STATE OF CITY FINANCES REPORT 2007

South African CitiesNetwork

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CONTENTS

FOREWORD BY THE PROJECT PARTNERS iv

ABOUT THE WRITERS v

CHAPTER ONE: INTRODUCTION TO THE STRATEGIC ISSUES IN CITY FINANCE 1
1.1 On the importance of cities and the financing of city government services 2
1.2 An overview of the report structure 5

CHAPTER TWO: THE DEVELOPMENT OF THE CURRENT SYSTEM OF CITY FINANCING IN SOUTH AFRICA 9
2.1 Introduction 10
2.2 Early city administration and finance in South Africa 10
2.3 Responses to the 1976 uprising and the township rent boycotts 12
2.4 The Local Government Negotiating Forum and broader constitutional debates 12
2.5 Municipal finance in the interim phase and the new legislative framework 14
2.6 The White Paper and the ensuing legislative and institutional framework 14
2.7 Conclusion 16

CHAPTER THREE: OVERVIEW OF THE CURRENT FINANCIAL POSITION OF THE CITIES 17
3.1 Introduction 18
3.2 Changes in net assets (community wealth) 20
3.3 Net operating results 22
3.4 Consumer debtors 29
3.5 Investments in property, plant and equipment (capital assets) 32
3.6 Financing of capital assets 34
3.7 Borrowing 35
3.8 Cash flow 37
3.9 Conclusion 38

CHAPTER FOUR: EXPENDITURE-SIDE CHALLENGES: POVERTY GROWTH AND MAINTENANCE 39
4.1 Introduction 40
4.2 Poverty and indigency in the cities 40
4.3 Backlogs and the need for city infrastructure and services 41
4.4 The scale of housing and infrastructure backlogs in the cities 42
4.5 The financial implications of a successful housing backlog elimination programme 44
4.6 Investments for growth in the cities 45
4.7 Maintenance and refurbishment challenges 48
4.8 Conclusion 49

CHAPTER FIVE: REVENUE-SIDE CHALLENGES: TAXATION, ACCOUNTABILITY & REVENUE ADMINISTRATION 51
5.1 Introduction 52
5.2 Implementation of the new Municipal Property Rates Act 2005 54
5.3 The abolition of RSC/JSB levies and options for replacement 56
5.4 Revenue administration, collection rates and arrears 58
5.5 Tax and tariff structures and the design of indigent support 61
5.6 Conclusion 64

CHAPTER SIX: FINANCIAL ADMINISTRATION IN THE CITIES 66
6.1 Introduction 67
6.2 Modernising organisational and financial administration 67
6.3 Municipal entities 70
6.4 Financial IT systems 71
6.5 Audit reports 74
6.6 Conclusion 75

CHAPTER SEVEN: CITIY FINANCES AND INSTITUTIONAL CHANGE 76
7.1 Introduction 77
7.2 The division of functions and the flow of funds 77
7.3 The restructuring of the electricity distribution industry 80
7.4 The single public service 86
7.5 Conclusion 89

CHAPTER EIGHT: A CITY FINANCIAL AGENDA 90

INDEX OF TABLES, CHARTS AND BOXES 94

REFERENCES 96

GLOSSARY OF TERMS 98

APPENDICES: FINANCIAL ALMANAC 99
1 Johannesburg: revenues, expenditures, net operating results and balance sheets, 2003 to 2006 99
2 Tswhane: revenues, expenditures, surpluses, and balance sheets, 2003 to 2006 101
3 eThekwini: revenues, expenditures, surpluses, and balance sheets, 2003 to 2006 103
4 Mangaung: revenues, expenditures, surpluses, and balance sheets, 2003 to 2006 105
5 Cape Town: revenues, expenditures, surpluses, and balance sheets 2003 to 2006 107
6 Buffalo City: revenues, expenditures, surpluses, and balance sheets 2003 to 2006 109
7 Msunduzi: revenues, expenditures, surpluses, and balance sheets 2003 to 2006 111
8 Nelson Mandela Bay: revenues, expenditures, surpluses, and balance sheets 2003 to 2006 113
9 Ekurhuleni: revenues, expenditures, surpluses, and balance sheets 2003 to 2006 115
10 Total: 9 cities: revenues, expenditures, surpluses, and balance sheets 2003 to 2006 117
11 Division of Revenue Act grants 2003–2006 119
12 Analysis of government grants 2005 & 2006 120
13 Operating budgets for 2005/6 121
14 Liabilities 2005 & 2006 122
15 Loan profiles 2007 to 2016 & thereafter 123
16 Debtors 2003 to 2006 124
17 Reserves 2005 & 2006 125

FOREWORD BY THE PROJECT PARTNERS

This report is concerned with what may appear to be a dry and technically forbidding subject, the financing of municipal infrastructure and services in South African cities, the financial state of our city governments, and their future financial prospects.

These themes are in fact critical components of our national growth and development path. Far from being merely `technical', these themes reflect and expose many of the fundamental socio-political and economic challenges, trade-offs and contradictions that face South Africa as a whole.

The financial challenges of South African cities deserve attention. Much of South Africa's future growth and development will depend upon well-functioning cities; the cities are home to a rapidly increasing proportion of South Africa's poor households; and most of the housing and infrastructure backlog is found in the cities.

This report is intended to focus attention on these challenges. Produced as a partnership between the Development Bank of Southern Africa, the Institute of Municipal Financial Officers (IMFO), and the South African Cities Network, it is also intended to provide empirical evidence and rigorous analysis to support policy and strategy decisions by all organs of state that have implications for municipal finance.

South African city finances have come a long way in the last 20 years: indeed, city organisational and financial arrangements, and their sheer financial strength, would have been hard to imagine in 1987. Yet it seems that the cities may not be afforded the opportunity to consolidate and build on this strength. Substantial changes to the service offerings and administrative structuring of cities, with significant financial implications, are currently being implemented. This report concludes that there is a significant risk that these changes will have negative financial implications for the cities, and makes proposals about what can be done to mitigate this risk and strengthen city finance in the medium term.

Our thanks go to the members of the writing and production teams who made the report possible. We are also very grateful to the municipal finance officials who provided information and comment; and the many people whose opinions shaped the story and message about city finances.

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Roland Hunter has four degrees in economics and development planning. He worked with civic associations on local government finance matters in the early 1990s, and thereafter spent twelve years as a senior public servant in provincial (Gauteng) and also local government (Johannesburg), in each case having accounting officer responsibilities for finance and economic development. As Executive Director: Finance and Economic Development at the City of Johannesburg, he oversaw its recovery from financial crisis, its introduction of medium-term budgeting, the steady improvement of its credit ratings, and the issuing of its first municipal bonds. His recent consulting work has taken him to Zambia, Swaziland and South Asia, working on specialist aspects of local government finance. He is a co-founder and director of Hunter van Ryneveld (Pty) Ltd, and also a Visiting Adjunct Professor at the Graduate School of Public and Development Management at the University of the Witwatersrand.

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CHAPTER ONE
INTRODUCTION TO THE STRATEGIC ISSUES IN CITY FINANCE

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1.1 On the importance of cities and the financing of city government services

Our cities are important. Home to a growing share of South Africa's population – both rich and poor – as well as two-thirds of the country's economic activity, they are sites of opportunity, growth and development; of culture and organisation, of social contradiction and ferment.

Cities are complex social systems. Their strength lies in the diversity of opportunities and the intensity of the cross-cutting activities they offer. This is what draws people to live in them and what drives city economies. Well-functioning cities create diverse and growing markets, and enable efficient economic production and exchange; poorly managed cities, however, reduce the competitiveness of urban economies and diminish quality of life.

Given their prominence in the national economy, the efficient functioning of the major cities is easily as important as the effective operation of wider national logistical systems such as the national road, rail, power and telecommunications networks.

The effective management of cities requires capable city governments, able both to provide urban services and regulate activities in the interests of the community as a whole. Some public services can be effectively provided by other institutions. But there are a range of key activities which are best undertaken by city governments, especially where these governments are able to exercise authority on their own, or in conjunction with others, over the entire urban area. This includes, in particular, all activities related to the built environment – how urban space is planned and configured; how movement across urban space is facilitated and managed; and how infrastructure and services are provided to support individuals, households and communities across the urban area. City governments may outsource the actual production of some of these services, but, ultimately, they need to ensure service provision in an integrated way that supports the urban system as a whole.

City government in South Africa exists within a multi-sphere system which includes provincial and national government. The various spheres of government are responsible for some of the services provided to city residents, and thus there is a need to co-operate across spheres. But for matters which relate to the built environment, cities are best managed by accountable and efficient city governments.

The finances of city governments are, in turn, fundamental to the functioning of city governments.

While city finance may appear to be a largely technical matter, it has deeply strategic, social, economic and political dimensions. Underlying these different dimensions are two key strategic themes.

Firstly, finance is about making choices regarding the allocation of scarce resources.

What is the optimal level at which city residents and businesses should be taxed in order to provide public services? If taxes are too low there will be insufficient resources to run public services; but if they are too high, local economic activity will be stifled. How should resources best be spent? Backlogs and poverty need to be addressed. But the maintenance of existing infrastructure cannot be neglected. And, at the same time, resources need to be provided for the extension of public goods and services required to underpin new economic activity which will drive the economy and the creation of jobs.

Secondly, finance shapes institutions.

The mechanisms by which an organisation manages its finances, and the transparency and rigour with which it does so, have important institutional impacts. Most significantly, the mechanisms define the patterns of accountability which drive the actual functioning of institutions and the choices they make. For example, the more a city government raises its revenue from its own citizens and businesses, the more attentive it will tend to be to their needs, and the greater its incentive to act in ways which grow the economy and thus its own tax base. A city government which is financed by national grants has far less of an incentive to do so.

This is not to suggest that there is no place for inter-governmental grants in city financing. On the contrary, an equitable share grant is essential in order to bring about a degree of horizontal equity among local governments, and serves as part of a strategy for addressing poverty at municipal level. But the configuration of city responsibilities means that city governments can, and should, be funded mainly by local revenue sources.

This document seeks to tell the story of the financing of the largest city governments in South Africa – in particular, the nine cities that are members of the Cities Network.

Contrary to the negativism often displayed in the media, the tale of city finances in these nine largest municipalities is currently a very reassuring story.

Over the last quarter of a century there have been many pressures on these cities. Under apartheid, the white local authorities were in a generally secure financial position, containing most of the local tax base and responsible mainly for the wealthier parts of the cities. But black local authorities – responsible for the majority of the city populations – were in perpetual financial crisis. This crisis continued, with financial instability an ever-present danger in many of the country's key cities as apartheid was dismantled, as new municipal institutions were established and as service backlogs in black areas were tackled.

Yet the research undertaken in compiling this document, based to a large degree on audited financial results and other well-founded evidence, indicates convincingly that, while there are significant challenges, the country's key cities are now increasingly financially secure. Indeed, taken as a whole, the cities are probably in a stronger financial position than at any time since the beginning of the 1980s. This positive outlook is not necessarily applicable to the whole of the local government sector; there appear to be many smaller and medium-sized local governments which are struggling institutionally. However, since the nine Network cities account for two-thirds of all spending by South Africa's 283 local governments, their relative financial strength is important (see Box 1).

Across the nine cities, the newly created single municipalities which united black and white areas, faced massive challenges through the 1990s and into the current decade. But, as the new institutions have stabilised, expenditure growth has been contained and revenues have increased – including the actual collection of revenue – and there has been much more realistic provisioning for bad debts. A new common accounting framework has been introduced, financial administration has become much more systematic, and in many municipalities there has been substantial modernisation of information technology systems. The strong financial position may in part be explained by a failure to spend sufficiently on services. However, since 2005 this has improved dramatically, with actual capital expenditure for the nine Network cities increasing from R6.157 billion in 2003/4 to R9.511 billion in 2005/6. A significant portion of this capital expenditure has been financed through improved cash flows generated from city activities.

The challenges remain daunting. There are major backlogs to be addressed, both in extending services in poor areas and investing in the maintenance of existing assets. In addition, there are major demands for expenditure on services and infrastructure to underpin new growth.

These challenges are heightened by the fact that financial health in the country as a whole depends largely on such matters as the rate of unemployment, the level of household income, rising household debt, and persistent unemployment. Nevertheless cities have started to show a good financial-management track record in the face of such challenges.

Ironically, just as the outlook brightens, new and serious dangers are emerging in the form of a number of worrying national policy directions on a key set of issues. Collectively, these could profoundly undermine the newly established capabilities.

