largest cost component.
- Overall, approximately 73% of total electricity costs are incurred by the retail segment, with the remaining 27% attributed to the wires business.

Cost Functionalisation:

- Energy purchases are the most significant cost component, surpassing other costs such as OPEX and surplus.
- CAPEX costs contribute minimally to the overall cost breakdown each year, due to the rate of return for the analysis being assumed at 2%.

Cost Classification:

- Energy purchases and the cost of losses comprise the energy-driven costs, with the highest costs incurred during the Low Season and standard TOU periods, mainly because the Low Season spans a larger portion of the year.
- Demand-driven costs include depreciation, network repairs and maintenance, and energy purchase demand-related costs, with the Low Season being the period of greatest demand-driven costs. It should be noted that the municipality will need to make provisions for capital replacement/development to ensure sustainable growth.
- Customer-driven costs are associated with providing the electricity distribution service, including expenses such as salaries.

Cost Allocation:

- The domestic customer category bears the largest proportion of costs, followed by commercial customers.
- Differences in costs among customer classes are primarily driven by variations in voltage of connection points, load factors, coincidence factors, and average specific consumption.

COS Results:

- Under the current rate regime, 83.7.10% cost reflectivity is achieved for FY2026/27.
- There is a mismatch between the structure of the revenue breakdown and the cost breakdown.
- A 27.7% increase, coupled with improvements in the tariff structure, would achieve cost-reflective rates for FY2026/27.
- Restructuring of tariffs will be considered during the 2027/28 Nersa tariff application.

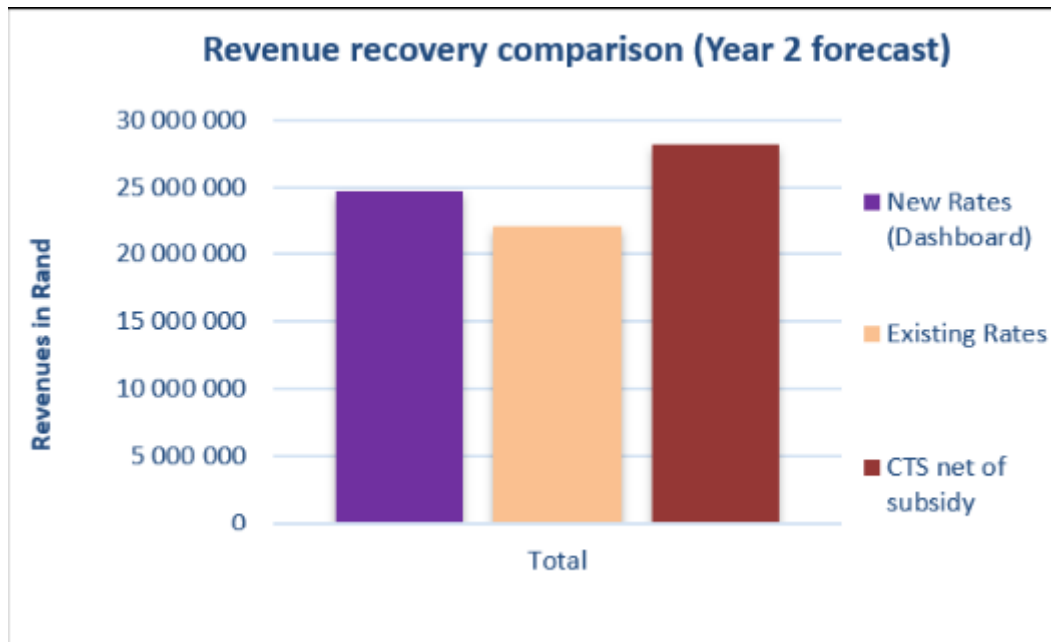


Table 2 BAU revenue comparison (FY26/27 forecast)

5. COST STUDY ANALYSIS

Energy purchases analysis

The municipality purchases all its energy from Eskom through a single point of delivery (POD). The COS model captures the tariffs for this POD as well as the volumes purchased at the intake point.

