3

Local government finances

Introduction

Local government plays a pivotal role in social and economic development

Local government plays a pivotal role in the social and economic development of communities and in enhancing democracy. Section 152 of the Constitution specifies the objectives of local government as: to provide democratic and accountable government; to ensure the provision of services in a sustainable manner; to promote social and economic development and a safe and healthy environment; and to encourage the involvement of communities and community organisations in the matters of local government.

In pursuing these objectives, the Constitution obliges local government to perform certain minimum 'developmental duties'. These are to structure and manage municipal administration, budgeting and planning processes, and, in doing so, give priority to the basic needs of the community and promote the social and economic development of the community. Municipalities are also required to participate in national and provincial development programmes.

Policy reforms aim to make municipalities more accountable and financially sustainable

The suite of legislation enacted since 1994 – the Municipal Structures Act (1998), the Municipal Demarcation Act (1998), the Municipal Systems Act (2000), the Municipal Finance Management Act (2003) (MFMA) and the Municipal Property Rating Act (2004) – forms the foundation of the new local government system, embodying the critical package of policy reforms in local government. The legislation aims to make municipalities more accountable, financially sustainable and capable of delivering essential services to their community.

The changes brought about by the legislation include the rationalisation of municipalities from 843 to 284 and the establishment of three categories of municipalities: one-tier metropolitan municipalities (category A), two-tier district municipalities (category C) and local municipalities (category B). There has also been a reassignment of powers and functions between local and district municipalities.

The consolidation and restructuring of local government has led to rebuilding institutions, reorganising administration, establishing workable governance arrangements, relocating personnel, improving revenue management and broadening access to services and basic infrastructure.

This chapter provides an update on the trends in municipal expenditure and income published in the *2003 Intergovernmental Fiscal Review*. It aims to inform stakeholders on progress in local government finances over the past 5 to 10 years. It identifies the reform agenda under way at present and the key challenges for the years to come.

The chapter looks at four broad areas of local government finances:

- municipal budgets and trends
- intergovernmental transfers to local government
- new trends in local government finances
- key budgetary challenges.

Municipal budgets and trends in 2003–04

The analysis in this section covers municipal budgets submitted to National Treasury before June 2004. The information reflects about 98 per cent of local government budgeted income and expenditure from 1996–97 to 2003–04. The municipal financial year starts on 1 July, three months after the financial year for national and provincial governments. More detailed data on municipal budgets are provided in annexure B, tables B1 to B20.

Underlying trends

The total municipal budget nearly doubled over the past eight years

The total municipal budget has nearly doubled over the past eight years. In 2003–04, it is estimated to be R86,0 billion, up 15,3 per cent from 2002–03, including national transfers to municipalities of R12,4 billion. The operating budget constitutes 81 per cent of the R86,0 billion (Table 3.1).

Table 3.1 Budgeted municipal expenditure, 1996–97 to 2003–04

R billion	1996–97	1997–98	1998–99	1999–00	2000–01	2001–02	2002–03	2003–04
Operating	34,0	38,2	41,1	44,4	48,1	52,7	61,5	69,3
Capital	11,8	10,8	13,7	13,7	13,7	11,7	13,1	16,7
Total	**45,8**	**49,0**	**54,8**	**58,1**	**61,8**	**64,4**	**74,6**	**86,0**
Percentage growth								
Operating		12,4%	7,6%	8,0%	8,3%	9,6%	16,7%	12,7%
Capital		-8,5%	26,9%	0,0%	0,0%	-14,6%	12,0%	27,5%
Total		**7,0%**	**11,8%**	**6,0%**	**6,4%**	**4,2%**	**15,8%**	**15,3%**

Source: National Treasury local government database

Metropolitan municipalities make up 58,8 per cent of the combined budget

Metropolitan municipalities make up 58,8 per cent of the combined budget of municipalities. Table 3.2 shows the 2003–04 budgets by category of municipality. In 2002–03, district municipalities budgeted to spend 20,7 per cent on capital. This increased to 48,2 per cent in 2003–04. In contrast, local municipalities reduced the proportion to be spent on capital from 22,3 per cent in 2002–03 to 20,8 per cent in 2003–04.

Table 3.2 Budgets by category of municipality, 2003–04

R million	Operating	Capital	Total	Percentage of total Operating	Percentage of total Capital
Category A (Metros)	42 677	7 889	50 565	84,4%	15,6%
Category B (Locals) [1]	23 905	6 286	30 190	79,2%	20,8%
Category C (Districts) [1]	2 705	2 513	5 218	51,8%	48,2%
Total	**69 286**	**16 687**	**85 974**	**80,6%**	**19,4%**

1. The operating budgets of category B and C municipalities exclude duplications of R2,9 billion.
Source: National Treasury local government database

The change in the budgets reflects shifts in powers and functions

The significant change in the proportion of operating capital budget to total budget for local and district municipalities is a reflection of the division of powers and functions announced by national government in 2003, and which took effect in the 2003–04 budget. The major shift in capital expenditure from local to district municipalities was in the water and sanitation functions, especially for municipalities in KwaZulu-Natal, Northern Cape and Limpopo.