Until 30 June 2006, a local business tax, known as Regional Services Council (RSC) levies, was collected by the six metropolitan municipalities. These levies generated close to half the amount raised from property tax, with the figure rising to nearly two-thirds in Johannesburg. As will be shown in this report, they have also been an extremely buoyant revenue source. These taxes were abolished on the grounds that they were poorly designed technically, and promises were made that they would be replaced by more effective instruments. As yet, however, there is no clear direction on what, if any, instrument will replace them. In the interim, the revenue loss is largely – although not fully – compensated by means of a grant. The politics of introducing a new local business tax is complex and there is a real danger that efforts to do so will be derailed, with extremely serious implications for city financing over the medium to long term. These implications are not evident in the financial analysis done for this report, which is based on financial statements that reflect the period until termination of RSC levies (see chapter 5).

There are also moves afoot to radically change the way in which electricity is distributed in South Africa, removing electricity supply from city control. Electricity was introduced to South Africa in the late nineteenth century by municipal government and has remained core to its operations and financing ever since. Apart from its importance to cash flows and balance sheets, in researching this report many municipal officials stressed how critical the responsibility for collecting electricity revenues was to recent successes in addressing non-payment across all services. Some of the cities have introduced highly imaginative mechanisms based on piggy- backing on electricity pre-payment systems to manage non-payment of other services while remaining sensitive to poor households (see chapter 7).

New initiatives to create a single public service have recently been tabled by national government. Ever since professional municipal administrations were established in the late nineteenth century, municipal officials have not been part of the central and provincial civil service. The impact of the proposals is little understood in local government, but appears to be aimed mainly at incorporating the municipal sector into the central and provincial civil service. While there are clearly shortcomings in the management of human resources within the cities, the new approach could seriously damage the relative autonomy of city governments and their ability to attract the skills required to address their very distinct and complex challenges (see chapter 7).

As yet, no firm decisions have been taken in any of these three areas. Nor is it being suggested that such proposals are being driven in bad faith. Rather, what appears to be happening is that the decisions are being made without any real understanding of their implications for city governments and administrations, and without an appreciation that – collectively – these changes will seriously weaken the cities. This could be a function of the limited access the bigger cities have to important national policy discussions.

There also appears to be insufficient understanding in some quarters that the key to success in a developmental state lies not in trying to control all implementation from the centre, but in creating effective, accountable local institutions with clear and coherent responsibilities together with the powers and capabilities to meet them.

City governments have not always been an effective voice in promoting their own interests, and must take some responsibility for the failure of other spheres of government to understand their administrative requirements and needs. It is hoped that this document may provide a catalyst for new debate in these critical areas. It is possible that the very scale and breadth of these envisaged changes could offer an opportunity for a rethink of the basis of city financing, which will leave cities, and South Africa as a whole, in a stronger position.

BOX 1 The significance of South Africa's cities

A comprehensive account of the significance of South Africa's cities in the overall national economy and society has been provided in The State of the Cities Report (2006: 2-11). In common with cities worldwide, our cities are centres of population, production, distribution, finance, services, development and administration. They are the decision-making centres of all forms of organisations: governmental, private, and non-governmental. They are centres of innovation, education, culture, and leading sites of change. The nine cities are home to over one third of the national population, including some 40% of the registered unemployed. Table 1 ranks South African cities according to estimated population in 2005:

Table 1 Estimated city populations in 2005

City	Population	% of total
Johannesburg	3 295 088	7.3
eThekwini	3 161 844	7.0
Cape Town	2 969 458	6.6
Ekurhuleni	2 528 303	5.6
Tshwane	2 040 517	4.5
Nelson Mandela Bay	1 100 320	2.4
Buffalo City	765 343	1.7
Mangaung	705 156	1.6
Msunduzi	565 196	1.3
Total: 9 cities	**17 131 225**	**38.1**
Total: RSA	**44 977 826**	**100.0**

Source: SACN (2006)

Table 2 Significance of City Economies in the 2004 National Gross Value Added

City	2004 GVA (R m)	% of RSA
Johannesburg	221 376	18.4
Cape Town	137 149	11.4
Tshwane	122 293	10.2
eThekwini	122 117	10.2
Ekurhuleni	86 393	7.2
Nelson Mandela Bay	35 921	3.0
Mangaung	26 168	2.2
Buffalo City	14 730	1.2
Msunduzi	9 023	0.8
Total: 9 cities	**775 171**	**64.5**
Total: RSA	**1 200 888**	**100.0**

Source: SACN (2006)

The economic weight of the South African cities is far greater than their share of the national population. The nine cities accounted for 64.5% of the national Gross Value Added (GVA) in 2004, and concomitant percentages of especially the tertiary and secondary economic sectors, from finance and business services through transport and communications, wholesale and retail trade, to construction and manufacturing. Table 2 ranks the cities in terms of their estimated share of GVA in 2004.

South Africa's nine city governments are therefore charged with the responsibility to ensure that municipal infrastructure and services are in place to support nearly two thirds of the economic activity of the country. It will readily be appreciated that any failures in respect of municipal service provision in the cities will have immediate consequences for national economic development in the form of higher costs, lower turnover, reduced GVA, and so on, as well as equivalent consequences for social, political, and other forms of activity. A well-functioning city administration may hardly be noticed, as its services will be taken for granted, but any deficiencies in these services are immediately apparent and costly.

Perhaps less well understood is the role and significance of city government financing in this overall picture. City governments, charged with supplying services of considerable significance for two thirds of the economy and one third of society, are big spenders. They accounted for 71% of the total budgeted operating expenditure of local government in 2005/6, and 54% of the total budgeted capital expenditure (National Treasury 2006). Table 3 illustrates the actual expenditure of the nine cities for 2005/6[1]. These expenditures comprise significant portions of the local city economies. Furthermore, they are raised largely from local residents and businesses: less than 10% of the total city spending in 2005/6 was derived from grants.

The effectiveness with which financial resources are raised, managed and deployed for municipal services and development frameworks in the cities is thus a matter of some significance.

1 Actual expenditure for the whole local government sector, based on audited financial statements for 2005/6, was not available at the time of writing.

Table 3 Expenditure by city 2005/6

City	Capital (R m)	Operating (R m)	Total (R m)	% of the 9 cities
Johannesburg	2 743	13 299	16 041	25.0
eThekwini	2 087	9 243	11 331	17.7
Cape Town	1 500	9 635	11 135	17.4
Tshwane	1 228	7 636	8 864	13.8
Ekurhuleni	766	7 540	8 306	13.0
Nelson Mandela Bay	544	3 011	3 555	5.5
Mangaung	252	1 382	1 634	2.5
Msunduzi	187	1 434	1 621	2.5
Buffalo City	203	1 401	1 604	2.5
Total: 9 cities	**9 511**	**54 581**	**64 092**	**100.0**

Source: SACN Almanac (2006)

1.2 An overview of the report structure

This report is structured so as to deal with the two key strategic themes of resource allocation and institutional matters.

Chapter 2 provides a brief review of the history of city financing in South Africa. Noting the origins of formal city government in the nineteenth century, it tracks some of the key developments in city financing through the twentieth century, explaining apartheid city financing and how protests in response to this lay at the core of anti-apartheid opposition during the 1980s.

The chapter outlines the various transitional phases of local government and the origins of the reform programmes since 1994, which in many ways took their impetus from the strong local character of political

organisation during the late apartheid period. It closes by noting the recent stabilisation of the local government system in the nine cities, as demonstrated by their credit rating histories.

Chapter 3 provides a detailed review of the financial position of the nine cities based on the 2002/3 to 2005/6 audited* financial statements. The review encompasses the operating results of the cities (expenditures and revenues); debtors and credit control; investments in property, plant and equipment; borrowing, cashflow and the audit reports. It provides detailed evidence that indicates the significant nature of the improvement in the financial position of the cities in recent years. Cash flows are stronger, while expenditure on property, plant and equipment has increased, particularly in respect of infrastructure. This has been funded to a large degree by government grants rather than borrowings or internal reserves. The detailed review also indicates current problems, including continuing large debtors' balances, and a failure to fully spend capital budgets even though expenditure is markedly higher than before.

Chapter 4 examines some of the expenditure-side challenges facing the cities, setting out a three-way classification relating to the need to provide for poverty, for growth and for the maintenance of existing service delivery assets.

**Note: At time of writing the financial statements for 2005/6 of all but two of the cities had been audited.*

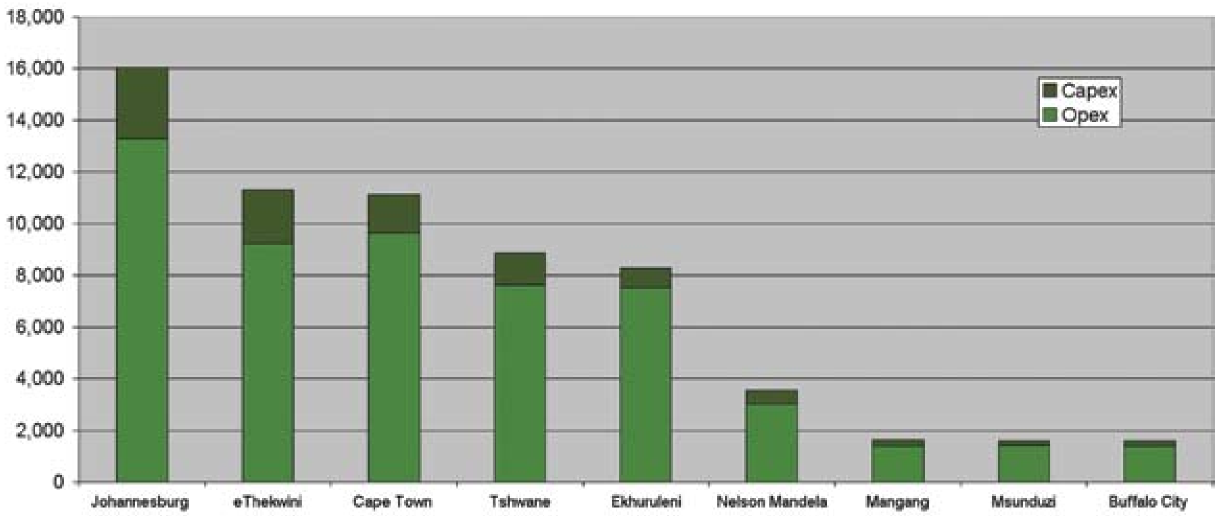
For city governments, confronting the 'poverty challenge' is perhaps their central priority. While poverty is a broad and multifaceted problem, and cities have a general developmental responsibility within their areas of jurisdiction, in practice the bulk of the poverty challenge as it affects city governments is about dealing with the housing backlogs and providing municipal services to poor households at below or no cost.

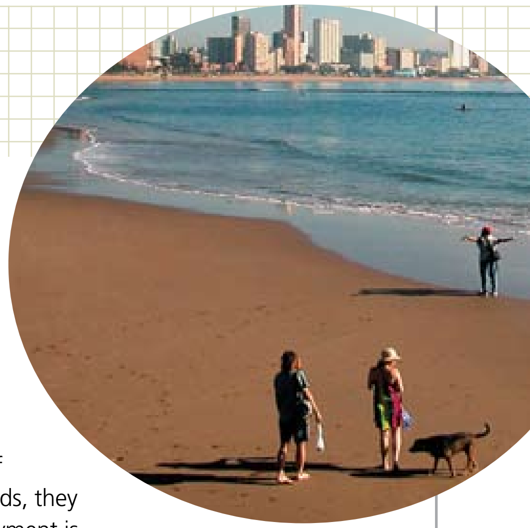
Much of the financial responsibility for housing construction is carried by the national government. Therefore, dealing with the housing backlogs may be a project management challenge, but should not be a financial burden. The same goes for the provision of free services, though the ongoing costs of this are far higher. In theory these costs should be covered by equitable share grants. In practice, however, things are somewhat different: specifications are raised ever higher, the subsidy fails to keep pace, and top-up funds are sought. Despite the comprehensive package of grants available to cities for financing their service delivery to poor households, cities do ultimately carry significant costs and risks.

A key strategic issue is that there appears to be no way around the conundrum that success in the delivery of housing and essential municipal services seemingly induces greater in-migration, with the result that reducing the housing backlog becomes an ever-moving target.

The chapter then turns to the other two key expenditure imperatives – the maintenance and growth challenges. Maintenance spending by city governments on municipal

Chart 1 Expenditure by City 2005/6





assets provides a varied picture, but financial constraints no longer appear to be a valid reason for current maintenance backlogs. There is evidence of a need from the larger cities to spend urgently on infrastructure for growth. Here the city government must generally rely upon its own financial strength, in the form of reserves, or borrowing, to obtain the necessary capital funding. Tariffs should reflect the cost of the new infrastructure. Yet, provided sober development thinking prevails and there is a reasonably close working relationship between the property development sector and the city government, the provision of new economic service infrastructure could be self-financing. The new commercial and industrial properties will generate new property tax flows for the municipality and, assuming the implementation of a new local business tax goes ahead, revenues from this will facilitate the financing of the necessary infrastructure.