COS models and revenue forecasts are always sensitive to sales forecasts. The Prince Albert Municipality COS model assumes a nominal increase for Year 1 and Year 2, followed by a 1% annual increase in kWh sold. This projected sales increase is not based on recent historical data, which was severely impacted by load shedding, but rather on the expectation that load shedding will subside over time.

It should be noted that the amounts disclosed are based on the audited Annual Financial Statements for the financial years mentioned above. It is also important to note that the AFS accounts for accruals covering electricity sold but not yet invoiced, with bulk electricity usage based on units relevant to the specific reporting period, which may not necessarily align with issued invoices, or the information disclosed in the D-Forms. However, any differences should be immaterial in nature.

The revenue on the other hand showed the following trend:

- The revenue from electricity sales has steadily increased over the years, reaching a high of R22 709 865 in 2024/25 with no increase from the 2023/24 financial year in electricity tariffs. With the increase in electricity tariffs for the 2025/2026 financial year, the municipality expects a further increase in revenue from electricity sales.

Total energy purchased and total energy sales has stabilised with the decline of loadshedding clearly visible. Energy losses have been under control in the last audited financial year with the loss standing at 5.99%.

Revenue requirement analysis

Section 3.2.1.1 of the NERSA COS framework addresses the revenue requirement and states that NERSA adopted the Cost-Plus Methodology as an interim approach for implementation by licensees, including small licensees with limited capacity and database challenges. This is because other regulatory methodologies, such as the rate of return, price cap, revenue cap, and yardstick regulation, would be difficult to implement for several reasons, including the potential struggle of licensees to maintain proper accounting and property records, among others.

Even though these are historical costs (with the test year for the study being FY2024/25), it is important to adjust these costs for prudence and efficiency to ensure that when they are allocated to different customers, the allocation reflects the proper costs. The framework covers key elements of the revenue requirement, including purchases, operating costs, repairs and maintenance, depreciation, and return on assets or interest on loans.

Figure 4 below provides a breakdown of the revenue requirement based on the various functions within the electricity value chain, divided between the wires and retail/trading segments. The data is based on a forecast for the financial year 2025/26 (Year 2).

Several key points can be drawn from the figure:

- The revenue requirement for FY2026/27 is estimated at R29 491 507 (excluding the impact of subsidies).
- The wires costs are primarily driven by network-related expenses, including network repairs and maintenance, depreciation, and the cost of losses.
- For the retail business, the dominant cost is energy purchases from Eskom.
- Overall, a greater proportion of total electricity costs are incurred by the retail segment, amounting to R22 788 416 (73%), while the costs related to the wires segment total R8 252 267 (27%).