Johannesburg, Cape Town and eThekwini comprise approximately two-thirds of the total budget for metropolitan municipalities

Closer inspection of the 2003–04 budgets of the six metropolitan municipalities and large local municipalities clearly demonstrates where there is the most municipal activity (Table 3.3). Johannesburg tops the list at R12,2 billion, followed by Cape Town at R10,3 billion and eThekwini (Durban) at R9,8 billion. These three comprise nearly two-thirds of the total budget of metropolitan municipalities.

But when these budgets are compared to population figures a slightly different picture emerges. The average budget per capita for the metropolitan municipalities is R3 444. The highest is Johannesburg at R3 774, then Tshwane (Pretoria) at R3 565 and Cape Town at R3 543. Although eThekwini has the third-highest budget of the six metropolitan municipalities, it has the lowest budget per capita at R3 172.

Urban municipalities have growing poor populations

Changing demographics, as reflected in the 2001 census results, show that urban municipalities, mainly as a result of migration, have growing poor populations. Many poor families settle in informal settlements on the periphery of urban municipalities, thus presenting these municipalities with a challenge to develop sustainable settlements.

The most significant local municipality budgets are Buffalo City (East London), Mangaung (Bloemfontein) and Msunduzi (Pietermaritzburg), which are all over R1,0 billion. Stellenbosch has the highest budget per capita at R3 297, close to the average for metropolitan municipalities.

Table 3.3 Operating and capital budgets for a sample of municipalities, 2001–02 to 2003–04

Municipality	Population 2001 (thousand)	Total budget (R million) 2001–02	2002–03	2003–04	Rand per capita 2002–03	2003–04
Metros						
Johannesburg	3 226	10 314	10 978	12 175	3 403	3 774
Cape Town	2 893	9 492	9 775	10 251	3 379	3 543
eThekwini (Durban)	3 090	7 920	9 336	9 802	3 021	3 172
Ekurhuleni (East Rand)	2 480	7 667	8 087	7 998	3 261	3 225
Tshwane (Pretoria)	1 986	5 436	6 071	7 081	3 057	3 565
Nelson Mandela (Port Elizabeth)	1 006	2 094	2 492	3 258	2 477	3 239
Subtotal	**14 681**	**42 923**	**46 739**	**50 565**	**3 184**	**3 444**
Percentage growth			*8,9%*	*8,2%*		*8,2%*
Top local municipalities						
Buffalo City (East London)	702	1 261	1 320	1 511	1 880	2 152
Mangaung (Bloemfontein)	645	1 065	1 297	1 497	2 011	2 321
Msunduzi (Pietermaritzburg)	553	1 111	1 177	1 298	2 128	2 347
Rustenburg	396	574	699	739	1 765	1 866
uMhlathuze (Richards Bay)	289	554	617	717	2 135	2 481
Polokwane (Pietersburg)	508	536	719	664	1 415	1 307
Mbombela (Nelspruit)	475	374	437	530	920	1 116
Drakenstein (Paarl)	194	371	449	511	2 314	2 634
Sol Plaatje (Kimberley)	201	430	438	504	2 179	2 507
Govan Mbeki (Highveld East)	222	369	355	442	1 599	1 991
Stellenbosch	118	271	342	389	2 898	3 297
Maluti-a-Phofung (Harrismith)	361	182	282	362	781	1 003
Mafikeng	259	194	169	281	653	1 085
Msukaligwa (Ermelo)	125	113	137	154	1 096	1 232
uMngeni (Howick)	74	66	83	92	1 122	1 243
Cederberg (Clanwilliam)	39	47	52	56	1 333	1 436
Engcobo	148	63	48	55	324	372
Musina (Messina)	39	31	33	39	846	1 000
Tokologo (Boshof)	32	18	31	32	969	1 000
Subtotal	**5 380**	**7 630**	**8 685**	**9 873**	**1 614**	**1 835**
Percentage growth			*13,8%*	*13,7%*		*13,7%*
Total	**20 061**	**50 553**	**55 424**	**60 438**	**2 763**	**3 013**
Percentage growth			*9,6%*	*9,0%*		*9,0%*

Source: National Treasury local government database

Expenditure trends

The capital budget grew faster than the operating budget in 2003-04

Expenditure trends between 1996–97 and 2002–03 as set out in table 3.1. demonstrate that the operating budget grew faster than the capital budget. This trend reversed in 2003–04, with the capital budget growing by 27,5 per cent compared to a 12,7 per cent rise in the operating budget. This reflects an improvement in the quality of data and shift towards greater municipal infrastructure development.

Operating expenditure

On average, 33 per cent of operating income finances personnel costs

Of the R69,3 billion operating budget for 2003–04, 32,9 per cent was spent on personnel, 24,1 per cent on bulk services and 43,0 per cent on ‘other’, which includes repairs and maintenance, general expenditure, interest and redemption of loans, and provisions for under-collection of revenue (Table 3.4).