The report therefore moves in **Chapter 5** onto the tax relationship between the city government and its taxpayers. In some ways this is the fundamental local governance relationship; and in this arena substantial changes are underway. For approximately two decades a local business tax has been in place, which has provided a buoyant revenue source – the importance of which has probably not been sufficiently grasped, even by the cities themselves. The abolition of this revenue source and its replacement by an interim grant from the national government not only causes financial damage to the cities, but also seriously weakens local governance, reducing the accountability the city governments feel towards the business sector. The weakening of this relationship does not assist in developing a bias for growth to complement the understandable attention to challenges of poverty.

But the removal of a viable business tax is not the only big change facing the tax profile of cities. The standardisation of the property tax mechanisms in terms of the Municipal Property Rates Act poses a significant challenge. This change, well-considered and long in development, is altogether more positive for the cities. Nevertheless, there are potential shifts in the incidence of property tax, associated with the move from taxing only – or largely – the site value of the property, to a standard system based on taxing the full market value of the property. The cities will need to manage this shift in property tax incidence carefully.

Once the formal tax basis of the city government has been well established, it must bill and collect the revenues that are due. This is one of the fundamental differences between local government and provincial government: while the latter has very small own-revenue components, relying predominantly on a weekly transfer into its bank account from national government, city governments raise over 90% of their revenue from their own sources. That is, their own customers, citizens and consumers. To do this, they require a revenue administration – an immensely complex operation. For, not only are these taxes and charges in respect of a combination of public, mixed and private goods, they are also charges for which payment is hard to enforce (no simple remote disconnection as with a failure to pay telephone charges!); and pricing is concessionary for particular categories of households in terms of the indigent and free basic services policies. The issue of non-payment has haunted the cities for many years.

The issue again highlights the importance of governance relationships. There is a three-way relationship between the quality of service delivery, the tax and tariff structure in terms of which prices are charged for those services, and revenue administration. A key strategic issue is that getting the indigent policy and revenue administration right allows the city government to pursue its debts in a more or less normal commercial manner and achieve high collection rates. But if the indigency policy misses its target, or if there are errors in the revenue administration, attempts to be tough on credit control will always be undermined by concerns about whether the debtor is an indigent, or whether the bill is simply incorrect. A city government must work hard to establish and maintain its legitimacy on these issues.

Having examined revenue administration, the report then returns in **Chapter 6** to a more general view of city financial administration, and in particular the modernising of organisational and financial administration that has taken place in the cities over the last decade. The transformations in this respect have been fundamental. The implementation by the cities of the Municipal Finance Management Act, specifically in respect of budget reform, accounting reform, and procurement reform, has greatly strengthened the rigour of their financial operations. The cities have adopted varying approaches to their financial information technology systems, and they face significant challenges in respect of their human and financial administrative capacity challenges. But the systems and procedures that the nine cities have largely implemented now compare well with many much more developed countries across the globe.

This sets the scene for an examination in **Chapter 7** of the new challenges of institutional changes highlighted earlier in this introduction. These include the restructuring of the electricity distribution industry, which runs the risk of fundamentally weakening our city administrations, including credit ratings, delivery capacity, and even governance. Yet there are alternative restructuring models which could achieve all the objectives while building on the strengths of the cities, rather than reducing them. A second set of dramatic changes could arise from the establishment of a single public service; again the implications for cities appear largely negative. The chapter also discusses the division of functions between the spheres of government, stressing the need for the cities to be recognised as the key locus of responsibility for functions related to the built environment, and to ensure that they have concomitant financial resources.

The chapter also suggests that the inadequate consideration of the consequences *for cities* of these changes is partly the result of excessively timid stances taken by the cities themselves on national restructuring processes, and a failure to speak collectively on these matters.

Where does all this leave South African cities? In **Chapter 8** the various themes of the work are drawn together into a perspective on the financial futures of South African cities and suggestions on what needs to be done to ensure growing success. South African cities, working within a clear framework of emerging national legislation, have indeed achieved a great deal. Yet there are sobering truths to confront. The current financial strength of the cities can in part be ascribed to the inability of the national housing delivery system to operate on a sufficient scale in the cities. Steady inroads into the housing backlog in the cities will add substantial operating account pressures to the cities.

South African cities are not merely at a way-station on the road to an inevitably brighter future. On the contrary, our cities are in the midst of a maelstrom of change, touching profoundly on their capacity, effectiveness, even their nature. South African cities have not for some time been in as strong a financial position as they are now. Yet, at the same time, there are seismic shifts taking place in the foundations of city financing, which run the risk of undermining this strength and holding back city development. The revenue base of the cities is being weakened just as they face growing expenditure challenges. The triple-punch combination of the replacement of RSC levies by a national grant, the potential removal of electricity distribution from city responsibility, and the potential impact of the single public service on city administrations and operations, means that our city administrations could shortly be pale reflections of their true potential. In short, the financial and administrative future of South African cities is in considerable doubt.

CHAPTER TWO
THE DEVELOPMENT OF THE CURRENT SYSTEM OF CITY FINANCING IN SOUTH AFRICA

THE DEVELOPMENT OF THE CURRENT SYSTEM OF CITY FINANCING IN SOUTH AFRICA

2.1 Introduction

South African local government has been so comprehensively transformed over the last decade that it may be easy to forget the historical context within which the need for this transformation arose. This chapter provides a brief overview of the colonial origins of city administration and finance and an account of the transition from apartheid city governments to the current metropolitan governments[1].

The two key themes already identified, namely, the changes in the patterns of resource allocation – particularly between black and white populations – as well as the relationship between finances and patterns of institutional accountability, have been evident through the decades.

It is a story of change, but also of some consistency. Some of the current practices, such as the system of property taxes, have their roots in the late nineteenth and early twentieth centuries.

Of particular significance is the fact that change at a local level in South Africa was negotiated in the early 1990s locally and collectively by local agents even while the process of national constitutional negotiations was underway. Indeed, driven by a need to address practical service delivery challenges, some of the local negotiations were initiated prior to national constitutional talks. Subsequently, as will be explained, the two processes were integrated.

During constitutional negotiations a number of key political parties opposed to the African National Congress (ANC) sought to establish a federal system based on strong provinces. However, it was the strength of local processes and local organisation in the broad anti-apartheid movement that forced the issue of local government onto the constitutional agenda and created the basis for the current dispensation, giving significant original constitutional powers to local government.

As is noted below, a key ANC discussion document on regional government (ANC Regional Policy 1992), which included an important section on fiscal decentralisation, recognised the critical importance of local revenue generation to local accountability while seeking, at the same time, to ensure a national framework that would facilitate redistribution and address the needs of the poor even in relatively poor areas.

2.2 Early city administration and finance in South Africa

The current system of local government in South Africa has its roots in 1836, when the first councils were introduced in terms of colonial legislation. The employment of a permanent professional administration, based on the Weberian separation of the administrative and political functions, was initiated in the larger towns in the 1890s. This was associated with significant investment in public works and infrastructure, such as roads and water supply systems that were managed by the municipalities, as well as enhancing systems to levy and collect revenue.

Municipalities took the lead in supplying electricity in South Africa, with Kimberley, Johannesburg, Pretoria, Cape Town, Durban, East London and Bloemfontein all establishing electricity reticulation and distribution services in the last decade of the 19th century.

At union in 1910 the prevailing municipal legislative framework of the Cape Province was extended to all four provinces, with the detailed functioning of municipalities governed by way of provincial ordinances. The services provided by the municipalities largely focused on servicing

1 This chapter draws significantly on work done by van Ryneveld (1996, 2006a, 2006b, 2007) and Savage, et al (2003).

1836	1890s	1910	1913 & 1923	1971	1976	1982	1983	1985	Late 1980s
First councils introduced in terms of colonial legislation	• Introduction of first professional local administrations, based on separation of political and administrative functions • Significant local infrastructure systems installed (roads, water supplies) • Establishment of the first local electricity reticulation systems	Cape municipal legislative framework extended to all provinces at Union, with provincial ordinances governing detailed municipal functioning. Cities financed conventionally through property taxes and service charges.	The racial character of local government in the cities was formalised with the Native Land Act (1913) and the Native Urban Areas Act (1923). `Locations' were administered by municipalities as agents of the national Department of Native Affairs. Separate `Native Revenue Accounts' introduced for the purpose.	Administration Boards established to manage `Bantu areas' in terms of the Bantu Affairs Administration Act (1971). Services in these areas financed by sales of sorghum beer, flat rate `rents' levied on households, and levies paid by employers	Soweto uprising: beerhalls targeted along with other apartheid manifestations. Subsequent privatisation of the beerhalls removed key source of local revenue.	Black Local Authorities Act provides for directly elected Councils in designated black areas.	Township uprisings led to troops being deployed in the Vaal. Spread of township rent boycotts deprives new black local authorities of their main envisaged revenue source.	RSC levies introduced to generate funds from business sector to provide infrastructure in black areas	• Continued local resistance in black areas forces central government to provide ex post budget support to black local authorities (BLAs), and loan guarantees to the DBSA for loans to the BLAs. • Emergence of local level negotiations around service charges and local government structures

people of European origin – in residential, commercial and industrial areas. During much of the twentieth century, local government institutions in 'white' South Africa developed similarly to those in other dominions of the British Empire. The closest parallel was probably with New Zealand, although many elements were incorporated from all over the English speaking world.

Property taxes became the main source of revenue of municipalities for the provision of public goods and related general services. From early on electricity was financed by means of consumption-linked service charges, with this approach subsequently also being followed in respect of water provision.

The racial character of local government in the cities became formalised when the 1913 Native Land Act designated small parts of the country as 'Reserves' for the indigenous people of South Africa to be held through various forms of traditional tenure. The 1923 Native Urban Areas Act formalised greater segregation in urban areas. Municipalities administered the African urban areas – known as 'locations' – as agents of the National Department of Native Affairs. Separate Native Revenue Accounts were created for financing the governance and servicing of these areas.

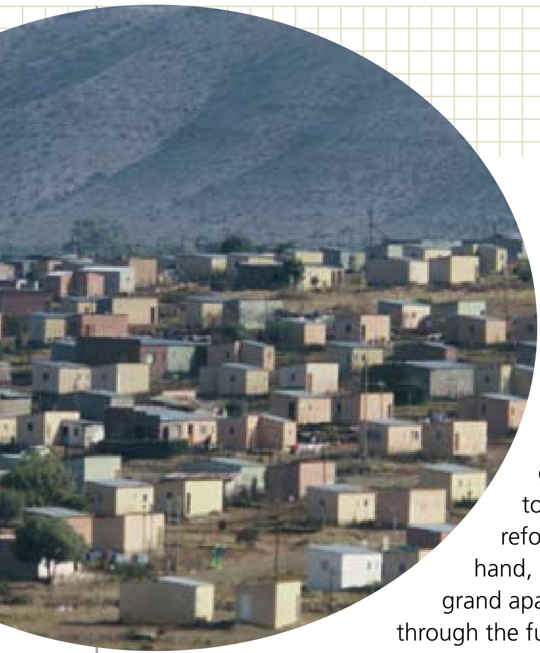
This arrangement lasted until 1971, when – as part of the apartheid legislative programme – the Bantu Affairs Administration Act of 1971 established Administration Boards directly under the control of central government to manage African urban areas. The cities were free to deploy their fiscal resources for the development of the `white' parts of the cities only. Increasingly, the African urban residential areas that were available to those people who had urban rights of residence were located at a considerable distance from the urban core. The differences in living conditions and urban services between white and black areas were extremely stark. While conditions in white areas were similar to relatively well-off areas in economically developed countries, services and facilities in black areas, and especially African areas, were rudimentary.

No Africans could own fixed property outside of the 'homelands'. Thus, in keeping with the principle that Africans were 'temporary sojourners' in urban areas, the only housing available to Africans in the cities was owned by and rented from the state. Housing consisted largely of small, square, single or semi-detached dwellings for those with residential rights, or large hostels for single migrant workers for those with more temporary rights. There was fairly extensive reticulation of water, often to each dwelling, although pressure was sometimes poor. Roads were generally unsurfaced. Despite a large and sophisticated electricity sector, until the early 1980s not a single African urban residential area had electricity.

To finance services in African areas, the Administration Boards levied flat rates on each urban dwelling for rent as well as charges for water and other services. However, this revenue tended to only partly cover costs. Employers were required to pay levies to the Administration Boards for each African they employed, which further supplemented the Administration Boards' income. However, the most significant source of income for urban services tended to be from the sale of liquor to residents through beer halls run by the Administration Boards. Only these liquor outlets were permitted by the authorities.

The Soweto uprising of 1976 marked the starting point of the process of unravelling and disintegrating the apartheid vision. It was an urban revolt which, while directed initially at the apartheid education policies, also targeted the local urban Administration Boards and other manifestations of the apartheid state. From the outset, for example, the state-run beer halls were targeted and many destroyed across the country.

