NATIONAL ENERGY REGULATOR OF SOUTH AFRICA

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The Decision and Draft Reasons for Decision

In the matter regarding the

Municipal Tariff Application for the 2026/27 Financial Year

By

Mkhondo Local Municipality

THE DECISION

1. At its meeting held on 27 May 2026, the Regulator Executive Committee (REC) considered the Mkhondo Local Municipality tariff application. Based on the facts and evidence presented, the REC approved the tariff increases for the 2026/27 financial year set out in section 9 (Page 25) below.
2. Based on the available information and the analysis performed thus far, the Regulator Executive Committee decided to:

   2.1 approve the tariffs that are based on the Cost of Supply (COS) Study as recommended in the tariff analysis section for implementation by the municipality with effect from 1 July 2026;

   2.2 the municipality must submit a report accounting for all the costs that have been noted in its COS study, to enable the Regulator to perform its independent verification/audit process by 31 January 2027; and

   2.3 the municipality must submit a quarterly smart efficiency plan with improvements measures identified in reducing all losses and submit by 30 September 2026

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ABBREVIATIONS

COS	Cost of Supply
D-form	Distribution Form
ERTSA	Eskom's Retail Tariff Structural Adjustments
FBE	Free Basic Electricity
IBT	Inclining Block Tariff
IPP	Independent Power Producer
MFMA	Municipal Finance Management Act
NERA	National Electricity Regulation Act
NERSA	National Energy Regulator of South Africa
OPEX	Operating Expenditure

3. INTRODUCTION

3.1 The National Energy Regulator of South Africa (NERSA) considers municipal tariff applications annually in accordance with its statutory mandate to regulate prices and tariffs. Municipal electricity tariffs must be approved by the Energy Regulator before implementation on 1 July of each financial year.

3.2 Mkhondo is situated in Mpumalanga. The Municipality has a total of 18 980 customers, of which domestic customers account for 69,29% of electricity sales. The Municipality applied for an average tariff increase of 15% in the 2025/26 financial year and again for the 2026/27 financial year. The Municipality provides 50 kWh of free basic electricity per month to 1 728 registered indigent customers.

3.3 The details regarding customer statistics are highlighted in table 1 below.

Table 1: Customer Statistics (Data obtained from the latest D-forms – 2024/25FY)

Customers categories	(kWh)	(%) KWh	Customers numbers
Domestic (Prepaid)	36 897 245	64,87	17 737
Domestic (Conventional)	2 515 726	4,42	609
Manufacturing/Industrial	10 033 655	17,64	58
Commercial (Conventional)	6 834 437	12,02	458
Other customers	16 941	0,03	2
Electricity Department	581 858	1,02	116
Totals	**56 879 862**	**100**	**18 980**
Free Basic Electricity (FBE)	122 722	0,31	1 728

3.4 NERSA received Mkhondo Local Municipality's tariff application together with its existing cost of supply (COS) and is based on the Cost-Plus methodology on 31 March 2026.

3.5 For this application, the Municipality has indicated that Council has approved the tariff application. The Council meeting at which this application was approved took place on 31 March 2026, and the Council resolution has been submitted to NERSA. Proof of customer consultation was also submitted on 31 March 2026.

3.6 NERSA followed the notice and comment consultation process. Mkhondo Local Municipality's tariff application was published on the NERSA website on 31 March 2026, on social media platforms and national and local newspapers to solicit written comments from affected parties.

3.7 NERSA's decision was taken on 27 May 2026 after consideration of the written comments received from affected stakeholders and the analysis conducted by NERSA.

4 LEGAL AND REGULATORY FRAMEWORK

4.1 Background

4.1.1 The approval of municipal electricity tariffs constitutes a core regulatory function of the Energy Regulator and must be exercised in accordance with the applicable legislative framework, national policy directives and court orders. The principal legal instruments governing the exercise of this regulatory authority include the National Energy Regulator Act, 2004 (Act No. 40 of 2004) ("NERA"), the Electricity Regulation Act, 2006 (Act No. 4 of 2006) as amended ("ERA"), the Promotion of Administrative Justice Act, 2000 (Act 3 of 2000) ("PAJA"), and the Electricity Pricing Policy for the South African Electricity Supply Industry, 2008 ("EPP").

4.1.2 The approval of municipal electricity tariffs follows the Eskom Multi-year Price Determination and Eskom Retail Tariff and Structural Adjustment decision and is undertaken annually to align with the municipal budgeting process contemplated in the Municipal Finance Management Act, 2003 (Act No. 56 of 2003).

4.1.3 In addition, the municipal tariff approval process has recently been the subject of judicial scrutiny in the High Court of South Africa (Gauteng Division, Pretoria) in AfriForum NPC v National Energy Regulator of South Africa and Others (Case No. 2025/137620), which resulted in structural directives governing the timing and conduct of NERSA's tariff approval process.