Table 3.4 Budgeted municipal operating expenditure, 2000–01 to 2003–04

	2000–01	2001–02	2002–03	2003–04
R billion				
Salaries	15,9	17,9	19,8	22,8
Bulk services	14,9	13,7	15,3	16,7
Other	17,3	21,1	26,4	29,8
Operating budget[1]	**48,1**	**52,7**	**61,5**	**69,3**
Percentage growth				
Salaries	15,2%	12,6%	10,6%	15,2%
Bulk services	8,0%	-8,1%	11,7%	9,2%
Other	2,4%	22,0%	25,1%	12,9%
Operating budget	**8,1%**	**9,6%**	**16,7%**	**12,7%**

1. Excludes duplications between district and local municipalities.
Source: National Treasury local government database

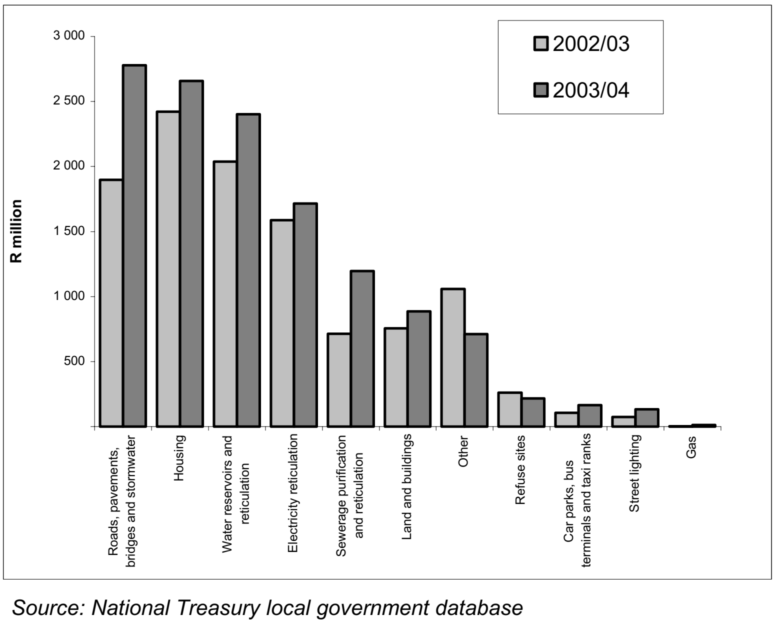
Personnel expenditure grew by 15,2 per cent in 2002-03. The *2003 Intergovernmental Fiscal Review* raised concerns about the rapid increase in overall personnel expenditure in local government. It was reported that the salaries and benefits of municipal employees were generally considerably higher than their counterparts in national and provincial governments. Local government faces the challenge of containing administrative and personnel costs.

Capital expenditure

Capital investments in municipal infrastructure are essential

Capital investments in municipal infrastructure are essential if municipalities are to fulfill their development mandate. It has taken time for capital expenditure to feature as a significant part of municipalities' funding priorities, largely owing to the series of amalgamations, insufficient capacity, and a shortage of financing options.

Figure 3.1 Local government capital budget: 2003–04



Source: National Treasury local government database

81 per cent of capital expenditure for 2003–04 has been attributed to infrastructure

Similar to 2002–03, 81 per cent of budgeted capital expenditure in 2003–04 has been attributed to general infrastructure. Figure 3.1 shows that in 2003–04, the largest proportion of general infrastructure expenditure was earmarked for roads, pavements, bridges and storm-water (R2,9 billion), housing (R2,8 billion), water reservoirs and reticulation (R2,5 billion) and electricity reticulation (R1,8 billion). Moreover, the roads, pavements, bridges and storm-water category, and sewerage purification and reticulation category have benefited the most from real increases in expenditure between the two years at 46 per cent and 68 per cent, respectively.

Revenue trends

Operating income

User charges are the largest contributor to local government revenue

The four main sources of revenue for municipal operating expenditure are user charges, property rates, Regional Services Council (RSC) levies and intergovernmental grants (Table 3.5). The 'other' source of funding, which is also significant, includes traffic fines, rental of housing stock, interest on investments, recovery of outstanding debt, and the use of previous years' surplus funds.

Table 3.5 Budgeted municipal operating income, 2001–02 to 2003–04

R billion	2001–02	2002–03	2003–04
User charges	25,0	28,0	31,0
Property rates	11,5	12,5	14,3
RSC levies	3,9	4,4	5,2
Intergovernmental grants	3,6	6,7	8,1
Other	10,3	10,0	14,3
Total	**54,3**	**61,6**	**72,9**
Percentage growth			
User charges		12,0%	10,7%
Property rates		8,7%	14,4%
RSC levies		12,8%	18,2%
Intergovernmental grants		86,1%	20,9%
Other		-2,9%	43,0%
Total		**13,4%**	**18,3%**

Source: National Treasury local government database

User charges

User charges for providing water, sanitation, electricity and refuse removal services are the largest contributors to local government revenue. Revenue from user charges increases from R28 billion in 2002-03 to R31 billion in 2003-04.