1990	1991	1993	1994	1995/6	1997	1998	2000	2003	2004	2006
Unbanning of the ANC	Establishment of the national Local Government Negotiating Forum (LGNF)	• Local Government Transition Act sets out a three-phase transition process for local government • Pre-Interim phase begins	First national and provincial government elections	• First local government elections • Establishment of two-tier transitional local government arrangements in the cities • Interim phase begins.	Financial crisis in Johannesburg	• Municipal Demarcation Act • Municipal Structures Act	• Municipal Systems Act • Second local government elections • Final phase begins	Municipal Finance Management Act	Municipal Property Rates Act	• Third local government elections • Abolition of RSC levies



2.3 Responses to the 1976 uprising and the township rent boycotts

The South African government responded to the uprising with various reform initiatives. On the one hand, attempts to implement grand apartheid were strengthened through the further development of the homeland system. On the other hand, efforts were made to improve conditions in African urban areas, implicitly recognising the permanence of these areas. In 1982, the Black Local Authorities Act was passed, providing for directly-elected municipalities in African urban areas. The Administration Boards were renamed Development Boards and now reported to the four provincial administrations, while the process to establish fully-fledged black local authorities was put in motion.

However, these attempts at reform were unable to contain the general surge of dissatisfaction among mainly black South Africans. The newly established black local authorities, in particular, became a target of opposition. On the one hand these bodies were unable to marshal the administrative and financial resources required to address local needs, while at a political level participation in these structures was broadly interpreted as lending support to the legitimisation of the apartheid regime.

An important issue was the funding of the black local authorities. Significant revenue was made available for capital development to improve infrastructure through institutions such as the newly established Development Bank of South Africa. However, revenue for operations was highly constrained. In response to the attacks on the beer halls in 1976 and afterwards, and in line with new policies to foster a black entrepreneurial class, the beer halls were privatised, which impacted significantly on operating revenues.

At the same time operating costs were rising, in some cases sharply, to service the new infrastructure that was being provided. This led to considerable increases in the service charges levied on black township residents which, in turn, resulted in a campaign of service charge boycotts.

It was a civic-led campaign against service charges imposed by black local authorities in the Vaal Triangle (in what is now Gauteng) which first led to the military entering the townships to restore control in 1983. This process was soon replicated in many black townships across the country. The imposition of a series of states of emergency ensued and ended only with the unbanning of political movements such as the ANC and the release of Nelson Mandela in 1990.

During this period of turmoil the government sought new ways to increase the flow of resources to bolster the new black local authorities through the creation of Regional Services Councils. These councils were financed by levies on wages and turnover (still referred to as RSC levies).

The boundaries of Regional Services Councils (RSCs) were drawn so as to include black and white urban areas within single councils. The RSCs were made up of representatives of each of the councils within their boundaries. Voting was weighted largely based on the consumption of municipal services in each of the constituent councils, although the formula underweighted the bigger constituent councils.

The RSC revenue was intended for the financing of capital infrastructure in areas where this was lacking. And, while the richer councils dominated decision making, in many areas they facilitated a significant flow of resources from rich to poor areas. The RCSs were not intended to include homeland areas. However, a political compromise between the province of Natal and the self-governing territory of KwaZulu led to the formation of Joint Services Boards (JSBs) across 'homeland' boundaries, performing roles similar to those of the RSCs. Thus, in KwaZulu-Natal, the levies are referred to as JSB levies.

But, as indicated, operating revenues were insufficient. In response, black local authorities were provided with ex-post fiscal transfers, funded via central government through provincial administrations, along with guarantees for loans from the Development Bank of Southern Africa (DBSA). Significant amounts of borrowed revenue were absorbed by operating costs. By 1991/92 the grants to black local authorities had reached R903,7 million (van Ryneveld 1996). The biggest recipients of ad hoc grants were the townships around Cape Town and Johannesburg.

By 1989, government increasingly recognised that a new local dispensation was required which would involve the amalgamation of black and white local authorities.

2.4 The Local Government Negotiating Forum and broader constitutional debates

After the unbanning of the ANC in 1990, the development of a new national constitution became the focal point of efforts to create a new dispensation. Nevertheless, local level negotiations aimed at combining black and white areas had already achieved considerable momentum.

This led to the creation of the national Local Government Negotiating Forum (LGNF) in 1991. The LGNF was an initiative driven by the anti-apartheid civic movement in response to government's reform efforts. It sought to create a single framework to give direction and consistency to the myriad of emerging local processes. Fortunately, it secured the co-operation of the apartheid authorities and became the forum for negotiations between 'statutory' and 'non-statutory' anti-apartheid formations.

The main focus of the LGNF was to establish a process whereby the previous racially fragmented municipal areas could be combined into single bodies. Deliberations eventually led to the passage of the Local Government Transition Act (LGTA), in terms of which much of local transition initiatives took place until the passing of new legislation in the late 1990's. The outcome of this process formed the basis of the chapter on local government of the Interim Constititution, in terms of which the country was governed until the passage of the current constitution in 1996.

The LGTA did not substantially change local government systems or revenue sources, but did underpin a major process of boundary changes which led to huge shifts in patterns of resource allocation. The Act provided for three phases of local transition:

- **Pre-interim phase:** In this phase local government negotiating fora were to be established at the local level to prepare for elections on the basis of locally negotiated boundaries. These elections eventually took place across the country in 1995, with the exception of KwaZulu-Natal and the Western Cape, which held elections in 1996.
- **Interim phase:** This phase began with the 1995 and 1996 local government elections, and entailed the implementation of local government and related provisions contained in the interim constitution and the LGTA. During this interim period there was to be a more comprehensive investigation into the long-term structure and functioning of local government, including a White Paper and legislation to govern the subsequent phase. The White Paper and legislation is discussed in section 2.6 below.
- **Final phase:** This was the term given to the dispensation which emerged from the interim phase and the new constitution. It began in December 2000 with the election of new municipalities established in terms of the new legislation flowing from the White Paper.

Initially, the local government negotiations ran somewhat separately from national level negotiations. However, decentralisation soon became a critical national issue. In early 1993, the ANC Constitutional Committee held a conference to develop a mandated position on provincial government for negotiation purposes. This was preceded by the compilation of a discussion document entitled ANC Regional Policy. Much of the substance of the discussion document became the basis of the ANC negotiating position, and subsequently found its way into the interim and final constitutions.

The document accepted that consensus had been reached on the creation of three tiers of government, but emphasised the inter-dependent nature of the tiers. It also placed the notion of metropolitan governments firmly on the agenda, stating that this was 'essential to the cause of unifying, deracialising and democratising cities, in addition to the more efficient and effective provision of affordable services' (ANC 1992:7).

The section on Finance and Resources, which set out significant elements of the basis for the inter-governmental fiscal system, sought to counter attempts by federalists to argue for the devolution of taxes to the provincial tier while at the same time creating the foundation for fiscal decentralisation to the local level.

It argued that 'a new system must seek to enhance democratic accountability while ensuring that the public resources of the country are shared fairly amongst the whole population. The starting point should be a strong emphasis upon the need to strengthen local control over the use of public resources. This helps to ensure that usage is efficiently and appropriately tailored to local conditions. **The link between paying taxes and receiving public services must be recognised as an important element in the strengthening of democratic accountability, and is most direct at local level**'(ANC 1992:9). [emphasis added]

But it also argued that there were constraints to fiscal decentralisation, concluding that, while some taxes could be retained at local level, especially property taxes and possibly some excise duties such as fuel levies, the bulk of taxes should be collected nationally. To the extent that expenditure took place at lower levels, these taxes should be distributed by fair and transparent means through fiscal transfers. These transfers, it argued, should be formula- driven, and would have to 'take into account the capacity of various lower level governments to raise their own resources so that inequalities amongst regions and localities could be counteracted' (ANC 1992:11).

2.5 Municipal finance in the interim phase and the new legislative framework

During the interim phase new local government structures were introduced, spanning the former racially-defined areas. In urban areas, Transitional Local Councils (TLCs) constituted the most basic form of local government. The LGTA also defined metropolitan areas and provided for a two-tier framework consisting of Transitional Metropolitan Councils (TMCs) together with 'primary' Metropolitan Substructures (MSSs).

The rural areas generally also saw the introduction of a two-tier system, with District Councils replacing some of the former Regional Services Councils and Joint Services Boards, and the creation of Transitional Rural Councils and Transitional Representative Councils (TRCs)[2] as primary, rural, local institutions.

While the processes and structures set in motion by the LGTA were by and large successful, there were a number of tensions and problematic issues. Prominent amongst these was the financial crisis which developed in Johannesburg. Various factors contributed to this crisis – a number of them related to the fragmentation caused by the two-tier system, which made city government very challenging. The trigger for the crisis was a November 1996 amendment to the LGTA which prevented foreign borrowing by local governments, combined with the way in which the two-tier metropolitan system prevented the use of cash generated in richer sub-structures to be applied to poorer substructures. This experience was one of the more important catalysts for the adoption of a single tier 'unicity' structure for metropolitan areas during the final phase.

As part of its 1994 election campaign and process of preparing to govern, the ANC drafted the Reconstruction and Development Programme, popularly known as the RDP. It was a detailed document (ANC 1994), and in respect of municipal and related services set out a number of targets for housing, water and sanitation, refuse removal and electrification. Most of these targets have now been met and, indeed, exceeded, although this did not happen within the first five years.

In 1995, the government drafted a Municipal Infrastructure Investment Framework (MIIF), which set out financial mechanisms and an institutional approach for overcoming service delivery backlogs. The MIIF argued for a ten year, rather than five year programme to overcome backlogs, stating that the programme would require a significant capital grant from central government 'in the order of R30-R35 billion' (Ministry in the Office of the President/ Department of National Housing 1995 ii). Municipalities were to finance capital expenditure through a combination of the redirection of existing local resources together with recurrent and capital grants and loans for capital development.

2 TRCs never really took off, being under-resourced, operating in a policy vacuum and often in conflict with traditional authorities and District Councils over their powers and functions.

The MIIF set out a number of key elements of a new financial framework for the provision of service infrastructure. It emphasised the principle of financing capital expenditure through borrowing, while current expenditure would be financed by current income. It argued that redistributive mechanisms should be transparent and addressed through the emerging system of devolved taxes and grants, rather than by manipulating the financial sector, granting central guarantees for local borrowing, or creating special public sector lending institutions.

The MIIF has undergone at least two iterations since it was first published.

2.6 The White Paper and the ensuing legislative and institutional framework

Research for the White Paper on Local Government was initiated in 1996 and the White Paper published in March 1998. It did not break significantly new ground on municipal financing issues but was important in reinforcing many of the approaches developed in constitutional negotiations and afterwards. It did give prominence to issues related to municipal borrowing.

It recognised that problems in municipal finance were to be found in both the shortcomings in policy as well as the poor implementation thereof, that redistribution and growth had to be balanced, and that differences across municipalities had to be accommodated. It argued that changes were needed in four areas, namely, local revenue instruments and policies, national to local transfers, gearing in private investments, and budgeting, accounting and financial reporting systems.

On the subject of local revenue instruments and policies it recognised that local choice over the tax rate was the most significant element in strengthening local accountability. Regarding property taxes specifically it argued for a simpler system applied nationally. This system had to be based on the market value of property rather than the variety of systems that were in place across the country.

The White Paper viewed RSC levies as inefficient taxes. However, it recognised their importance and that they would need to be retained until a suitable alternative, yielding the same net revenue, was introduced. It also suggested that a municipal fuel levy be introduced.

On user charges it largely repeated the principles for service tariffs that were already contained in the first MIIF. It did strengthen them somewhat, arguing that all households other than the indigent should pay the full costs of services consumed, rather than the minimum level of operations and maintenance costs referred to in the MIIF. Municipalities would develop a set of targeted subsidies to ensure all had access to a minimum level of basic services.

It stressed that grants should be transparent, equitable and predictable and recognised the need for changes, including a properly constituted 'equitable share' in line with the Constitution. The formula-based system should 'enable municipalities to provide a basic level of services to low income households in their areas of jurisdiction at affordable cost' (White Paper 1998:120). The funds should not be allocated via the provinces.

The White Paper strongly reinforced the importance of municipal borrowing, stating that 'ultimately, a vibrant and innovative primary and secondary market for long and short term municipal debt should emerge'. It stressed 'the

BOX 2 Recent credit ratings

After an extended and demanding process of change, the nine Network cities have stabilised and improved their financial position substantially in recent years. Since 2000 municipalities have been strongly urged by National Treasury, in particular, to get credit ratings from independent ratings agencies even if they were not intending to borrow. As cities have gained more confidence in their own financial performance they have followed this advice. The ratings, shown in the Table 4, are a valuable indicator of the sound and improving city finances.