4.1.4 This section provides the legal and policy context within which the Energy Regulator evaluated and determined the municipal electricity tariff application for the 2026/2027 municipal financial year.

4.2 Statutory Mandate of the Energy Regulator

4.2.1 NERSA is established as a juristic person in terms of section 3 of the NERA. In terms of section 4 of NERA, the Energy Regulator, as the decision-making body, must regulate the electricity industry and perform the functions set out in the ERA. The Energy Regulator's regulatory mandate is therefore primarily governed by the ERA. Section 3 of the ERA particularly provides that the Energy Regulator is the custodian and enforcer of the national electricity regulatory framework and exercises regulatory authority over activities regulated under the ERA.

4.2.2 In particular:

a) Section 4(a)(i) of the ERA provides that the Energy Regulator must consider applications for licenses and may issue licenses subject to conditions.
b) Section 4(a)(ii) of the ERA provides that the Energy Regulator must regulate prices and tariffs.
c) Section 14(1)(d) of the ERA authorizes the Energy Regulator to impose license conditions relating to the setting or approval of prices, charges, rates and tariffs charged by licensees.

4.2.3 Municipalities distributing electricity do so under electricity distribution licenses issued by the Energy Regulator and are therefore subject to the tariff approval framework established under the ERA.

4.3 Tariff Determination Principles under the ERA

4.3.1 When determining or approving electricity tariffs, the Energy Regulator must apply the principles contained in section 15(1) of the ERA.

4.3.2 Section 15(1) provides that the Energy Regulator:

a) must enable an efficient licensee to recover the full cost of the licensed activity;
b) must allow for a reasonable return commensurate with the risk of the licensed activity;
c) may provide incentives for continued improvement of technical and economic efficiency;
d) must avoid undue discrimination between customer categories;

e) may permit cross-subsidies of tariffs to certain classes of customers; and
f) may have regard to the need to ensure security of supply, diversity of supply and the promotion of renewable energy.

4.3.3 These statutory requirements form the core legal principles guiding the determination of electricity tariffs within the South African electricity supply industry.

4.4 Administrative Law Requirements

4.4.1 The approval of municipal electricity tariffs constitutes administrative action as defined in section 1 of the PAJA. Accordingly, the Energy Regulator must ensure that its tariff determinations are lawful, reasonable and procedurally fair as required by sections 3 and 6 of PAJA. Procedural fairness requires that affected parties and the public be afforded a reasonable opportunity to make representations before a final decision is taken.

4.4.2 Public participation processes conducted by the Energy Regulator therefore form an essential component of the municipal tariff approval process and are intended to ensure transparency, accountability and fairness in regulatory decision-making.

4.5 Policy Framework: Electricity Pricing Policy (2008)

4.5.1 In addition to the statutory framework, the Energy Regulator must have regard to the EPP. The EPP establishes national policy principles for electricity tariff setting, including cost reflectivity, transparency, economic efficiency and equity.

4.5.2 Policy Position 1 of the EPP provides that the revenue requirement for a regulated licensee must be set at a level that covers the full cost of production, including a reasonable risk-adjusted margin or return on appropriate asset values.

4.5.3 Policy Position 2 states that electricity tariffs must reflect the efficient cost of rendering electricity services accurately and that the average level of tariffs must be set to recover the approved revenue requirement.

4.6 Cost of Supply Studies

4.6.1 The EPP recognizes that cost reflective tariff structures require a sound understanding of the underlying cost drivers associated with electricity distribution.

4.6.2 Paragraph 8.1 of the EPP notes that cost of supply methodologies has historically not been consistently applied across the electricity distribution industry.

4.6.3 Policy Position 23 therefore requires electricity distributors to undertake cost-of-supply studies at least every five years, or when significant structural changes occur in the customer base or cost structure.

4.6.4 Such studies must be conducted in accordance with the methodology approved by NERSA and must accompany tariff structure applications submitted to the Energy Regulator.

4.7 Judicial Oversight of the Tariff Approval Process

4.7.1 The municipal tariff approval process administered by NERSA was the subject of litigation in AfriForum NPC v National Energy Regulator of South Africa and Others (Case No. 2025/137620) before the High Court of South Africa, Gauteng Division, Pretoria.

4.7.2 In its final judgment delivered on 4 December 2025, the Court held that NERSA's public participation process relating to the 2025/2026 municipal tariff approvals did not comply with the procedural requirements of section 4 of PAJA and was therefore unlawful.

4.7.3 However, recognizing the potentially disruptive consequences of setting aside tariff determinations already implemented by municipalities, the Court declined to invalidate the tariffs. Instead, to assist in the timeous and lawful approval of municipal tariffs, the Court issued a structural interdict regulating the municipal tariff approval process going forward.

4.7.4 NERSA subsequently launched a variation application which sought to vary the timelines which were set by the Court on 4 December 2025, considering the practical difficulties which arose as ins relation to the NERSA's compliance with the court order. The court having heard NERSA's application, granted the variation application in respect of the fixed deadlines for the 2026/27 municipal tariff approvals.