Property rates

Property rates make up 20 per cent of local government revenue and are levied in metropolitan and local municipalities (Table 3.6).

Table 3.6 Property rates by category of municipality, 2001–02 to 2003–04

R billion	2001–02	2002–03	2003–04
Metros (Category A)	6,3	8,9	10,1
Local (Category B)	3,1	3,7	4,3
Total	**9,4**	**12,6**	**14,4**

Source: National Treasury local government database

The new Municipal Property Rating Act will bring about significant changes to how these levies are raised. The primary aims of the Act are: to assist municipalities to broaden their rates base to include previously excluded property and provide transitional rules to phase in rates in these areas; and to provide uniform national rules regarding valuation and appeals, rating policy and rate setting.

The new Municipal Property Rating Act requires valuations based on the market value of a property

Previously, various valuation methods were used. The Act now requires valuation to be based on the market value of a property, namely, land plus improvements. Each municipality will continue to set and collect property rates in a manner appropriate to its circumstances. Municipalities should monitor the impact of the new valuation system on different sectors, including the residential sector, to avoid exorbitant increases in rates. Should the rates base substantially increase due to the new market-based valuation roll, municipalities should reduce the rate in the Rand levied. In addition, municipalities need to take into account the growth rates in budgets as determined annually by National Treasury.

Table 3.7 Revenue from Regional Services Council levies, 1999–00 to 2003–04

District councils R million	1999–00	2000–01	2001–02	2002–03	2003–04
Eastern Cape	217	223	121	135	141
Free State	142	148	165	171	197
Gauteng	367	368	146	171	214
KwaZulu-Natal	189	198	203	186	263
Limpopo	84	84	90	111	196
Mpumalanga	202	217	248	282	305
Northern Cape	140	140	62	54	84
North West	55	55	126	154	185
Western Cape	126	132	143	155	207
Subtotal	**1 521**	**1 567**	**1 303**	**1 419**	**1 791**
Percentage growth		*3,0%*	*-16,9%*	*8,9%*	*26,2%*
Metros					
Eastern Cape	–	–	142	149	180
Gauteng	1 095	1 098	1 692	1 876	2 369
KwaZulu-Natal	270	283	210	323	135
Western Cape	500	527	562	654	749
Subtotal	**1 865**	**1 908**	**2 606**	**3 001**	**3 433**
Percentage growth		*2,3%*	*36,6%*	*15,2%*	*14,4%*
Total	**3 386**	**3 474**	**3 908**	**4 421**	**5 224**
Percentage growth		*2,6%*	*12,5%*	*13,1%*	*18,2%*

Source: National Treasury local government database

Regional Services Council levies

Two-thirds of RSC levies collected in six metropolitan municipalities

RSC levies are an important source of revenue for metropolitan and district municipalities, making up 7 per cent, or R5,2 billion, of total local government revenue in 2003–04 (Table 3.7). Of this, Johannesburg collects R1,4 billion, reflecting the fact that 74 per cent of company head offices are based in this municipality. Johannesburg also had the largest budgeted absolute increase in collections, of around R350 million, between 2002–03 and 2003–04. Two-thirds of RSC levies collected come from the six metropolitan municipalities.

The RSC levy is an inefficient, inequitable and poorly administered tax instrument

The RSC levy system consists of two components, a regional services levy and a regional establishment levy, calculated on payroll and turnover respectively. The actual rates vary by municipality, but have been frozen since 1996. The RSC levy has been severely criticised as being an inefficient, inequitable and poorly administered tax instrument. At present, National Treasury is reviewing this tax as part of its review of the local government fiscal framework.

Capital income

Table 3.8 shows that since 2002–03 budgeted capital spending has been increasingly financed from national and provincial infrastructure grants and subsidies. The bulk of this is through the consolidated municipal infrastructure programme. Previously, capital spending was largely financed by external loans, own sources and other sources, such as donations and public contributions.

Table 3.8 Budgeted sources of finance for capital expenditure, 2001–02 to 2003–04

R million	2001–02	2002–03	2003–04
National transfers [1]	3 947	5 160	7 522
Internal advances, contributions from revenue, public contributions	4 935	4 908	5 680
Other financing, provincial contributions	1 166	1 361	1 842
External loans	1 725	1 692	1 694
Total	**11 773**	**13 120**	**16 738**
Percentage growth			
National transfers		30,7%	45,8%
Internal advances, contributions from revenue, public contributions		-0,6%	15,7%
Other financing, provincial contributions		16,7%	35,4%
External loans		-1,9%	0,1%
Total		**11,4%**	**27,6%**

1. Transfers received from national during municipal financial year and excludes indirect and grants in-kind.
Source: National Treasury local government database

There is scope for private sector involvement in the financing of capital projects

There is clearly scope for private sector involvement in the financing of capital projects in the local government sphere. Surveys reveal that borrowing from the private sector remains an untapped resource. National government has committed itself to assisting municipalities to do this through the development of a strong municipal borrowing market under the auspices of the MFMA. This is discussed further in the section on new trends in local government finances.[1]