Table 4 Domestic currency credit ratings of South African cities 2002 - 2007

City	Rating agency		2007	2006	2005	2004	2003	2002
Buffalo City	CA Ratings	long term	A-	A-	A-	A-		
		short tem	A2	A2	A2	A2		
Cape Town	CA Ratings	long term		AA-	A+			
		short tem		A1+	A1			
Ekurhuleni	Global Credit Ratings	long term	AA	AA	AA	AA-	A+	A+
		short tem	A1+	A1+	A1+	A1+	A1	A1-
	CA Ratings	long term	AA-	AA-				
		short tem	A1+	A1+				
eThekwini	Global Credit Ratings	long term		AA	AA	AA	AA-	AA
		short tem		A1+	A1+	A1+	A1	A1+
Johannesburg	Fitch	long term	A+	A	A-	A-	A-	BBB+
		short tem	F1	F1	F1	F1	F2	F2
	CA Ratings	long term	A+	A+	A	A	A	
		short tem	A1	A1	A1	A2	A2	
Mangaung	Global Credit Ratings	long term	A+	A+	A	A	A	A
		short tem	A1	A1	A1	A1	A1	A1
Msunduzi	Global Credit Ratings	long term	A	A	A-	BBB+	BBB+	BBB
		short tem	A1-	A1-	A2	A2	A2	A3
Nelson Mandela Bay	CA Ratings	long term		A	A	A-		
		short tem		A1	A1	A1		
Tshwane	CA Ratings	long term		A+	A+	A+	A+	
		short tem		A1	A1	A1	A1	
	Global Credit Ratings	long term	A+	A+	A+	A+	A+	A
		short tem	A1	A1	A1	A1	A1-	A2

The year indicated in the column header is the year the rating was issued. This rating would rely upon the financial statements for the previous year and budgets for the year indicated.

importance of achieving financial discipline through decentralised market relationships (between borrower and lender) rather than the direct, centralised control of local government' (Ministry of Provincial Affairs and Constitutional Government 122). It went into some detail on the need to develop approaches that would enhance credit without central guarantees. It also recognised the need for concessional loan finance and the role to be played by public sector financial intermediaries, by supporting rather than replacing market development.

Furthermore, it addressed the need to modernise accounting and budgeting practices.

The section concluded by emphasising 'the total commitment of government to building a financially independent and viable system of local government in the long term' (Ministry of Provincial Affairs and Constitutional Government 127).

Between 1998 and 2004 the White Paper led to the passing of key legislation such as the Municipal Structures Act, the Municipal Demarcation Act, the Municipal Systems Act, the Municipal Property Rates Act and the Municipal Finance Management Act.

The current system was established in the local elections in late 2000, following the passage of the first three of these laws. A demarcation process, undertaken by the Demarcation Board, significantly reduced the total number of municipalities from 842 to 283. This was after the number had been reduced from over 1200 prior to the start of the interim phase in 1995.

Of critical importance was the replacement of the complex two-tier local government system by single-tier metropolitan councils in the six areas that were given metropolitan status by the Demarcation Board. The two-tier local government system remains in the rest of the country, with a total of 47 districts and 230 local councils. Buffalo City, Msunduzi and Mangaung all operate within the two-tier system and thus share their jurisdictional area with District Councils.

2.7 Conclusion

The challenges of change have thus been felt not only in the changes in the allocation of resources, but also in fundamental institutional reform. Municipalities, including the nine Network cities, have been through not one but two substantial processes of institutional change since 1995. This entailed a period of institutional instability spanning over a decade and a half. Major boundary and other institutional changes have placed huge stress on administrative systems and processes. Long-standing administrative entities have been split up and others with completely diverse systems and processes have had to be amalgamated. This has inevitably caused loss of institutional memory, massive challenges in systems integration, and often great difficulties in retaining data integrity, which lies at the core of many financial and administrative processes.

The local government system in the cities could quite conceivably have collapsed under this pressure. It is testimony to the dedication and professionalism of many local political representatives and administrative officials, as well as the generally sound policies and programs that have been adopted nationally, that the local government system in the major urban areas has remained coherent and functional.

The broad direction of change has been positive, creating the conditions for a vibrant and relatively independent set of municipalities. The widely drawn boundaries have made it possible for individual cities to speak with one voice, while the overall approach to financing has created the basis for achieving a reasonably good balance between establishing local fiscal independence and addressing redistributive issues through local measures combined with fiscal transfers from national government.

Although these trends towards building decentralised government were consistent with fairly widespread international trends, this chapter has shown how, in South Africa, the approach was largely an outcome of local political processes.

There remains much to be done, but it can be said that a good degree of financial and institutional stability has now been achieved. Good credit ratings do not, by themselves, represent good local government, but the sound ratings that have been achieved in recent years as shown in Box 2 offer a useful indicator of financial and institutional achievement after a long process of very significant change.

Yet the process of change has not stopped. In the introduction it was noted that the cities still face a number of critical changes, apart from the challenges of addressing poverty while facilitating economic growth. These changes, which are dealt with in subsequent chapters, will be extremely challenging. There is a danger that they could even threaten much of the progress that has been made.

CHAPTER THREE
OVERVIEW OF THE CURRENT FINANCIAL POSITION OF THE CITIES

OVERVIEW OF THE CURRENT FINANCIAL POSITION OF THE CITIES

3.1 Introduction

The previous chapter has outlined the complex and demanding process of change of the last two decades. But where do the cities now stand financially? This chapter provides an overview of the current finances of the nine Network cities based on rigorous analysis of their audited financial statements for the most recent years, together with original, unrevised municipal budget information published by National Treasury.

This chapter seeks to understand the current financial position of the cities and recent changes to this, to review their financial performance and to identify the possible challenges that they may encounter.

The periods reviewed cover the 2003 to 2006 financial years. There is increased focus and analysis of the 2005 and 2006 financial years as these are the only periods where comprehensive and comparable data is available across all nine Network cities.

The reasons for this are threefold. Firstly, there were major differences in the basis of accounting in municipalities prior to the 2005 financial year, making comparison difficult. A new basis of accounting became mandatory from the 2006 financial year (2005 comparative information had to be restated retrospectively). However, some cities adopted the new basis of accounting earlier than others, thus limiting the scope for more comprehensive comparisons.

Secondly, as cities changed their basis of accounting, it was not possible to accurately compare periods subsequent to the change with periods prior to the change.

Thirdly, Cape Town only consolidated their financial and accounting systems at the beginning of the 2004 financial year. Prior to that separate accounting records were maintained for each of the former administrative entities that were amalgamated to form the city following the demarcation process in 2000. The revenue and expenditure shown in the City of Cape Town's annual financial statements between the 2001 and 2003 financial years thus includes inter-administrative entity transactions which could not be eliminated for financial reporting purposes, and which distort comparisons across years and across municipalities.

The introduction of the new Generally Accepted Municipal Accounting Practice (GAMAP) to replace the old 'fund accounting' systems has resulted not only in a basis for accounting which is clearer and more in line with standard international practice, but also means that, for the first time ever, there is consistency across the country. Previously there were differences across the old provinces which made national comparisons almost impossible. Box 3 explains the changes to the accounting basis in some detail.

However, the new accounting basis means that the amounts recorded under certain items change as a result of a change in accounting practice rather than because of any real change in financial circumstances. For example, some resources previously recorded under the old 'funds' are now shifted to the 'accumulated surplus'. The resultant rise in the surplus should thus not be mistaken for an improvement in financial circumstances. That said, as this chapter will show, there have been very significant improvements in the cities' financial circumstances. What this analysis seeks to do is separate out the changes arising from changes in the accounting basis to reveal the real changes in financial circumstances.

BOX 3 The replacement of Fund Accounting with new GAMAP/GRAP accounting and financial reporting standards

The historical basis of accounting used by local government was referred to as the 'fund accounting system'. In terms of this system 'funds' were created in the books of accounts against which expenditure on capital assets that had been funded by external borrowings and appropriations from operating revenues could be shown. While the system was largely based on accrual accounting, this 'fund' approach contradicted the underlying philosophy of accrual accounting, which seeks to present accounts in a way which gives a picture of real economic transactions rather than flows of cash.

The fund accounting system was further complicated by different accounting and financing requirements arising from the four Provincial Ordinances that governed municipal finances. This resulted in inconsistent accounting and financial reporting requirements. Although standardised templates were prescribed, these were not comprehensive and did not result in consistency in the preparation of annual financial statements across municipalities, thereby making comparison impossible. Interpretations of how to apply the standardised template differed amongst municipalities, further limiting consistency and comparability.

A key aspect of the fund accounting system as it was applied in South Africa was the requirement that municipalities set aside a part of their operating revenue in statutory funds to use as a financing source for future capital expenditure. The idea was to limit reliance on external borrowings to replace existing capital assets or to expand the capital asset base.

From an accounting perspective these funds were treated as external borrowings. The municipality therefore charged itself interest on the amounts used to finance capital expenditure. The amounts utilised also had to be repaid over prescribed maximum periods. These funds, often referred to as 'statutory funds' because of the legal requirement to establish them in terms of various old Provincial Ordinances, strengthened the overall financial position of municipalities and over time became an important source of financing capital expenditure. The portion of the statutory funds that were not used to finance capital expenditure had to be invested in financial instruments. This contributed to the strong financial position of the large white local authorities in the late 1980s and early 1990s.

The fund accounting system, together with the legal prescriptions contained in the Provincial Ordinances, had a number of advantages. Generally, these included:

- *cash based budgeting – although this did not prevent budgets being drawn up on the assumption of cash collections that never materialised*
- *the accumulation of community wealth that strengthened long-term sustainability*
- *the generation of sufficient cash resources to finance continuous development and the replacement of existing infrastructure.*

However, a number of factors led to the decision to discontinue the fund accounting system. As indicated, the underlying motivation was that the annual financial statements prepared on the fund basis did not properly reflect economic reality, but more specific factors included:

- *the difficulty of understanding fund accounting concepts and annual financial statements prepared in accordance with such concepts*
- *the difficulty in detecting financial distress or changes in the financial position from a review of the annual financial statements based on the fund approach*
- *the significant differences between fund accounting and conventional accounting standards primarily used in the private sector*
- *the lack of comparability between financial statements even of similar-sized municipalities.*

The new constitution requires that National Treasury make legislation for the development of Generally Recognised Accounting Practices (GRAP). This offered the legislative opening to replace the fund accounting system with new accounting standards. These new standards are known as GAMAP because they are specific to municipalities. The development of accounting practices in the municipal sphere is well ahead of practices in the national and provincial spheres. Thus GAMAP is an interim set of standards applying only to municipalities pending the development of a comprehensive set of GRAP standards which will apply to all spheres of government. At present there are three standards of GRAP, and 8 standards of GAMAP, that apply to municipalities. Eventually more GRAP standards will be developed which will replace the existing standards of GAMAP.

High capacity municipalities[1] were required to implement the GRAP/GAMAP accounting standards with effect from the financial year commencing 1 July 2005.

GAMAP was originally issued in October 1998. It was based on the South African Generally Accepted Accounting Practice (SA GAAP) of the time. Between 1998 and 2004 GAMAP was substantially revised to take into account the changes that occurred in SA GAAP. The GAMAP standards that were approved by the Accounting Standards Board[2] in 2004 are referred to as 'new GAMAP'. Whilst legally obliged to implement GAMAP/GRAP when preparing financial statements for the 2005/6 year, all the cities other than eThekwini, Msunduzi and Manguang, adopted the standards earlier than legally required.

Table 5 sets out the status of implementation of the GAMAP/GRAP standards. In most instances, GAMAP/GRAP is implemented one year retrospectively, unless impossible to do so due to local municipal circumstances. Furthermore, those cities that were early adopters did not restate their comparatives as there was not a legal requirement to do so at the time of early adoption.

1 All municipalities were ranked as high, medium or low capacity municipalities for the purposes of implementing the Municipal Finance Management Act (MFMA). Certain provisions of the MFMA have been phased in based on this capacity ranking. Typically, high capacity municipalities have a shorter time-span to implement the Act. All of the cities are ranked as high capacity municipalities.

2 The Accounting Standards Board is responsible for developing and approving standards of GRAP. The Board, once it has approved GRAP standards, forwards the standards to the Minister of Finance for gazetting and setting the date from when the standard will apply to the various spheres of government and entities within the public sector.

These developments mean that the 2005 and 2006 financial years will render the most accurate comparisons, although useful analysis can be done over a longer time frame. To ensure meaningful analysis over the longer period certain financial information prepared according to the previous fund accounting convention has been restated to improve comparability and enable trend analysis. This has been highlighted in the information presented in Chapter 3.

The introduction of GAMAP/GRAP is complicated and a number of errors or inaccurate descriptions have been identified in some of the annual financial statements that were analysed, particularly in the first year of implementation. These have not been highlighted and the information has been restated where possible to correct these inaccuracies.

In sum, the adoption of GAMAP/GRAP reporting standards has facilitated meaningful comparisons between the cities included in this review. The standards provide a more accurate portrayal of the financial position and financial performance of the cities and thus facilitate a more reliable assessment of the financial challenges facing the cities.