4.8 Court-Directed Timelines

4.8.1 The timelines below are applicable in respect of the 2026/27 municipal tariff approvals

a) written notice of bulk tariffs by 6 March 2026;
b) municipal tariff applications to be submitted by 31 March 2026;
c) public participation processes to be concluded by 21 April 2026; and
d) the publication of NERSA decisions by 11 May 2026.

4.8.2 Municipal tariff approvals from 2027/28 are to comply with the following timelines:

a) written notice of bulk electricity tariffs be communicated by 31 January each year;
b) municipal tariff applications be submitted to NERSA by 20 March each year;
c) municipal tariff approvals and the Tariff Reasons for Decision document, be approved and published by 5 May of each year.

4.9 Conclusion

4.9.1 The determination of municipal electricity tariffs by the Energy Regulator must therefore be undertaken within a comprehensive regulatory framework consisting of the NERA, ERA, PAJA, EPP and the binding judicial directives issued by the High Court in AfriForum NPC v NERSA (Case No. 2025/137620).

4.9.2 The reasons that follow in this Reasons for Decision document demonstrate how the Energy Regulator complied with the legislative, policy and judicial framework in determining the municipal electricity tariff for the 2026/2027 municipal financial year.

5 FINANCIAL AND TECHNICAL PERFORMANCE

5.1 In evaluating the financial and technical performance of Mkhondo Local Municipality, the assessment relied on the Distribution forms (D-forms) for the 2024/25 financial year submitted as part of the licensee's tariff application. The information contained in the D-forms was verified against the supporting source documents provided by the municipality, including the Trial Balance and Annual Financial Statements. As a result, the data captured in the D-forms is considered reliable for the tariff analysis.

5.2 Table 2 below indicates that Mkhondo Local Municipality's electricity business improved its financial position, with the percentage deficit declining from 52.22% in the 2023/24 financial year to 34,89% in the 2024/25 financial year. Although this reflects some improvement in cost recovery, the electricity business remains in a significant deficit position, which indicates that revenues are still insufficient to recover the full cost of supplying electricity.

5.3 Energy losses declined from 51,04% in the 2023/24 financial year to 44,99% in the 2024/25 financial year, as shown in Table 2 below. While this reflects a measure of improvement, the level of losses remains materially above prudent utility norms and continues to place significant pressure on the Municipality's financial sustainability. The municipality should therefore intensify efforts to reduce both technical and non-technical losses to improve operational efficiency and strengthen revenue recovery.

Table 2:FINANCIAL INDICATORS

Indicators	***Municipality 2023/24 D-forms information***	***Municipality 2024/25 D-forms information***
Percentage surplus: **(%)**	-52.22	-34.89
Energy losses: **(%)**	51.04	44.99

5.4 The Municipality has high energy losses of 44.99%, which significantly undermines its financial sustainability.

5.4.1 If losses were capped at 12%, the Municipality would:

a) improve net revenue by approximately R13.8 million; and

b) reduce the deficit from 34.89% to a surplus of 4.44%.

c) resulting in additional revenue forgone of 90 million

5.4.2 If losses were capped at 6%, the Municipality would:

a) improve net revenue by approximately R27million; and

b) reducing the deficit from 34.89% to a surplus of 8.38%.

c) resulting in additional revenue forgone of 104 million.

Table 3:SENSITIVITY ANALYSIS

	D-Form Input	**Energy Loss@12%**	**Energy Loss@6%**
Average Selling Price c/KWh	256,77		
Sales kWh	56 879 861,97	92 313 626,79	97 538 926,42
Purchases kWh	103 391 262,00	103 391 262,00	103 391 262,00
Losses kWh	46 511 400,03	11 077 635,21	5 852 335,58
Losses percentage	44,99%	12,00%	6,00%
Additional Energy (kWh)		35 433 764,82	40 659 064,45
Additional Revenue (Rands)		90 981 535,36	104 398 280,25
	D-Form Input	Energy Loss@12%	Energy Loss@ 6%
Total Revenue (Rands)	221 023 937,28	312 005 472,64	325 422 217,53
Total Expenses (Rands)	298 144 351,80	298 144 351,80	298 144 351,80
Net Profit (Loss)	-77 120 414,52	13 861 120,84	27 277 865,73
Percentage Surplus/Deficit	**-34,89%**	**4,44%**	**8,38%**

General Conclusion on the Financial and Technical Indicators

5.5 Based on the above information, the licensee's electricity department does not demonstrate satisfactory financial and technical performance, as reflected in the significant deficit and persistently high energy losses. This position creates a material risk to the financial sustainability of the electricity business, as continued under-recovery may impair the municipality's ability to fund bulk electricity purchases, maintain and refurbish network infrastructure, and provide a reliable electricity service. It also heightens the risk of cash flow pressure, further accumulation of creditor obligations, and a greater likelihood that inefficiencies will be passed on to customers through future tariff increases.