Intergovernmental transfers

National transfers

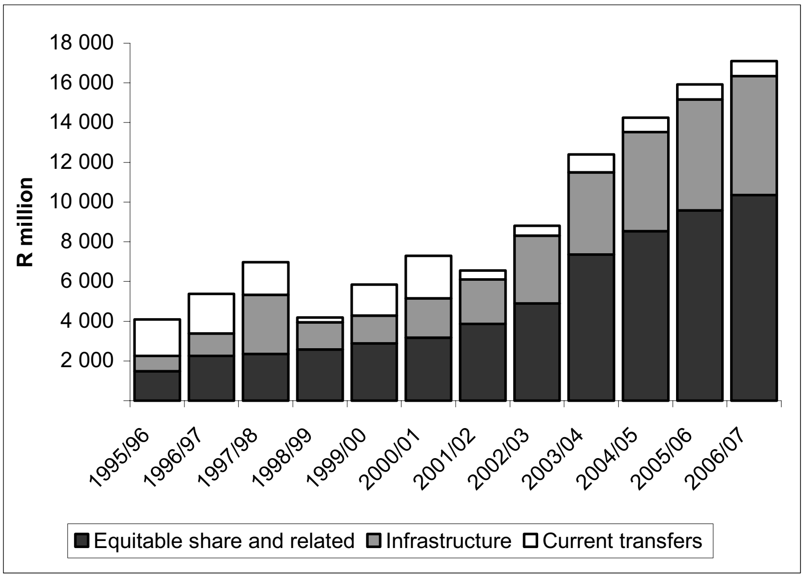
Strengthening local government is on government's list of medium-term priorities

Over the past 10 years, local government has been receiving an increasing percentage of national revenue at an average annual growth rate of 15 per cent. Although this growth is off a low base, government has recognised the need to overcome the challenges at the local government level to improve basic service delivery. This places strengthening the local government sphere firmly on government's list of priorities over the medium term.

Expenditure needs vary across municipalities depending on the following factors, to name a few:

- the extent of own revenues
- the extent of backlogs
- the size of the population and, more importantly, the size of the poor population
- the assignment of powers and functions.

Figure 3.2 National transfers to local government



Source: Department of Provincial and Local Government

At present, government is reviewing the local government fiscal framework to create a sustainable environment, which enhances service delivery.

It is frequently claimed that over two-thirds of municipal activity is self-funded, though this is not necessarily the case in individual municipalities, especially in Eastern Cape, KwaZulu-Natal and

[1] National transfer do not reconcile to national financial year as the local government's financial differ.

Limpopo. Table 3.9 shows the highest and lowest dependency rates in provinces. Nationally, the highest is 92 per cent in Bohlabela (Limpopo) and the lowest is 3 per cent in Cape Town).

Local government funding increased significantly in 2003/04

Figure 3.2 shows that there was a significant increase in local government funding in 2003/04.

Table 3.9 Transfers to municipalities, 2003/04

Metro or consolidated district and local municipalities R million	Total municipal budgets[1]	Total transfers[2]	Transfers as percentage of budget
Alfred Nzo (Umzimvubu)	331,1	282,8	85,4%
Nelson Mandela	3 258,0	219,0	6,7%
Eastern Cape	**8 589,8**	**2 669,0**	**31,1%**
Thabo Mofutsanyana (Maluti a Phofung)	1 000,7	369,8	37,0%
Northern Free State (Metsimaholo)	987,5	150,9	15,3%
Free State	**4 824,2**	**1 176,9**	**24,4%**
Metsweding (Kungwini)	300,8	33,4	11,1%
City of Johannesburg	12 175,1	385,1	3,2%
Gauteng	**30 438,5**	**1 209,7**	**4,0%**
Umkhanyakude (Jozini)	279,5	174,1	62,3%
eThekwini	9 801,9	537,7	5,5%
KwaZulu-Natal	**16 083,3**	**2 286,0**	**14,2%**
Bohlabela (Bushbuckridge)	267,1	246,0	92,1%
Capricorn (Polokwane)	1 054,0	327,0	31,0%
Limpopo	**3 368,8**	**1 815,7**	**53,9%**
Ehlanzeni (Mbombela)	1 057,1	314,9	29,8%
Nkangala (Emalahleni)	1 460,9	228,4	15,6%
Mpumalanga	**3 214,5**	**774,1**	**24,1%**
Kgalagadi (Ga-Segonyana)	272,6	131,9	48,4%
Frances Baard (Sol Plaatje)	688,6	109,1	15,8%
Northern Cape	**1 662,7**	**429,7**	**25,8%**
Central (Mafikeng)	594,1	223,6	37,6%
Southern (City of Klerksdorp)	1 113,2	128,5	11,5%
North West	**3 411,6**	**842,4**	**24,7%**
Central Karoo (Beaufort West)	131,7	49,5	37,6%
Cape Town	10 251,2	304,7	3,0%
Western Cape	**14 483,8**	**594,6**	**4,1%**
Total	**86 077,2**	**11 798,0**	**13,7%**

1. Includes total municipal capital and operating budgets.
2. Excludes indirect and grants in kind.
Source: National Treasury local government database

There are three broad streams of national transfers: equitable share, infrastructure and current transfers. At present, around 55 per cent of local government funding is through the equitable share. See annexure B, table B21 for a detailed breakdown of national transfers to local government.