Table 5 Summary of the dates that GAMAP was implemented

City	Financial year ended 30 June			
	2003	2004	2005	2006
Johannesburg	Fund accounting basis	Implemented new GAMAP	Terms of GAMAP	Terms of GAMAP
Tshwane	Fund accounting basis	Terms of GAMAP	Implemented new GAMAP	Terms of GAMAP
eThekwini	Fund accounting basis	Fund accounting basis	Terms of GAMAP	Implemented new GAMAP
Mangaung	Fund accounting basis	Fund accounting basis	Terms of GAMAP	Implemented new GAMAP
Cape Town	Fund accounting basis	Implemented new GAMAP	Terms of GAMAP	Terms of GAMAP
Buffalo City	Fund accounting basis	Terms of GAMAP	Implemented new GAMAP	Terms of GAMAP
Msunduzi	Fund accounting basis	Fund accounting basis	Terms of GAMAP	Implemented new GAMAP
Nelson Mandela Bay	Implemented old GAMAP	Terms of GAMAP	Implemented new GAMAP	Terms of GAMAP
Ekurhuleni	Fund accounting basis	Terms of GAMAP	Implemented new GAMAP	Terms of GAMAP

Legend: Financial statements prepared on the fund accounting basis; Financial statements prepared in terms of GAMAP; Implemented old GAMAP; Implemented new GAMAP

3.2 Changes in net assets (community wealth)

An understanding of changes in net assets is a good starting point for analysing city finances, since net assets indicate the wealth of the cities. The net asset figure includes the total assets of the cities that have been financed from own resources. Those assets not included under net assets have been financed from creditors and lenders.

Overall, the financial position, as measured by the net assets (or community wealth) accumulated by the cities, has improved significantly. Net assets have increased from R21.5 billion at 30 June 2003 to R47.6 billion at 30 June 2006, which is an increase of R26.1 billion.

Table 6 shows the breakdown of net assets of the cities in total:

Table 6 Summary of Net Assets

Component of Net Assets	2005 R'000	2006 R'000
Capital Replacement Reserve	1 478 057	1 710 684
Capitalisation Reserve	10 394 114	10 112 201
Government Grants Reserve	7 567 876	9 298 008
Donations and Public Contributions	2 026 450	2 032 998
Insurance Reserves	1 416 236	1 323 543
Housing Development Funds	1 786 175	1 668 898
Other	1 243 016	1 323 791
Accumulated Surpluses	15 839 049	20 117 727
Total Net Assets	**41 750 973**	**47 587 850**

The most significant change in net assets is in respect of the accumulated surpluses. This change, which amounts to R24.3 billion for the financial years ended 30 June 2003 to 30 June 2006, can be attributed to the following:

- a significant improvement in the net operating results
- changes in how the accounts are presented arising from the implementation of GAMAP
- transfers to or from other components of net assets
- other transactions.

It is obviously critical to separate out the changes arising merely from changes to the basis of accounting. This is done in Table 7 which analyses the movements in the accumulated surpluses of the cities.

Table 7 Analysis of changes in the Accumulated Surpluses of the Cities (Cumulative from 2003 to 2006)

	R'000
Adjusted Net Operating Results	***8 419 480***
Net operating results	9 117 701
Less: Bad debt provision	(698 221)
GAMAP adjustments	***16 375 439***
Land audit	7 931 900
Fair value adjustments	(1 290 115)
Implementation of GAMAP	9 733 654
Movements within Net Assets	***(1 047 882)***
Transfers from donations and public Contributions reserve	(587 117)
Transfers from government grants Reserve	(3 895 714)
Depreciation offsetting	4 810 786
Capitalisation adjustment	(1 051 275)
Transfer to capital replacement reserve	(324 562)
Other	***578,127***
Other adjustments	353 509
Correction of errors	224 618
Total	***24 325 164***

The changes in the net operating results are most crucial and are explained in more detail under a separate heading below.

In respect of the implementation of GAMAP adjustments, the change from the former fund accounting to GAMAP has increased the operating result by R16.4 billion. An understanding of the technical basis of this may be helpful. It is due to the reversal of amounts contributed to statutory funds that have been discontinued as well as the partial reversal of a portion of capital assets that were fully expensed on acquisition. As these capital assets will be depreciated over time – and this depreciation is recorded as an operating expense – the reversal of the expensing of capital assets results in surpluses against which depreciation can be progressively offset. A failure to follow this approach in implementing GAMAP/GRAP would have resulted, in effect, in the double-charging of expenses to ratepayers and consumers. A further reason is that government grants used to finance capital assets, which were previously credited to the cost of the capital asset acquired, have also been partly reversed and transferred to the accumulated surpluses, with the balance being taken to reserves separately within net assets. The same treatment applies to donations and public contributions.

The intention of government grants and public contributions is essentially to subsidise the cost of

BOX 4 Explanation of items in Table 6

The Capital Replacement Reserve is the amount set aside from accumulated surpluses that will be available to finance capital expenditure in future years. There is no legal requirement to contribute to this reserve; the only requirement is that this reserve is backed by investments. The level of the reserve varies significantly between the cities. Those cities that have encountered some form of financial distress in the late 1990s and early 2000s have a limited Capital Replacement Reserve, as typically the reserve had been eroded to sustain the cities during the period of distress.

The Capitalisation Reserve is a mechanism to phase out the former fund accounting system. The balance on this Reserve relates specifically to certain capital assets acquired prior to the implementation of GAMAP/GRAP. It is reduced as the capital assets to which the reserve relates, are depreciated. Over time the balance on the Capitalisation Reserve will be transferred to the accumulated surplus to offset depreciation.

The Government Grants Reserve and the Donations and Public Contributions Reserve are the amounts that have been received from these sources to finance capital assets. Theoretically these amounts should be included in the accumulated surplus but they have been separately reserved. This separates surpluses generated from own sources (which are shown as accumulated surpluses) from those surpluses that are generated from third parties. All assets are depreciated from year to year, and this is recorded under expenses. The Government Grant Reserve and Donations and Public Contributions Reserve are then used to offset the depreciation in respect of those capital assets originally financed from these sources. Amounts are transferred from the accumulated surplus to these reserves when the capital asset is acquired, and transferred back to the accumulated surplus as the capital asset is depreciated.

Insurance reserves are amounts set aside to cover certain insurance risks that are carried by the cities.

The Housing Development Fund is a statutory fund that has to be used to provide rental housing and develop low-cost housing for indigent communities.

providing infrastructure. In accounting terms citizens now receive this benefit in the form of an offsetting of depreciation which they would otherwise have had to match by increasing taxes and tariffs and so increasing revenues. The offsetting is shown separately and is not included in annual operating surpluses; it is represented rather as a transfer from the relevant reserve to the accumulated surplus.

The adjustments arising from the implementation of GAMAP will not recur in future years. These adjustments have not increased net assets in relation to the former fund accounting system. Instead, there has been a reallocation to the accumulated surplus from the former statutory funds and amounts credited to the cost of capital assets. This is referred to as loans redeemed and other capital receipts in the former fund accounting system.

The implementation of GAMAP has resulted in significant improvements in the stated financial position in instances where capital assets have been revalued to fair value as part of the GAMAP implementation approach. The reason for this is that capital assets for which historical cost information is not available must be recorded at fair value (or market value). This has impacted on a number of municipalities that have implemented GAMAP and resulted in the accumulated surplus increasing by a further R5.6 billion. Specifically, the City of Johannesburg has credited accumulated surpluses by an amount of R8.1 billion from applying fair value to certain of its capital assets, mainly land. This has accounted for a substantial increase in the net assets of the city. It should be noted that, as the cities develop comprehensive asset management systems for the identification and recording of capital assets, further once-off adjustments to net assets can be expected. There is a three-year transitional period to develop these systems after the implementation of GAMAP and most cities are still preparing the necessary information.

3.3 Net operating results

The annual operating surpluses, which represent operating revenue less operating expenditure, have contributed significantly to the increase in net assets. Although these amounts are affected by changes in accounting standards, as is explained below, they also reflect real financial changes which are largely positive. Table 8 shows the operating results of each of the cities for the financial years ended 30 June 2003 to 30 June 2006.

The major differences between GAMAP/GRAP and fund accounting can be summarised as follows:

- *The concept of 'Depreciation' has been introduced while the system of expensing certain financing sources (i.e. recording expenditure against certain financing sources – such as funds) has been discontinued. Generally, this has resulted in a reduction in what are shown as expenses in the year of implementation.*
- *In terms of the fund accounting system, government grants that were used for the acquisition of capital assets were credited to assets. In terms of GAMAP/GRAP, these amounts are credited to revenue. Revenue therefore increases as a result of the implementation of GAMAP/GRAP. The same treatment applies to capital assets that are financed by developers; these are referred to as public contributions in the new GAMAP/GRAP approach (for example, the upgrading of road interchanges outside new property developments which are financed by the developer). The inclusion of capital grants in what is generally referred to as the 'operating budget' does result in an increase in this 'operating budget' and represents a fairly significant conceptual change to past thinking.*
- *Gains or losses on the disposal of capital assets are recorded as revenue or expenditure respectively – again, bringing these into the 'operating budget' from which they were previously excluded. In terms of fund accounting, there was no loss shown on disposal of capital assets and all gains were credited directly to statutory funds.*
- *The system of mandatory contributions to statutory funds has been discontinued in terms of GAMAP/GRAP. This has the effect of reducing shown expenses.*
- *The practice of using provisions and reserves to set aside funds for future use has been discontinued. The reserves that can be created are regulated and have been rationalised. Municipalities may reserve surplus funds on a voluntary basis. But provisions can only be recognised if there is an obligation. Typically there is a reduction in expenses as a result of the elimination and rationalisation of provisions and reserves.*
- *On the other hand, liabilities for certain expenses, particularly obligations relating to landfill rehabilitation and employee benefits, must be recognised in term of GAMAP/GRAP. This has led to a need to increase recorded expenses.*

Table 8 Summary of Operating Results								
City	Operating Surplus/(Deficit)				Surplus as a percentage of total revenue			
	2003	2004	2005	2006	2003	2004	2005	2006
	R'000	R'000	R'000	R'000	%	%	%	%
Johannesburg	(273 150)	337 290	1 123 927	876 313	(3)	3	8	6
eThekwini	198 472	234 776	350 730	1 058 186	3	3	4	10
Cape Town	n/a	109 043	499 307	1 973	n/a	1	6	0
Ekurhuleni	479 014	588 725	254 228	1 122 608	7	8	3	13
Tshwane	377 011	24 074	595 365	315 352	7	0	8	4
Nelson Mandela Bay	16 755	(120 760)	(68 536)	76 648	1	(4)	(2)	2
Buffalo City	2 533	19 066	183 586	205 220	0	2	12	13
Msunduzi	15 737	2 207	5 500	167 645	2	0	0	10
Mangaung	39 315	70 301	226 538	2 702	4	6	17	0
Total	**855 687**	**1 264 722**	**3 170 645**	**3 826 647**	**2**	**3**	**6**	**7**

The non-metropolitan cities have been able to generate higher surpluses relative to total revenues than the metropolitan cities. This is despite the fact that non-metropolitan municipalities do not generate RSC-levy revenue. These higher surpluses may arise from more generous inter-governmental grants relative to overall revenue.

There have been significant increases in the net operating surpluses, despite the exclusion of Cape Town information for the 2003 financial year. This is reflected in the surplus expressed as a percentage of revenue, which has increased from 2% in 2003 to 7% in 2006. In order to better understand the reasons for the improvement in the net operating results, the trends in operating revenues and operating expenses have been analysed.

Operating revenues[3]

Operating revenues have increased substantially over the review period. Annual revenue per year increased by 14% between June '04 and June '05, and by 8% between June '05 and June '06. These percentages are significant and indicate that the cities have been able to grow their revenue base at a consistently high level.

One of the reasons for the increase in operating revenues is the change in accounting standards. In the former fund accounting system, government grants and public contributions that were used to finance capital expenditure were not included in revenue but instead recorded directly in the balance sheet. This has contributed to the growth in revenue and is noticeable in the 2005 financial year, when most of the cities implemented GAMAP/GRAP. The financial impact of this change in revenue cannot be accurately determined. An additional change that emanates from the introduction of GAMAP/GRAP and impacts on revenue is the treatment of gains arising from the disposal of items of property, plant and equipment. However, none of the cities have received any substantial revenue from this source.

The major sources of revenue are shown separately for metropolitan municipalities since only these municipalities generate RSC levies.

3 Operating revenues are those amounts that are credited to the Statement of Financial Performance (Income Statement) from an accounting perspective. Operating revenues include gains on the disposal of property, plant and equipment, but exclude annual increases in the market value of certain investments which are deemed to be revenue, profits of joint ventures and taxation.