5.6 The current position can be improved through targeted efficiency interventions, particularly by reducing technical and non-technical losses, strengthening revenue collection, improving billing accuracy, ring-fencing electricity-related costs, and prioritising maintenance and refurbishment of ageing infrastructure. If these measures are implemented effectively, the municipality would improve cost recovery, strengthen cash generation, and progressively move from the current deficit position towards a sustainable surplus.

6 DETERMINATION OF MKHONDO LOCAL MUNICIPALITY'S TARIFFS BASED ON THE COST OF SUPPLY STUDY

6.1 The Mkhondo Local Municipality submitted its existing COS study, which supports the tariff application, which will be approved in the 2026/27 financial year. The Municipality's cost of supply study included all requirements of NERSA's approved COS Framework (i.e. revenue requirement, costs functionalisation, costs classification, costs allocation and rate setting). The Mkhondo Local Municipality submitted its existing COS study which supports the tariff application which will be approved in the 2026/27 financial year.

6.2 Policy Position 23 states that,

> *"Electricity distributors shall undertake COS studies at least every five years, but at least when significant licensee structure changes occur, such as in customer base, relationships between cost components and sales volumes. This must be done according to the approved NERSA standard to reflect changing costs and customer behaviour. The cost-of-service methodology used to derive tariffs must accompany applications to the regulator for changes to tariff structures".*

6.3 The cost of supply study confirms the existence of cross-subsidisation, the industrial and commercial customers are subsidising the residential customers. This is also evident from the proposed increase by the municipality whereby the commercial and industrial customers' tariffs are increasing by 12% and 15% respectively and 9% for residential customers.

6.4 The revenue requirement for Mkhondo Local Municipality was determined using a cost-plus methodology in accordance with the NERSA COS Framework.

6.5 Section 18.7 of the October 2023 NERSA-approved Cost of Supply Framework states that:

> *"An adjustment index will be issued to licensees to allow them to submit the tariff applications, which will be used to determine the costs that must increase with CPI, purchase costs, and other OPEX. Where annual plans, such as repairs and maintenance, and CAPEX plans, have been assessed and approved by NERSA, these can be adjusted based on that."*

6.6 In line with section 18.7 mentioned above, Table 4 below was developed, and the definition of the columns is as follows:

I. Column 1: is the actual FY2024/25 licensee performance and is sourced from the D-forms that are based on the audited annual statements.

II. Column 2: is for the FY2025/26 revenues and electricity volume that are the base for FY2026/27 tariffs. The figures were tested for reasonableness (since at the time of the approval, they were estimates) when the Regulator considered and approved the FY2026/27 cost of supply base tariffs. Once the financial year ends, the actual figures will be verified using the audited statements.

III. Column 3: is for the licensee's submitted FY2026/27 budgeted figures to be tested for reasonableness for determining tariffs for the control period under review.

IV. Column 4: is for NERSA's recommended adjustments after considering the reasons, facts, and evidence the licensee provided to motivate/justify the budgeted figures.

V. Column 5: is for the NERSA's recommended amounts that sum up to allowable revenues the licensee must recover in FY2026/27. The total allowable revenue for the FY2025/26 tariff review is based on the cost of supply revenue and the volumes used to determine the tariffs that were approved by the Energy Regulator, as shown in Table 4:MUNICIPALITY'S REVENUE REQUIREMENT

6.7 The COS study is valid for five years; however, municipalities need to reflect the adjustments on their cost drivers for each financial year under the existing COS (i.e. FY2026/27). NERSA utilised the budgeted figures to verify efficiencies and to ensure that municipalities do not over- or under-recover their operating overheads during the FY2026/27 tariff review process.

6.8 To be fully cost reflective, the Mkhondo Local Municipality applied for a revenue requirement of R332 million. After R10 million in adjustments, an allowable revenue of R322 million is recommended for the 2026/27 tariff review period, as reflected in Table 4 below. The revenue requirement for a regulated licensee must be set at a level sufficient to cover the full cost of the licensed activity, including a reasonable risk-adjusted margin or return.