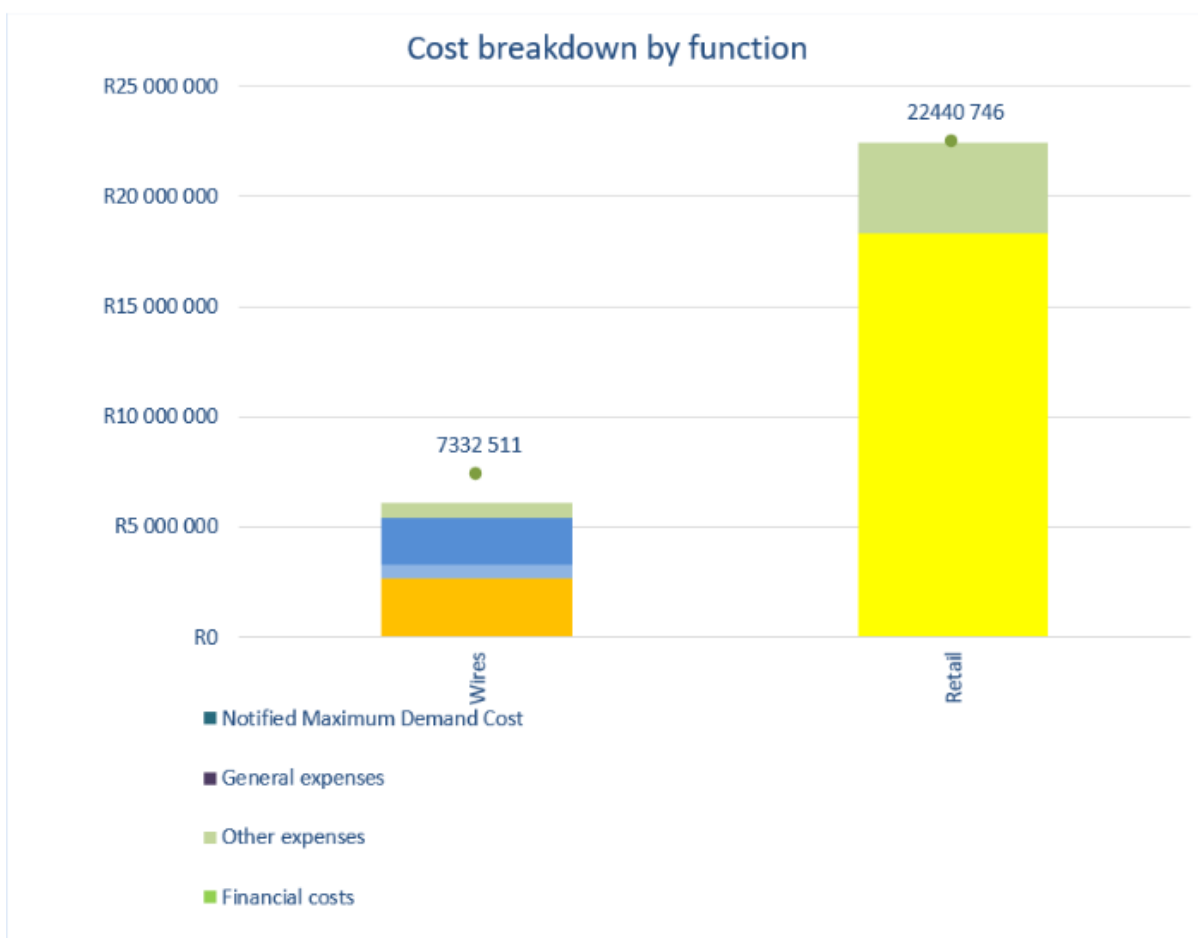


Figure 4 Cost breakdown by function

Energy Purchases

Prince Albert Municipality has a single incoming electricity supply from Eskom that it uses for distribution. The municipality's projected losses for FY2025/26 are 9%. The municipality purchases electricity from Eskom, with total energy purchases projected to be R26 230 193 in FY2026/27. The licensee used the purchases from the test period to forecast sales for the financial year for which it is applying. The forecasted purchases include electricity for street lighting, own use, and the allowable loss factor.

Cost functionalisation, classification, and allocation

The model adheres to the NERSA COS framework methodology for these steps. Costs are first divided by function, then classified according to their cost drivers, and finally allocated to customer categories based on usage. These methodological steps are sound, and the key results have been summarized in the previous section.

COS results

The key finding is that the municipality needs to increase its tariffs by 27.7% to achieve full cost-reflectivity in FY2026/27.

The municipality's COS results are shown per tariff category in the figure below.