Equitable share

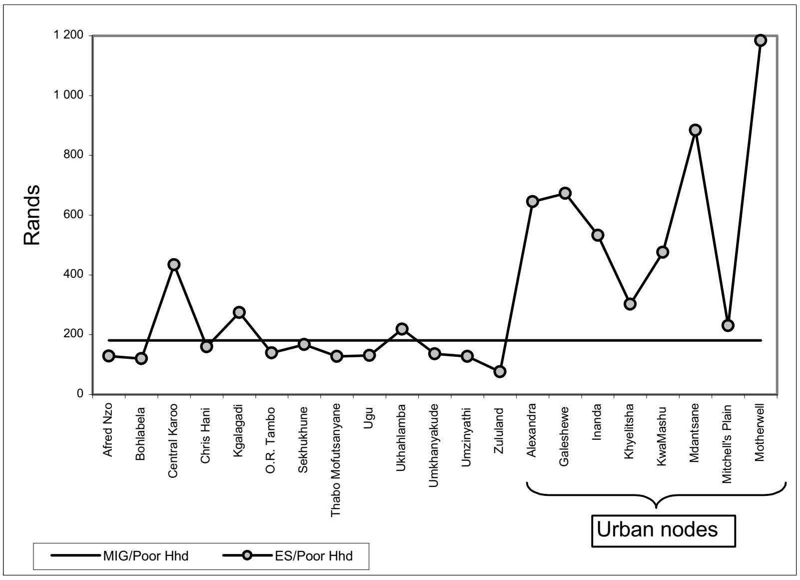
Over the past decade the intergovernmental fiscal system has moved towards greater discretion at the local sphere. Thus, the unconditional equitable share grant progressively forms a greater proportion of the overall transfers to local government.

The unconditional equitable share grant forms a progressively greater proportion of overall transfers

The review of the equitable share formula falls under the broader review of the local government framework. It will critically analyse the formula and put in place a simpler, more robust, transparent and reformed one.

An example of an area under review is the allocation of funding to nodal areas. Nodal areas have been identified according to poverty-weighted criteria. At present, there are 21 nodal areas, 13 of which are in rural areas. Figure 3.3 depicts the distribution of equitable share funding per poor household in each nodal area. In contrast, the municipal infrastructure grant (MIG) allocates R181 to a municipality for every poor household in its nodal area. The review aims to explore the most appropriate way to allocate funding to nodal areas.

Figure 3.3 Allocations per poor household in nodal areas



Source: National Treasury local government database

Municipal infrastructure grant

The creation of the new consolidated MIG in 2003 paved the way for the swifter delivery of infrastructure to poor communities. The adoption of the MIG makes it possible to systematically eliminate the backlogs in basic infrastructure over a 10-year period beginning in 2004.

The MIG paves the way for swifter delivery to the poor

The *Census 1996* and *Census 2001* results shown in table 3.10 indicate the extent of these backlogs in water, sanitation, electricity and refuse removal.

Table 3.10 Backlogs in access to basic infrastructure by category of municipality

Households (thousand)	Year / percentage	Category A	Categories B and C	Total
Backlogs in access to water [1]	1996	568	3 045	3 613
	2001	486	2 711	3 197
	Percentage growth	*-15%*	*-11%*	*-12%*
Backlogs in access to sanitation [2]	1996	204	1 389	1 593
	2001	737	3 923	4 660
	Percentage growth	*261%*	*182%*	*193%*
Backlogs in access to electricity [3]	1996	661	3 191	3 852
	2001	785	2 722	3 507
	Percentage growth	*19%*	*-15%*	*-9%*
Backlogs in access to refuse removal [4]	1996	488	3 775	4 263
	2001	524	4 726	5 250
	Percentage growth	*7%*	*25%*	*23%*
Number of households	1996	3 224	5 900	9 124
	2001	4 294	7 488	11 783
	Percentage growth	*33%*	*27%*	*29%*

1. Piped water on site (1996), piped water within 200m of dwelling (2001).
2. Pit latrine (1996), ventilated pit latrine (2001).
3. Electricity used for lighting (1996) (2001).
4. Refuse removed by local authority less than weekly (1996), refuse removed weekly (2001).
Source: Census 1996 and Census 2001

The number of households grew by 29 per cent between the 1996 and 2001 censuses, which partly explains the general increase in backlogs. Local municipalities have a significantly larger number of backlogs compared to metropolitan municipalities. The greatest strides in eliminating backlogs have been made in the water sector.