Table 4:MUNICIPALITY'S REVENUE REQUIREMENT

Energy balance	Unit	Actual FY 2024/25 Costs	FY2025/26 Tariffs Costs per submitted COS	FY2026/27 budgeted Costs as per the Licensee	NERSA Adjustment (considering efficiencies)	FY2026/27 Allowable Revenue
Sales	kWh	58 879 862	59 419 242	68 332 128	-	68 332 128
Eskom bulk purchases	kWh	109 054 235	111 597 584	116 851 569	-	116 851 569
Total Energy Requirements	kWh	109 054 235	111 597 584	116 851 569		116 851 569
Total Losses	kWh	50 174 373	52 178 342	48 519 441		48 519 441
Technical losses	kWh	13 086 508	13 391 710	14 022 188	-	14 022 188
Non-technical losses	kWh	(37 087 865)	(38 786 631)	(34 497 252)	-	(34 497 252)
Allowed losses	%	12,00%	12,00%	12,00%		12,00%
Total Energy losses	%	46,01%	46,76%	41,52%		41,52%
Energy purchases from Eskom	Rand	206 515 218	171 442 145	235 427 349	-	235 427 349
other energy purchases		-	-	-	-	-
total energy purchases		206 515 218	171 442 145	235 427 349	0	235 427 349
Cost of technical losses	Rand	24 781 826		28 251 282	0	28 251 282
Non-Technical Losses		(70 233 022)		(69 503 531)		(69 503 531)
Operational expenditure (incl. Depreciation)	Rand	40 880 705	18 693 081	56 971 008	-21 422 266	35 548 742
General & Other	0	35 696 493	18 693 081	54 945 945	-21 422 266	33 523 679
Salaries and allowances	Rand	14 817 115	13 826 732	17 112 816	0	17 112 816
Materials and supplies	Rand	3 503 318	565 133	3 000 000	0	3 000 000
Contracted Services	Rand	15 089 564	2 114 216	10 644 524	0	10 644 524
and allowances (exclu. Repairs and Maintenance)	Rand	2 286 496	2 187 000	2 205 740	0	2 205 740
Eskom debts interest	Rand	20 519 412	36 219 267	21 422 266	(21 422 266)	
Current year depreciation	Rand	519 073	539 396	560 599	0	560 599
Shared OPEX	Rand	5 184 212	0	2 025 063	0	2 025 063
Charges from other Municipal Departments		3 237 036			0	
General expenses		1 947 176	0	2 025 063	0	2 025 063
3.Other Expenses	Rand				0	0
Hire Charges		503 136		523 261		523 261
Travel and Subsistence		171 225		178 074		178 074
Protective Clothing		592 311		616 003		616 003
wet fuel & Licensing		537 829		559 342		559 342
Skills Development Fund Levy	Rand	142 675		148 382	0	148 382
Total Expenditure before surplus		272 177 749	190 135 226	292 398 357	-21 422 266	270 976 090
Surplus	Rand	16 330 665	11 408 114	40 935 770	(15 193 041)	25 742 729
Total Expenditure Including Surplus		288 508 414	201 543 340	333 334 126	36 615 307	296 718 819
Other revenues	Rand	-559 003	-597 785	-633 652	633 652	0
Reconnection fees	Rand	559 003	597 785	633 652	(633 652)	
Total Allowable Revenues	Rand	287 949 411	200 945 555	332 700 474	(10 238 927)	322 461 548
		increase required		*15,54%*		*11,99%*

6.9 The actual figures were verified using Eskom invoices and verified electricity-related operating costs (tested against 2024/25 D-Forms, Trial Balance and Audited AFS). Only prudently incurred and efficiently verified costs, supplemented by a reasonable surplus margin are recommended for approval. This forms the basis for projecting costs for the 2026/27 financial year will be projected using assumptions to calculate revenue requirements.

6.10 Furthermore, NERSA has verified all expense items included in the revenue requirements to ensure that they relate only to the electricity function of the licensee. In instances where expenses are deemed inflated or unjustified, these have been adjusted accordingly.

6.11 In line with COS Framework requirements: Shared municipal costs were ring-fenced and allocated strictly to the electricity business using the D-Form. Cost attribution was verified against the Trial Balance and Audited AFS, ensuring separation of electricity and non-electricity functions. Any costs not demonstrably related to electricity distribution were adjusted or excluded. This approach ensures compliance with the principle of cost causality and prevents cross-subsidisation between municipal functions.

6.12 It is important to test the efficiency and prudency of the costs in the 2025/26FY since this is the most recently considered revenues in support of the approved tariffs during this period. This forms the basis on which costs for the 2026/27FY will be projected using assumptions to calculate revenue requirements for that year.

6.13 Table 4 above reflects that the revenue requirement for the 2026/27 financial year was not accepted as applied for in all respects but was subjected to a prudency and efficiency review in terms of the NERSA Cost of Supply Framework, section 15 of the Electricity Regulation Act, and the Electricity Pricing Policy.

6.14 The adjustments, therefore, serve to remove or limit costs that could result in undue customer prejudice, including unsupported or inefficient expenditure, while still allowing the licensee to recover prudent operating costs, depreciation and a reasonable surplus margin.

6.15 On this basis, the table demonstrates an appropriate regulatory balance between cost reflectivity, financial sustainability of the electricity business, and the protection of customers from over-recovery, thereby ensuring that the recommended allowable revenue remains justified and aligned with the approved cost drivers for the tariff period under review.

Bulk Purchases

6.16 For the 2026/27 financial year, the licensee applied for bulk purchase expenditure of R235 million, representing approximately 58% of total bulk purchase costs. In assessing this item, NERSA applied the principle that only prudently and efficiently incurred costs may be passed through to customers.