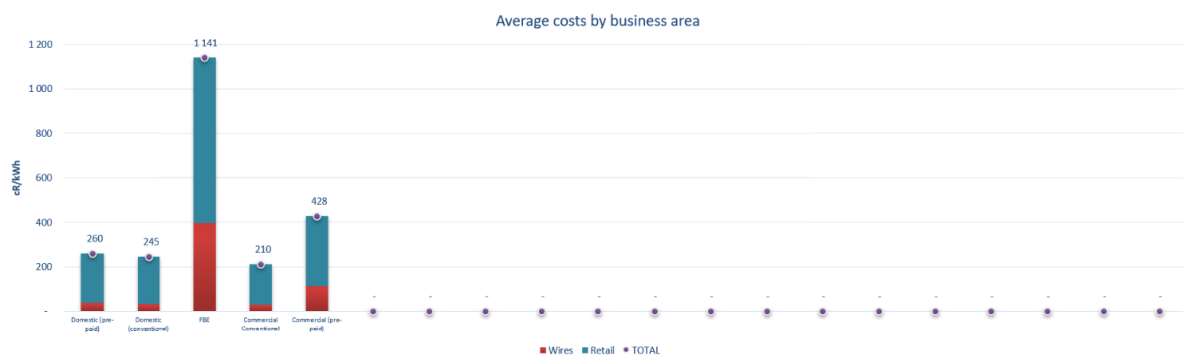


Figure 5 average costs by business area

Comparing these costs to the income per tariff category reveals the over- or under-recovery per tariff category, as shown in the figure below. When interpreting this graph, it is important to note that it is presented in percentage terms, not absolute Rand values.

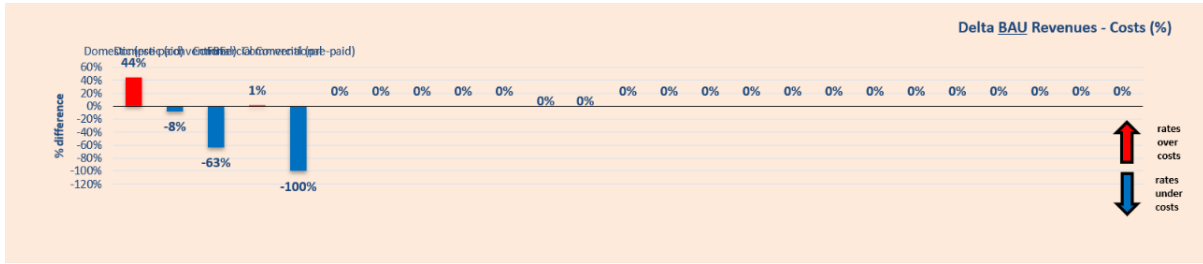


Figure 6 % Over/under recovery of customers

The key insight is that indigent households are currently receiving electricity services at a price below cost (i.e., being cross-subsidized), while domestic use customers are paying above cost for electricity. There is a clear need for tariff restructuring to address this imbalance.

The business-as-usual (BAU) rates, as shown in the graph below, indicate that the existing tariff structures are not cost-reflective. More than 90% of costs are recovered through a variable energy charge, making the municipality susceptible to volumetric risk. The Cost of Supply (COS) results indicate that to achieve cost reflectivity, the municipality must recover 60% of its costs through variable energy charges, with the remainder being recovered through stable or fixed demand and customer charges. As the uptake of distributed generation increases in electricity distribution networks, a more cost-reflective approach to setting tariffs is recommended.