Table 9 Sources of Revenue (Metropolitan Municipalities)					
Source of Revenue	**Proportion of operating revenue (%)**			**Annual increase[4] (%)**	
	2004	**2005**	**2006**	**2005**	**2006**
Property rates	23	23	23	11	7
Electricity	31	29	29	9	4
Water	12	12	12	10	9
Other service charges	8	7	7	(1)	0
Interest	4	3	4	5	9
Government grants	6	8	10	57	32
RSC levies	16	17	17	23	3
Other revenue	23	23	23	11	7
Total	**100**	**100**	**100**	**14**	**7**

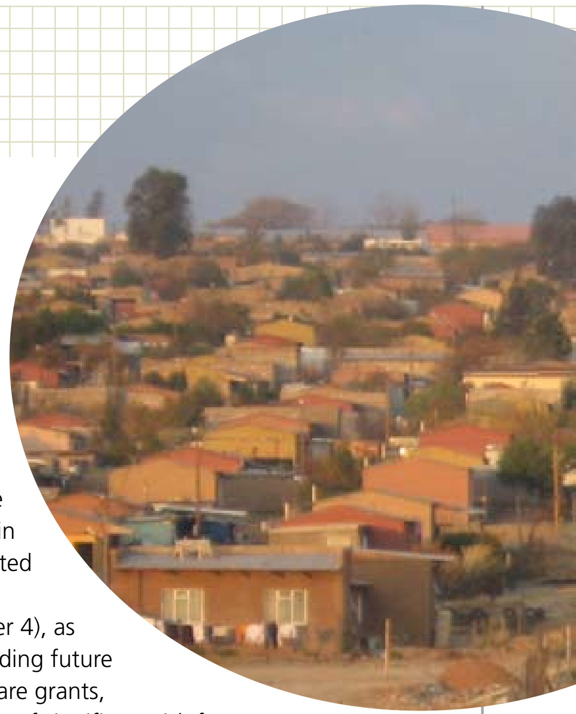
Proportionately, there has not been a significant change in revenue trends, except in respect of electricity and government grants. Electricity has decreased from 31% of total revenue in 2004 to 29% of total revenue in 2006. Government grants have increased from 6% of total revenue in 2004, to 10% of total revenue in 2006. What this means is that the rate of increase in electricity revenue has not matched the rate of increases in the other major sources of revenue. This could be attributable to lower electricity tariff increases partly resulting from attempts to reduce the surplus generated by electricity. The increase in government grant revenue, on the other hand, has been significantly higher than the overall increases in total revenue.

Table 10 sets out a summary of each of the metropolitan municipalities' revenue sources and the trends for each of the major revenue sources referred to above. Whilst there has not necessarily been consistently high revenue growth over each of the periods included in Annexure A, there have been abnormally high increases in each of the revenue sources for one or two of the periods reviewed. Part of the reason for these increases is the reclassification of government grants and public contributions, as explained above.

Given the relatively low macroeconomic spending limits that have been issued by National Treasury (between 5%–6%) and low-budgeted tariff increases approved by municipal councils, this does indicate that there has been economic growth in the cities, particularly in the 2003/4 and 2004/5 financial years. This is confirmed by the increases in the bulk purchases of water and electricity, which increased by 39% in total for all the cities in the 2004/5 financial year and by 7% in the 2005/6 financial year. Whilst some of the increases in bulk purchases are due to annual price increases, the increases are also driven by increased consumption. This can be ascribed to increased economic development and – to a limited extent – the increase in the provision of residential housing.

4 There is no reliable information for the City of Cape Town for the year ended 30 June 2003. In order to not distort the calculation of the annual increases in revenue, the increase between 2003 and 2004 has not been calculated.

Table 10 Sources of Revenue (Non-metropolitan Municipalities)					
Source of Revenue	**Proportion of operating revenue**			**Annual increase (decrease)**	
	2004	**2005**	**2006**	**2005**	**2006**
	%	**%**	**%**	**%**	**%**
Property rates	19	20	20	19	8
Electricity	32	30	32	6	17
Water	13	12	12	3	10
Other service charges	5	8	9	98	14
Interest	3	2	2	(42)	21
Government grants	14	20	21	66	15
Other revenue	14	8	6	(33)	(19)
Total	**100**	**100**	**100**	**14**	**11**



The revenue trends in the non-metropolitan cities show a slightly different trend. Other than government grants, which have increased substantially, and a corresponding decline in other revenue, there have not been significant changes in the mix of operating revenue. The major sources of revenue, namely property rates, electricity and water, have increased consistently over these 3 financial years and have only changed marginally as a proportion of total revenue.

The annual increases in the 2004/5 and 2005/6 financial years of 14% and 11% respectively suggest economic growth and increased residential housing development. The increases in revenue are unlikely to be driven only by tariff increases.

Government grants

Government grants consist of two components: unconditional grants (the equitable share) and conditional grants, where the recipient municipality has to fulfil the conditions of the grant before it can be recognised as revenue.

Table 11 is a summary of the equitable share allocations to the cities based on the annual Division of Revenue Acts.

Despite the unconditional nature of the equitable share grant, it is commonly associated with the provision of free basic services to the indigent. The recent rapid increases in the grants have indeed improved the ability of the cities to finance free basic services at this stage. However, potential increases in the number of beneficiaries in future, especially associated with housing delivery programmes (see Chapter 4), as well as uncertainty regarding future increases in equitable share grants, means that this is an area of significant risk for cities.

There has been a substantial increase in conditional grants as well as grant allocations from the various Provincial Governments.

Table 12 sets out a summary of the various grants that have been credited to revenue and which have been obtained from the annual financial statements. However, it should be noted that the information contained in the annual financial statements is not always complete or is summarised due to its complexity. Shortcomings in the administrative processes of receiving grants from provincial governments may be a contributory factor to this.

Table 11 Summary of Equitable Share Allocations

City	Equitable Share Allocations (R m)				Annual Change		
	2003	2004	2005	2006	%	%	%
Johannesburg	150 928	227 551	380 545	524 760	51	67	38
eThekwini	255 413	348 738	366 181	520 958	40	5	42
Cape Town	105 111	151 353	196 243	267 461	44	30	36
Ekurhuleni	123 706	182 871	296 535	460 058	48	62	55
Tshwane	100 592	149 731	191 810	261 870	49	28	37
Nelson Mandela Bay	96 108	141 799	150 846	199 333	48	6	32
Buffalo City	126 890	175 938	179 480	184 233	39	2	3
Msunduzi	49 302	71 000	69 469	101 800	44	(2)	47
Mangaung	134 036	188 012	190 135	167 319	40	1	(12)
Total	**1 136 138**	**1 636 993**	**2 021 244**	**2 687 792**	**44**	**23**	**33**

Table 12 Summary of government grants included in revenue				
Description of Grant	**Revenue**		**Proportionate Share**	
	2005	**2006**	**2005**	**2006**
	R'000	**R'000**	**%**	**%**
Equitable share	1 946 484	2 613 144	39	40
MIG	962 241	1 504 095	19	23
FMG	11 265	18 264	0	0
MSIG	3 044	6 932	0	0
Health subsidies	309 737	333 307	6	5
Restructuring grant	194 701	249 355	4	4
Ambulance subsidy	155 577	165 076	3	3
Housing	412 525	338 044	8	5
DWAF	7 610	22 236	0	0
Other	1 027 570	1 247 182	20	19
Total	**5 030 754**	**6,497,635**	**100**	**100**

The equitable share makes up the largest percentage of total government grants. The Municipal Infrastructure Grant (MIG) is the second largest grant. Housing grants and health grants are also significant but are reimbursive in nature and thus depend on the expenditure incurred by the beneficiary city. Other grants vary considerably but typically include specific project financing from the Provincial Governments. Due to the constraints in the information contained in the annual financial statements, some of the figures may also include some of the grants that have been separately specified above.

Table 13 is a summary of the grants for each of the cities in the 2003/4 to 2005/6 financial years. An important feature is the inconsistent level of grants and the very large annual changes in the grants received. This makes financial planning at city level significantly more complex and difficult and is clearly a factor in underspending against budgets.

Table 13 Summary of revenue from government grants					
City	**Revenue from Government Grants**			**Annual Increase**	
	2004	**2005**	**2006**	**2005**	**2006**
	R'000	**R'000**	**R'000**	**%**	**%**
Johannesburg	565 501	1 049 989	1 370 865	86	31
eThekwini	373 703	738 329	1 045 242	98	42
Cape Town	562 423	631 906	1 018 808	12	61
Ekurhuleni	581 767	765 330	978 374	32	28
Tshwane	235 047	701 609	785 258	198	12
Nelson Mandela	364 596	332 910	365 457	(9)	10
Buffalo City	216 130	395 751	397 241	83	0
Msunduzi	71 000	106 129	250 183	49	136
Mangaung	201 703	308 801	286 207	53	(7)
Total	**3 171 870**	**5 030 754**	**6 497 635**	**59**	**29**

In summary, revenue has increased as a result of the following factors:

- The growth in government grants. Although part of this growth is due to accounting changes, there has been a significant increase in both conditional and unconditional grants, particularly in the 2005 and 2006 financial years.
- There have been periods where revenue from the rendering of services has increased significantly. This indicates that there has been real growth in the economies of the cities, which is confirmed by the growth in the purchases of electricity and water for resale by the cities.
- There have been consistent increases in the major revenue sources, particularly in respect of the 3 non-metropolitan cities. This means that increases in government grants are not relieving cities of the need to raise revenue from rates and service charges. This may however occur in future years if the level of government grants continues to increase.

Operating expenses[5]

The impact of the implementation of GAMAP/GRAP on operating expenses is not as significant as the impact on operating revenues. The major change is that depreciation on property, plant and equipment has been introduced and replaces the previous expense that related to the repayment of certain capital financing. Based on the annual financial statements reviewed, there is no significant difference between depreciation and capital charges. In fact, the depreciation charge in the year of implementation of GAMAP/GRAP is lower than the capital charges that were included in operating expenditure in the year preceding implementation.

Table 14 sets out the major operating expenses showing each expenditure as a percentage of total annual operating expenses as well as the percentage change from one year to the next.

The annual increases in expenditure are lower than the annual increases in revenue, and this has been a key contributing factor to the operating surpluses referred to above.

Overall, there have not been significant changes in the proportional allocation of operating expenditure for the cities. Employee-related costs show a downward trend, which may arise from economies of scale as a result of the amalgamation of municipalities. A contributing factor may be that this cost is scrutinised continually by National Treasury through its municipal budget monitoring function. The larger metropolitan cities have been very successful in reducing their employee-related costs. For example, in the period 2004 to 2006, the City of Cape Town has successfully reduced its employee-related costs from 33% to 28% of total operating expenditure.

Furthermore, all of the cities have received restructuring grant assistance, with the exception of Ekurhuleni Metropolitan Municipality. It has been an explicit requirement of this grant that cities contain employee-related costs to between 28% and 30% of total operating expenditure.

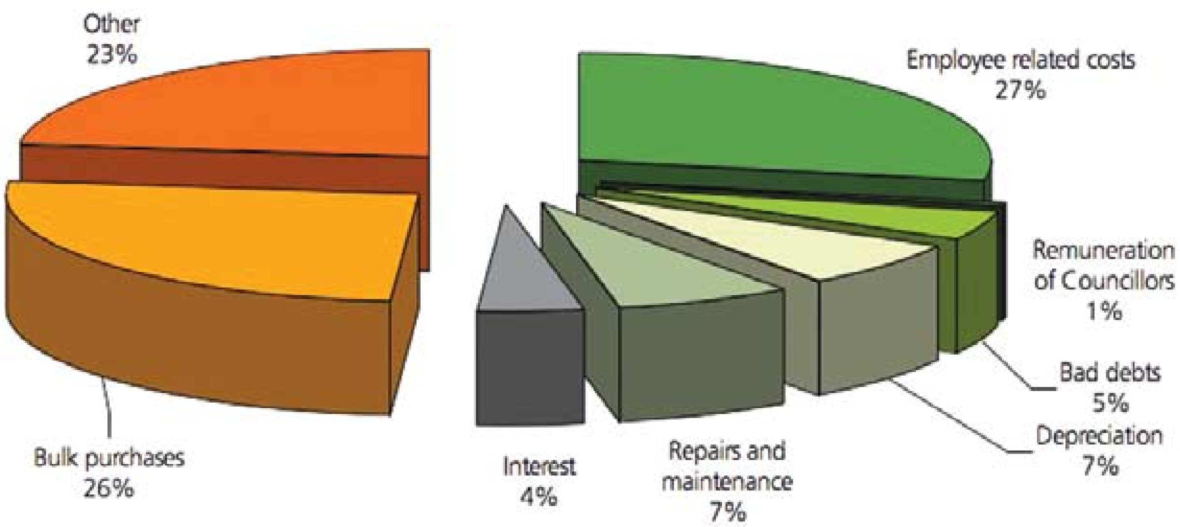
5 Operating expenses are the expenses that are recorded in the Statement of Financial Performance. Operating expenses include losses on the disposal of property, plant and equipment but exclude taxation and losses arising from changes in the market values of certain investments, assets or liabilities. It also excludes any losses arising from investments in joint ventures.