Current transfers

The capacity building and restructuring grants are the two main current transfers. They have been capped at R750 million from 2005/06. In the two outer years of the 2004 medium-term expenditure framework (MTEF) R550 million will be shifted from the capacity-building programme to the equitable share as shown in annexure B, table B21.

New trends in local government finances

Municipalities are exploring different ways to raise financing for infrastructure

Municipalities face some challenges in the delivery of public services and infrastructure. Despite the considerable achievements of the past 10 years, large backlogs remain.

Municipalities are exploring different ways to raise financing for municipal infrastructure. Investment in capital projects requires substantial resources over a considerable length of time. However, many capital projects have the ability to generate revenue. With this in mind, municipalities are turning to borrowing, in the form of loans and bonds, and to public-private partnerships (PPPs).

Borrowing

The *2003 Intergovernmental Fiscal Review* noted that the main reasons for the stagnant municipal borrowing market were related to the transition process and uncertainty in the financial markets. Several steps have since been taken by national government to address these challenges, the most recent being the enactment of the MFMA.

A quarterly survey shows that during the period ending March 2003 and March 2004 the total borrowing by metropolitan municipalities increased from R12,1 billion to R12,5 billion, as depicted in table 3.11. Together, eThekwini and the City of Johannesburg account for around 55 per cent of this borrowing. These figures do not include the recent R2 billion bond issued by the City of Johannesburg, which would not have translated into an equal increase in the stock of debt as part of it was used to restructure existing debt. This bond is discussed in more detail below.

Table 3.11 Borrowing by category A municipalities, March 2003 to March 2004

R million	March 2003	June 2003	September 2003	December 2003	March 2004
City of Cape Town	2 093,2	2 127,2	2 714,9	2 655,6	2 653,3
City of Johannesburg	3 333,2	3 684,3	3 904,1	3 962,2	3 842,8
City of Tshwane	1 750,6	1 764,4	1 847,2	1 948,5	1 539,9
eThekwini	3 493,0	3 287,0	3 146,0	3 100,0	3 085,4
Ekurhuleni	1 071,5	1 092,2	1 090,6	1 068,4	1 068,4
Nelson Mandela	342,1	356,4	333,0	328,0	296,9
Total	**12 083,5**	**12 311,6**	**13 035,7**	**13 062,8**	**12 486,7**

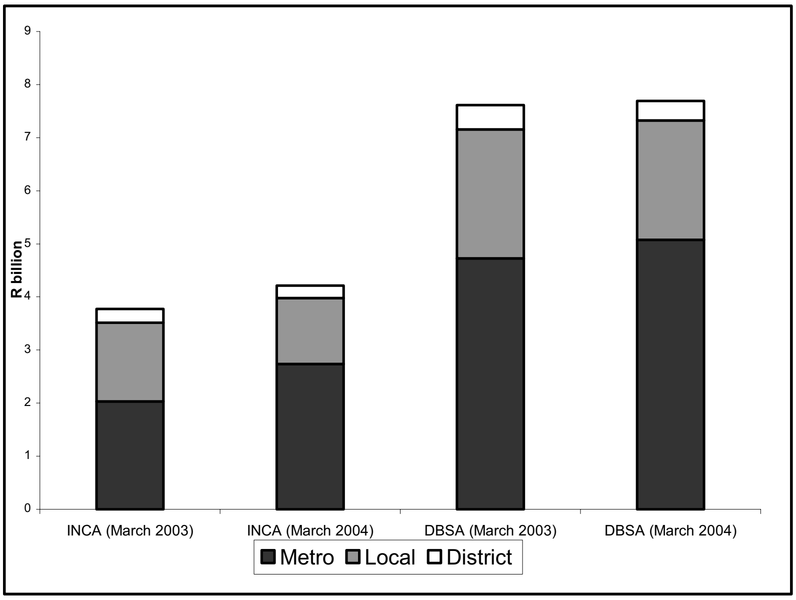
Source: National Treasury local government database

The DBSA and INCA dominate the municipal borrowing market

The municipal borrowing market continues to be dominated by two players: the Development Bank of Southern Africa (DBSA), a public sector lender, and the Infrastructure Finance Corporation (INCA), a private sector lender. Together these institutions' exposure to municipalities amounted to R11,9 billion during the quarter ending March 2004 (Figure 3.4).

The DBSA has the largest market share in municipal borrowing, largely in the form of long-term loans. Both institutions have concentrated on the metropolitan municipalities, which at present receive around 65 per cent of their total lending to municipalities. INCA's exposure to municipalities has increased substantially, mainly because of the debt acquired from the Public Investment Commission (PIC).

Figure 3.4 Borrowing by lender, March 2003 and March 2004



City of Johannesburg's bond

The City of Johannesburg has become the first municipality to issue a bond under the MFMA. The first bond was 1,5 times oversubscribed with a total of 14 investors buying into it. Pegged at R1 billion, the six-year bond was issued at a rate of 230 basis points above the R153 equivalent government benchmark bond. Interest on the bond will be paid biannually in arrears. The first payment will be in October 2004. The bond is trading in the secondary market. Proceeds from the bond will go towards refinancing the municipality's debts and funding capital expenditure.