6.17 To estimate the 2026/27 amount, the licensee annualised the year-to-date expenditure for 2025/26, as full-year actual data was not yet available and then applied an increase of 9.01% in line with the approved Eskom Retail Tariff and Structural Adjustments (ERTSA).

6.18 NERSA analysed the Eskom invoices and identified interest charges of R21.4 million paid by the Municipality. This amount was disallowed, because it is considered an inefficient cost and is therefore not recoverable from customers through tariffs.

Operating Expenditure (including Depreciation)

6.19 The licensee applied for operating expenditure of R54 million for the 2026/27 financial year, representing approximately 11% of the total costs included in the revenue requirement.

6.20 The electricity asset base was reflected at R1,44 billion in the audited Annual Financial Statements (AFS), while depreciation of R539, 396 was sourced from the Trial Balance. In NERSA's assessment, there is a direct relationship between the Municipality's operating expenditure and the size and condition of the electricity asset base. A larger and ageing network generally requires higher operating expenditure for routine operations, repairs and maintenance, fault response, network monitoring, metering, and other support activities necessary to keep the assets available and reliable for service delivery. Where the asset base is old, dispersed, or in poor condition, the operating burden typically increases because more resources are required to sustain network performance and limit service interruptions.

6.21 Depreciation reflects the consumption of the service potential of those assets over time and, although non-cash in nature, forms part of the cost of providing the licensed activity. Depreciation was calculated using the straight-line method over useful lives ranging from 20 to 45 years, consistent with the municipality's accounting policy for electricity distribution assets.

6.22 NERSA verified the depreciation amount by reconciling the Trial Balance to the AFS. On this basis, NERSA accepted only the prudent and electricity-related portion of operating expenditure and depreciation for inclusion in the approved revenue requirement, to ensure that the Municipality can continue to operate and maintain its electricity distribution assets without permitting the recovery of unsupported or inefficient costs from customers.

6.23 The operating expenditure comprises, among others, salaries and allowances of R17.1 million, materials and supplies of R3 million, and contracted services of R10 million. Salaries, wages, and allowances excluding repairs and maintenance amount to R2.2 million.

6.24 Interest on outstanding Eskom debt amounting to R21,4 million was disallowed, as this expenditure is considered inefficient and is therefore not recoverable from customers through tariffs.

6.25 NERSA assessed the methodology used by the licensee to forecast operating expenditure and is satisfied that, subject to the disallowance of inefficient costs, the remaining expenditure is reasonable and may be included in the approved revenue requirement.

6.26 Shared costs allocated to general expenses amount to R2 million and were assessed to ensure that only electricity-related costs were attributed to the licensed activity.

Table 5: Operating Expenditure

Cost drivers	Units	Applied Opex 2026/27	Adjustments	Recommended Opex 2026/27
General and other	**R**	**54 945 945**	**(21 422 266)**	**33 523 679**
Salaries and allowances	R	17 112 816		17 112 816
Materials and supplies	R	3 000 000		3 000 000
Contracted Services	R	10 644 524		10 644 524
Salaries, wages and allowances (exclu. Repairs and Maintenance)	R	2 205 740		2 205 740
Eskom debts interest	R	21 422 266	(21 422 266)	
Current year depreciation	R	560 599		560 599
Shared OPEX	R	**2 025 063**	**-**	**2 025 063**
Hire Charges	R	523 261		523 261
Travel and Subsistence	R	178 074		178 074
Protective Clothing	R	616 003		616 003
wet fuel & Licensing	R	559 342		559 342
Skills Development Fund Levy	R	148 382		148 382
Total	R	**56 971 008**	**(21 422 266)**	**35 548 742**

6.27 The Mkhondo Local Municipality applied a cost-plus methodology in determining the revenue requirement. Under this methodology, the allowable revenue is derived from prudently and efficiently incurred costs, together with an appropriate surplus margin determined by NERSA after considering the licensee's particular circumstances.

6.28 In essence, the cost-plus methodology allows a reasonable surplus margin to be added after prudently and efficiently incurred costs have been determined. The margin represents the surplus to be earned by the licensee, which NERSA determines after considering the circumstances and risk profile of the electricity business.

Surplus

6.29 In recommending a surplus, NERSA relied on section 15(1)(a) of the Electricity Regulation Act, which provides that tariffs must enable an efficient licensee to recover the full cost of its licensed activities, including a reasonable margin or return. In applying this provision, together with the cost of supply (COS) methodology, NERSA is required to ensure that Mkhondo Local Municipality recovers efficiently and prudently incurred costs, including a reasonable return, while preventing excessive compensation.

6.30 The licensee applied for a surplus of R40 million as part of the revenue requirement for the 2026/27 financial year. NERSA assessed this amount in the context of section 15 of the Electricity Regulation Act, the Electricity Pricing Policy and the Cost of Supply Framework, which require that an efficient licensee be allowed to recover prudent costs together with a reasonable margin commensurate with the risks of the licensed activity.