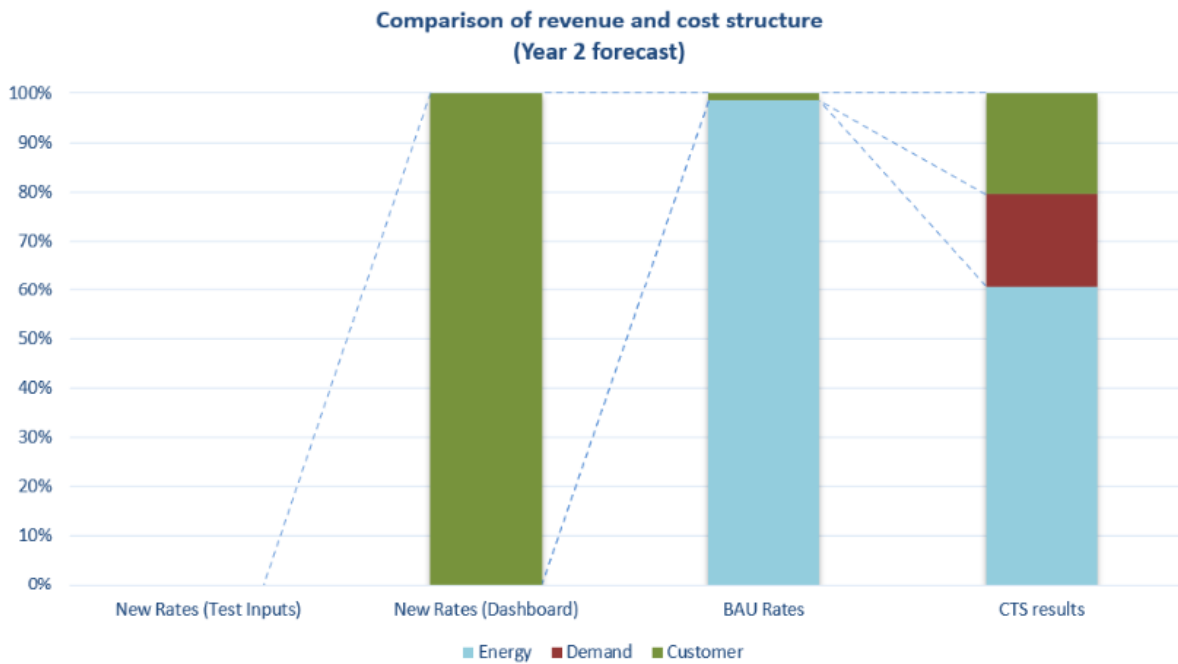


Figure 7 Comparison of revenue and cost structure

Cost-reflective charges are shown in the table below. These are the results of the Cost of Supply study and indicate what the municipality should charge customers to recover 100% of its revenue. However, due to South Africa’s socio-economic conditions and the municipality’s revenue recovery strategy, the municipality may deviate from these cost-reflective tariffs during the tariff design stage of the Cost of Supply study. Rate design is discussed in the next section and may differ from these results based on the municipality’s maximum tolerable tariff increase, subsidy policy, price signals, tariff design choices, and other factors.

RATE COMPARISON				
New rates for Year 2 (dashboard) (Wires+Retail)				
	Standing charge	Average demand rate	Average energy rate	Total average rate
Customer Categories	Rand/month	Rand/kVA/month	cR/kWh	cR/kWh
Domestic (pre-paid)	899	-	-	388
Domestic (conventional)	1 521	-	-	235
FBE	401	-	-	388
Commercial Conventional	14 012	-	-	221

Table 3 Cost reflective results by business area, class, season, TOU

5. KEY ASSUMPTIONS

This section of the report outlines the key assumptions made in the development of this Cost of Supply study. These assumptions were essential due to the unavailability of granular data and the lack of clear planning approaches within the municipality. The assumptions are as follows:

- The energy forecasts will increase year on year by 1%.
- The D-Form expenses will increase year on year by 5%.
- All Eskom purchase related expenditure will increase year on year by 15% and this will include Bad Debts, FBE, etc.
- The total maximum demand of the municipality is 3500 MVA.
- The Eskom bulk purchase energy price was assumed to increase by year on year by 15.7% (15.7% Based on MFMA Budget Circular 126 issued by National Treasury).

6. CONCLUSION

The Cost of Supply (COS) study undertaken for Prince Albert Municipality provides a comprehensive and transparent assessment of the actual costs associated with the provision of electricity services within the municipal area. The study confirms that the current cost structure is primarily driven by bulk electricity purchases, network operation and maintenance costs, administrative and customer service expenses, as well as system losses and capital-related charges.

Prince Albert Municipality's position on the implementation of the 2026/27 electricity tariffs is based on this COS and its approval by Nersa. This Cost of Supply (COS) study meets the requirements of the court ruling, allowing Nersa to consider and approve the municipality's tariffs for the 2026/27 financial year. The COS study clearly indicates and justifies the application to Nersa, with a revenue requirement of 27.7%.

The base year information was derived from the 2024/25 Audited Annual Financial Statements (AFS), based on the actuals reported on the D-Forms. The municipality has completed the 2024/25 D-Forms, and restructured tariffs for the 2026/27 financial year with an updated COS in support of these changes. It is imperative that the municipality addresses the issues highlighted by this assessment.

Yours Faithfully.

Adv. Thys Giliomee
Municipal Manager