The second bond of R1 billion will have a tenure of 12 years, 6 years longer than that of the first. The DBSA and the International Finance Corporation issued the second bond at a lower cost due to the securitisation of the risk profile.

Other municipalities are expected to enter the market over the medium term.

Public-private partnerships

PPPs are part of government's strategy for accelerating service delivery

PPPs are an important component of government's strategy for service and infrastructure rollout, but their viability has to be properly tested in each case. PPPs are being considered among a range of possible mechanisms for delivery in all spheres of government.

Read together, the amended Municipal Systems Act and the provisions of the MFMA that deal with PPPs provide the legal framework for municipal PPPs.

Each PPP is evaluated on its own merits

The MFMA prescribes that PPPs must provide value for money, present an appropriate allocation of risks between the contracting parties, and be affordable in terms of current and projected budgets.

The Act requires that a PPP regulatory framework be developed and prescribed by National Treasury. It also requires that municipalities conduct feasibility studies before concluding PPPs.

Key budgetary challenges

This chapter has so far highlighted the nature of municipal finances. The following section analyses some of the challenges faced by municipalities, which, once addressed, will enhance their finances, and, in turn, their ability to deliver services.

Revenue collection

The capacity of a municipality to deliver services is highly dependent on its ability to bill and collect revenue from its own sources. Poor capacity has worsened the financial distress in a number of municipalities.

The total outstanding consumer debt to municipalities has risen to R28 billion

The total outstanding consumer debt to municipalities has risen to an estimated R28 billion. Municipalities have often not applied the appropriate policies to address this challenge. Consequently, households and businesses have accumulated large arrears, which are preventing them from paying for current services and result in spiralling debt. Many households with large debts are poor, and there is little prospect of recovering their arrears. Resolving arrears is an important challenge.

Pro-poor policies

The challenge remains to extend services to poor households

National priorities and policies to alleviate poverty also exert significant budgetary pressures on municipalities, particularly those related to free basic services. The *2003 Intergovernmental Fiscal Review* noted the early successes in implementing the policy to provide free basic services, particularly water. However, of the 27 million people receiving free basic services, only 12 million were poor. The challenge remains to extend these services to poor households, particularly those without access to piped water and electricity.

This challenge can only be effectively met if municipalities address four principal operational issues:

- to ensure that there is adequate infrastructure in place to provide access to basic services to all households
- to define minimum levels and what constitutes an appropriate basket of services
- to develop an appropriate subsidy/targeting mechanism to ensure that households in need benefit with minimum leakage to non-qualifying households
- to ensure that overall average revenues are able to meet average costs.

A municipal indigency policy should serve as the critical framework

A municipal indigency policy should serve as the critical framework and should ensure that poor families are identified and receive free basic services. Moreover, an indigency policy should link to other poverty alleviation programmes implemented through other spheres of government, such as social grants and housing.

Budget reforms and the Municipal Finance Management Act

The MFMA took effect on 1 July 2004 and is spearheading the financial modernisation of the local government sphere. The MFMA is now the primary legislation governing municipal finance and supersedes provincial ordinances.

Financial governance

The MFMA fosters greater co-operation across and within the three spheres of government

One of the important objectives of the MFMA is to develop sound financial governance in every municipality. This means developing a comprehensive system that clarifies the responsibilities of mayors, councillors and officials. The system must be built around accountability and oversight, which are possible only if there is a culture of transparency and regular reporting in each municipality. The MFMA fosters a greater level of co-operation across and within the three spheres of government, based on systems of mutual support, information sharing, communication and co-ordination of activities.

Long-term planning

All municipalities should adopt three-year budgets

Municipalities progressively developed long-term integrated development plans (IDPs) following the reforms of the Municipal Systems Act in 2000. The MFMA strengthens this strategic approach by requiring budgets and reporting to be aligned with revised IDPs through the integration of processes. The MFMA reinforces and builds upon the need to engage and consult local communities, district municipalities, and provincial and national governments when setting strategic goals and budgets. A requirement for all municipalities to adopt three-year budgets will also ensure that the ongoing costs of strategies and services are sustainable in future years.

Maximising service delivery

Employment contracts should be linked to performance targets

The MFMA recognises that effective service delivery is only possible with good quality management information and through continuous and relevant performance measurement. This allows a council to set targets and goals for service delivery and management to be proactive. Linking the employment contracts of senior officials to a council's performance targets will ensure targets are met and services delivered.

Conclusion

While considerable progress has been made in building sustainable local government, the sphere has yet to evolve into a mature and fully functioning system. There are considerable challenges ahead in ensuring sound financial management and, in turn, effective and efficient service delivery.

The introduction of the MFMA and the Municipal Property Rates Act is another milestone on the reform agenda. The reforms highlighted here encourage a stronger, sustainable and more accountable local government sphere, better placed to meet the emerging demands and new challenges of the different communities it serves.