6.31 The Mkhondo Local Municipality initially applied for a surplus of R40 million. After the exclusion of identified inefficiencies, the surplus reduced to R25 million, representing approximately 8% of total costs for the 2026/27 financial year, as shown in Table 4 above.

6.32 To verify that the surplus is not excessive or detrimental to customers, NERSA benchmarked the applied surplus margin of approximately 8% against the indicative range of 10% to 20% contemplated in the Cost of Supply Framework, while also considering the municipality's actual operating circumstances, including high energy losses, collection risks, ageing infrastructure, and the need to maintain customer affordability. The applied margin is therefore below the benchmark range and cannot be regarded as excessive. Instead, it reflects a conservative allowance intended to support the financial viability of the electricity function without imposing an undue burden on customers.

6.33 Accordingly, the applied surplus is considered commensurate with the level of risk associated with the municipality's electricity distribution business. The Municipality is expected to use this support to upgrade and replace ageing infrastructure, reconfigure the network to reduce technical losses, replace conventional meters with smart meters, and progressively align tariffs with the cost of supply. NERSA therefore accepted this component as part of the approved revenue requirement, together with the other verified and efficiently incurred cost drivers, to arrive at an allowable revenue that supports service sustainability while protecting customers from over-recovery.

6.34 The Municipality's collection rate is 64% and will need to improve to 95% to meet industry norms and standards. The installation of smart meters is expected to enhance revenue collection, while tariffs aligned to the COS will promote more appropriate pricing signals.

6.35 It is therefore recommended that the Energy Regulator approve the allowable revenue of R322 million, as set out in Table 4 above. This revenue will be used in the subsequent steps of cost functionalisation, classification, allocation, and rate setting. These steps have been verified to be consistent with the approved revenue requirement and are discussed below.

Rate Design

6.36 The COS confirms the presence of tariff cross-subsidies, with commercial and manufacturing customers subsidising residential customers. The Municipality will be required to introduce a fair and transparent framework for managing such cross-subsidisation, particularly to protect vulnerable households. The municipality's commitment to a phased transition to cost-reflective tariffs aligns with NERSA's approach of avoiding tariff shock while improving allocative efficiency over time.

6.37 To achieve full cost reflectivity, the Municipality would be required to implement differentiated tariff adjustments across customer categories.

Revenues dashboard (extract from 2025/26 COS chart submitted)

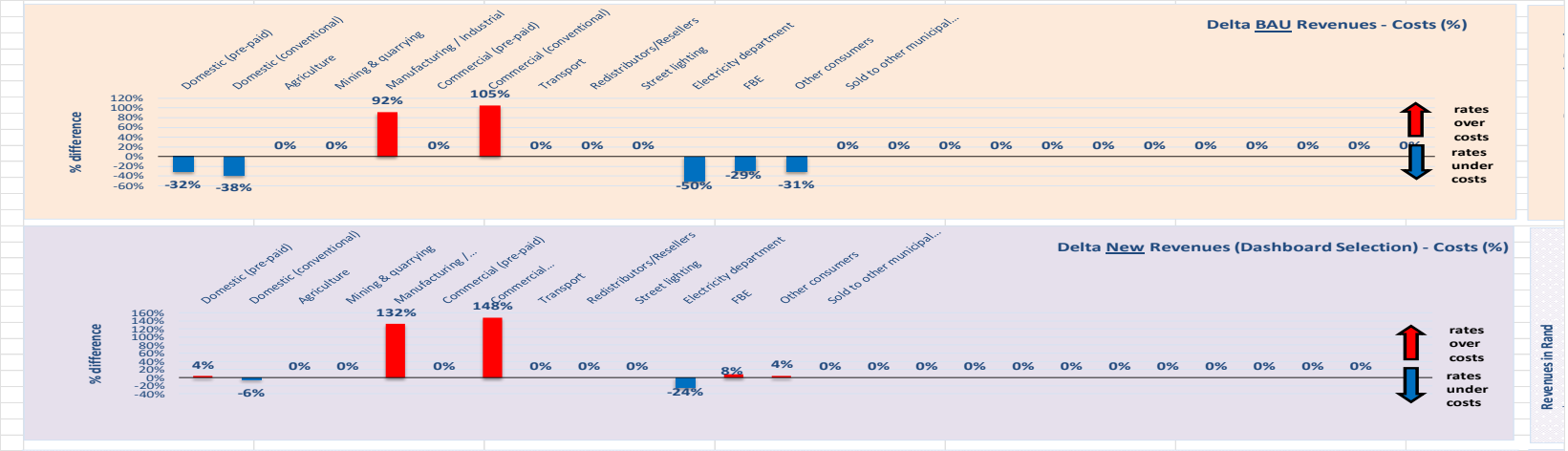


Figure 1: Revenue Recovery by Customer Category

Conclusion on Costs to Serve

6.38 The COS study is applicable for a five-year period. NERSA evaluated adjustments to cost drivers for the 2026/27 financial year, using the budgeted information submitted by the licensee to ensure the continued relevance, accuracy, and reasonableness of the costs. This assessment was undertaken to ensure that the licensee neither over-recovers nor under-recovers its efficiently and prudently incurred costs.

6.39 The cost-to-serve analysis indicates a required increase of 15.54%, while the allowable revenue reflects an increase of 11.99%. The licensee initially proposed a 15% increase but later revised its application to a weighted average increase of 11% after engaging with customers. Taking customer affordability into account, a lower weighted average increase of 11% for the 2026/27 financial year is therefore recommended.

6.40 The application initially published by NERSA on 31 March 2026 reflected a uniform tariff increase of 15%. Following preliminary analysis and consideration of stakeholder submissions, the municipality revised its application to a weighted average increase of 11%. The revision was intended to reduce pressure on commercial and industrial customers, while still maintaining a degree

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Table 7:Tariffs Analysis

1.1. Residential pre-paid	2025/26 Approved	Proposed% Increase	2026/27 Proposed	2026/27 Recommended	Recommended %Increase	Analysis and Key Findings
Block 1 (0-50 kWh)	200,00	9%	218,00	218	9%	
Block 2 (51-350 kWh)	254,00	9%	277,00	277	9%	
Block 3 (351-600 kWh)	354,00	9%	386,00	386	9%	
Block 4 (> 600 kWh)	424,00	9%	462,00	462	9%	
Basic Charge (R/month):	214,92	9%	234,00	234	9%	Uniform increase of 9%

1.2 Residential Conventional	2025/26 Approved	Proposed% Increase	2026/27 Proposed	2026/27 Recommended	Recommended %Increase	Analysis and Key Findings
Block 1 (0-50 kWh)	184	9%	201	201	9%	
B lock 2 (51-350 kWh)	238	9%	259	259	9%	
Block 3 (351-600 kWh)	344	9%	375	375	9%	
Block 4 (> 600 kWh)	411	9%	448	448	9%	
Basic Charge (R/month):	215	9%	234	234	9%	Uniform increase of 9%

2.1 Commercial Pre-paid 60Amps	2025/26 Approved	Proposed% Increase	2026/27 Proposed	2026/27 Recommended	Recommended %Increase	Analysis and Key Findings
Basic Charge (R/month):	847,7	11%	940,95	940,95	11%	An average of 11% tariff increase
Energy charge (c/kWh):	320	11%	362	362	11%	

2.2 Commercial Pre-paid 80Amps	2025/26 Approved	Proposed% Increase	2026/27 Proposed	2026/27 Recommended	Recommended %Increase	Analysis and Key Findings
Basic charge (R/month):	847,70	11%	940,95	940,95	11%	An average of 12% tariff increase
Energy charge (c/kWh):	284	13%	321,00	321,00	13%	

2.3Business <80A Single Phase	2025/26 Approved	Proposed% Increase	2026/27 Proposed	2026/27 Recommended	Recommended %Increase	Analysis and Key Findings
Basic charge (R/month):	847,70	11%	940,94	940,94	11,00%	An average of 12% tariff increase
Energy charge (c/kWh):	320,00	13%	362,00	362,00	13%	

2.4 Business >80A Single Phase	2025/26 Approved	Proposed% Increase	2026/27 Proposed	Recommended Tariff	Recommended %Increase	Analysis and Key Findings
Basic charge (R/month):	1, 686,83	11%	1, 872,38	1, 872,38	11%	An average of 12% tariff increase
Energy charge (c/kWh):	284,00	13%	321,00	321,00	13%	

3.Industrial Customer						
3.1 Industrial Small (<50 kVA)	2025/26 Approved	Proposed% Increase	2026/27 Proposed	Recommended Tariff	Recommended %Increase	Analysis and Key Findings
Basic charge (R/month):	3, 472,39	15%	3, 993,25	3, 993,25	15%	
Energy charge (c/kWh):	157,00	15%	181,00	181,00	15%	Proposed uniform tariff increase of 15%
Demand charge (R/kVA):	440,43	15%	506,00	506,00	15%	

3.2 Industrial Large (>=50 kVA)	2025/26 Approved	Proposed% Increase	2026/27 Proposed	Recommended Tariff	Recommended %Increase	Analysis and Key Findings
Basic charge (R/month):	3, 887,15	15%	4, 470,22	4, 470,22	15%	Proposed uniform tariff increase of 15%
Energy charge (c/kWh):	165,00	15%	190	190,00	15%	
Demand charge (R/kVA):	440,43	15%	506,00	506,00	15%	

11 CONCLUSION

Having considered Mkhondo Local Municipality's application, the supporting information, stakeholder comments, and the applicable legal and policy framework, the Energy Regulator approves the tariff adjustments as set out in this Reasons for Decision.

End