Table 14 Analysis of operating expenses

Expenses	Proportionate Allocations			Percentage Changes	
	2004	2005	2006	2005	2006
	%	%	%	%	%
Employee-related costs	30	29	28	5	4
Remuneration of councillors	1	1	1	6	10
Bad debts	5	7	5	33	(25)
Depreciation*	9	6	7	(24)	17
Repairs and maintenance	7	7	7	8	15
Interest	4	4	4	10	8
Bulk purchases	22	26	26	30	7
Other	22	21	23	6	16
Total	**100**	**100**	**100**	**10**	**7**

**Note: capital charges have been reclassified to depreciation to facilitate comparisons.*

Chart 2 Operating expenditures of the cities 2006



A detailed review of the cities' operating expenditure shows that, in some of the cities, employee-related costs have started to increase as a percentage of operating expenditure. Some of the cities interviewed indicated that a percentage of 30% was probably too low and that service delivery was suffering because of the many vacant posts in the operational and technical departments. These posts would have to be filled to improve service delivery to an acceptable level.

Bad debts range between 5% and 7%. This indicates that overall, payment levels have stabilised or increased over the period under review. Most of the cities have adequately provided for bad debts (see debtors and credit control). This expense will likely remain at these levels going forward, given the stabilised payment levels.

Depreciation expenses are likely to remain at current levels despite the increased focus on identifying and valuing the various components of infrastructure capital assets in terms of the new accounting standards. No depreciation will be charged on assets such as old infrastructure that is at the end of its useful life. However, this reduction will be offset by investments in new capital assets, particularly infrastructure, as these new capital assets will need to be depreciated over their useful lives.

From a financial reporting perspective, repairs and maintenance is an activity rather than a category of expenditure. Whether it should be included as a major category of expenditure in both budgets and annual financial statements is therefore debateable. The amount shown in Table 14 is not an accurate reflection of all repairs and maintenance expenditure. For example, a municipality may enter into an outsourced maintenance contract for certain repairs and maintenance tasks. Such a municipality could reflect this expenditure as a contracted service in its annual financial statements rather than classify it as repairs and maintenance. The repairs and maintenance expenses shown in the table above may thus not be indicative of the total spend on this activity.

However, assuming that there has not been a major change in the costing and accounting systems in the cities over the review period, this amount should probably have increased as a result of the significant additional investments in property, plant and equipment in recent years. Table 14 shows that the proportional spend in relation to total operating expenditure has remained static over the financial years 2003/4 to 2005/6. Using the operating budgets published by National Treasury for the 2005/6 financial year, the national average of all municipalities is also 7% of total budgeted operating expenditure. This suggests that the cities are facing the same challenges as other municipalities (National Treasury 2006).

The average spend on repairs and maintenance of five of the cities is equal to or higher than the average set out in the table above. Tshwane has the highest expenditure at 14% of its total operating expenditure. Four of the cities spend less than the average set out in the table, with Johannesburg only spending 2% of its total operating expenditure on repairs and maintenance.

The implications for the cities of underspending on maintenance are quite significant. The risk exists that asset stripping is taking place and major refurbishments will be required to maintain current level of services. More pressure will be placed on capital budgets to invest in the replacement of existing infrastructure at the expense of investments in backlogs. Most of the cities have recognised the importance of allocating additional resources to repairs and maintenance. However, such additional allocations will need to be financed from additional revenue or a reduction in other expense categories.

Interest paid has remained relatively constant. This is due to the low levels of debt, which have not changed significantly over the financial years ending 2004 to 2006. Interest rates had declined, but during the latter part of the 2006 calendar year they began to increase again. Yet interest paid is not a significant proportion of total operating expenditure; thus the cities will probably not be adversely affected by interest rate changes unless there is a significant increase in the level of borrowings.

Bulk purchases of electricity and water have increased significantly. The more electricity and water purchased, the greater the revenue earned from these sources if margins are maintained. Furthermore, if additional units of electricity and water are purchased and sold, the overhead cost per unit declines, thereby increasing the surplus generated from these services. Some of the increases in bulk purchases can be attributed to the extension of services to eliminate service backlogs as well as input-cost increases from the providers of bulk electricity and water. Nonetheless, the trends again indicate apparent increased economic activities in the cities.

In summary, expenditure has been contained due to:

- the low percentage of employee-related costs relative to total operating expenditure
- the downward trend in the proportion of employee related costs in the 2003/4 and 2004/5 financial years, although marginal increases are noted in the 2005/6 financial year. The possibility also exists that employee-related costs will increase in subsequent years
- the low expenditure on repairs and maintenance. There is a risk that asset stripping is taking place and that major investments in existing infrastructure will be required to ensure continued rendering of services. There have also been increases in the acquisition and construction of capital assets, particularly infrastructure, and increased allocations will be required to maintain these new capital assets.

3.4 Consumer debtors

The collection of amounts owed to municipalities for property rates and service charges has been a significant challenge facing all municipalities, and the cities in particular. There are a number of factors that have contributed to this challenge, including:

- The corruption of consumer databases that arose from the two significant structural and boundary changes since 1995/1996. The establishment of the 842 interim local government structures and the rationalisation thereof in 2005 to 284 local government structures has resulted in the corruption and incompleteness of some consumer databases.
- An initial continued reliance on historical credit control mechanisms that tended to be confrontational in nature, such as the cut-off of services and the sale in execution of properties in respect of defaulting ratepayers, combined with a lack of political will to use these traditional credit control mechanisms.
- The identification of indigent consumers, who are billed regardless of their ability to pay for the services consumed. In particular, the provision of services to beneficiaries of low-cost housing on credit exacerbated the challenge faced by municipalities. The introduction of prepaid meters and indigent support policies has subsequently assisted municipalities in mitigating this challenge. This is covered in some detail in Chapter five.
- The continuous charging of interest on uncollectable arrear accounts, which increased the amount outstanding on a monthly basis.

The increase in debtors balances, particularly in the late 1990s and early 2000s, has had a number of adverse financial implications for municipalities in general. In accounting terms some of the cities used that portion of revenue that was uncollectible to finance operating expenditure. In other words, although budgets were balanced on paper or reflected surpluses, revenue budgets were not reduced to reflect what cash would likely be collected. From a cash flow perspective, deficits were thus effectively budgeted. Expenditure budgets were not adjusted for the shortfall in revenue and from a financial perspective, more cash was being spent than was being received in revenue.

Municipalities had significant cash available at the time. But this was attributable to the reserves that were required to be maintained in terms of the various Provincial Ordinances and which legally could only be used to finance capital expenditure. The cash to fund the deficits was thus ‘borrowed’ from these reserves.

However, once the cash attributable to the statutory reserves was utilised, municipalities could no longer use this cash for its intended purpose, namely to finance capital expenditure. Municipalities therefore had to raise borrowings to finance capital expenditure or significantly reduce the level of capital expenditure budgeted. Significant under-spending on the capital budget was common practice, even in respect of the larger cities. This was not exclusively due to cash flow challenges. A number of other factors contributed, such as poor planning, delayed tendering and a lack of technical skills. However, there can be no doubt that adverse cash flows have had a substantial negative impact.

In addition, other expenses, particularly repairs and maintenance, were reduced in response to cash flow difficulties. This is evident in a number of the cities' annual financial statements. Historical allocations to repairs and maintenance have been reduced to relatively low levels and some of the cities have still not been able to remedy the low levels of expenditure on this activity (see comments under operating expenditure).

The financial difficulties that arose from the increasing debtors balances have been substantially addressed by the cities. This is apparent from the changes in debtors balances outstanding, reflected in Table 15 below. The measures taken by municipalities include the following:

- More realistic provisions for bad debts have been created. The net[6] debtors balance that is recorded in the annual financial statements of the cities is now a realistic assessment of the cash that will be recoverable from debtors.
- Provision is made for bad debts in the expenditure budgets of most municipalities. Based on Table 15, bad debts are approximately 5% of total operating expenditure of the city. This indicates that collection rates are now relatively high.
- The growth in gross debtors has been partly arrested and no longer significantly exceeds annual increases in revenue. This is due to greater management awareness and innovative debtors management in general as well as writing off debtors balances that are unlikely to be collected. The levying of interest on long overdue debtor accounts was also reintroduced, but now more effectively, thereby reducing the growth in gross debtors.
- More targeted support to indigent consumers. The introduction of free basic services has reduced the liability of low-income consumers. In addition, the exemption of low valued properties has also had an impact on the amount due from owners of low-cost housing in particular.
- There have been successful initiatives to improve the completeness and reliability of consumer billing databases in a number of municipalities.

6 Net debtors are gross debtors balances after deducting the provision for bad debts. It reflects the amount that is likely to be recovered from debtors. Gross debtors balances on the other hand reflect what has been billed and which is still legally payable by consumers. No cognizance is taken of whether the gross debtors balance is collectable. The relationship between gross and net debtors is that the former reflects the amount owed by debtors; the latter reflects the amount that is likely to be recovered from debtors.

Summary of debtors

Table 15 below summarises the overall outstanding debtors balances and the provision for bad debts for the 2006 financial year. Overall the cities are owed an amount of R25.6 billion and have provided approximately R16.4 billion for non-payment. The bad debt provision represents approximately 64% of the total debtors outstanding.

Table 16 below sets out the changes in gross debtors to revenue as well as net debtors to revenue for the financial years 2004 to 2006. The table shows that overall there has been a decrease in debtors balances outstanding

Table 15 Summary of Gross and net Debtors' Balances

City	2006			
	Gross Debtors	Bad Debt Provision	Net Debtors	Bad Debt Provision to Gross Debtors
	R'000	R'000	R'000	%
Johannesburg	8 677 808	(6 738 901)	1 938 907	78
eThekwini	3 002 168	(1 372 154)	1 630 014	46
Cape Town	3 932 631	(2 571 695)	1 360 936	65
Ekurhuleni	4 499 796	(3 622 626)	877 170	81
Tshwane	2 959 669	(830 673)	2 128 996	28
Nelson Mandela Bay	1 157 671	(621 274)	536 397	54
Buffalo City	394 724	(147 717)	247 007	37
Msunduzi	356 326	(184 258)	172 068	52
Mangaung	585 285	(298 312)	286 973	51
Total	**25 566 078**	**(16 387 610)**	**9 178 468**	**64**

relative to revenue[7], reducing from 66% to 63% (241 days outstanding to 230 days outstanding). Despite the increase in gross debtors balances, the percentage of net debtors relative to revenue has remained constant at 23% (84 days outstanding) over the financial years 2004 to 2006. This indicates that overall, sufficient provision is being made for the non-payment of debtors.

Ekurhuleni and Msunduzi have the lowest net debtor to revenue ratio (14% or 51 days outstanding) whilst Tshwane has the highest net debtor to revenue ratio (39% or 142 days). There is a possibility that Tshwane will have to make further provisions to reduce the risk of bad debts.

7 For the purposes of this calculation, only property rates and service charges revenue has been used. From an accounting perspective, this is not an accurate calculation, as in certain instances RSC levies are included in debtors balances but the associated revenue is not included in the calculation. RSC levies are recorded on the cash receipt basis, but the June levies payable in July may have been accrued in debtors. This calculation will be reconsidered.

The changes in gross debtors balances will depend on the extent to which debtors balances have been written off. Unfortunately, this information is not disclosed in the annual financial statements and therefore cannot be quantified. However, it does impact on the interpretation of changes in gross debtors.

The most notable improvement in the percentage of gross debtors to revenue is in respect of Msunduzi, where gross debtors have reduced from 45% to 29%. As there has not been a reduction in the bad debt provision or an increase in the bad debts-expense recorded in the annual financial statements, the improvement can be attributed to improved collections despite significant increases in revenue during the 2006 financial year.

Table 16 Summary of Debtor Ratios

City	Gross Debtors to Revenue			Net Debtors to Revenue		
	2004	2005	2006	2004	2005	2006
	%	%	%	%	%	%
Johannesburg	103	94	91	17	19	20
eThekwini	37	35	40	22	18	21
Cape Town	46	55	60	23	25	21
Ekurhuleni	94	75	73	12	14	14
Tshwane	47	52	54	37	39	39
Nelson Mandela Bay	49	49	57	25	23	26
Buffalo City	42	37	38	22	23	24
Msunduzi	62	48	29	49	31	14
Mangaung	71	50	60	49	37	30
Total	**66**	**62**	**63**	**23**	**23**	**23**

Chart 3 Gross debtors to revenue: 2004–2006

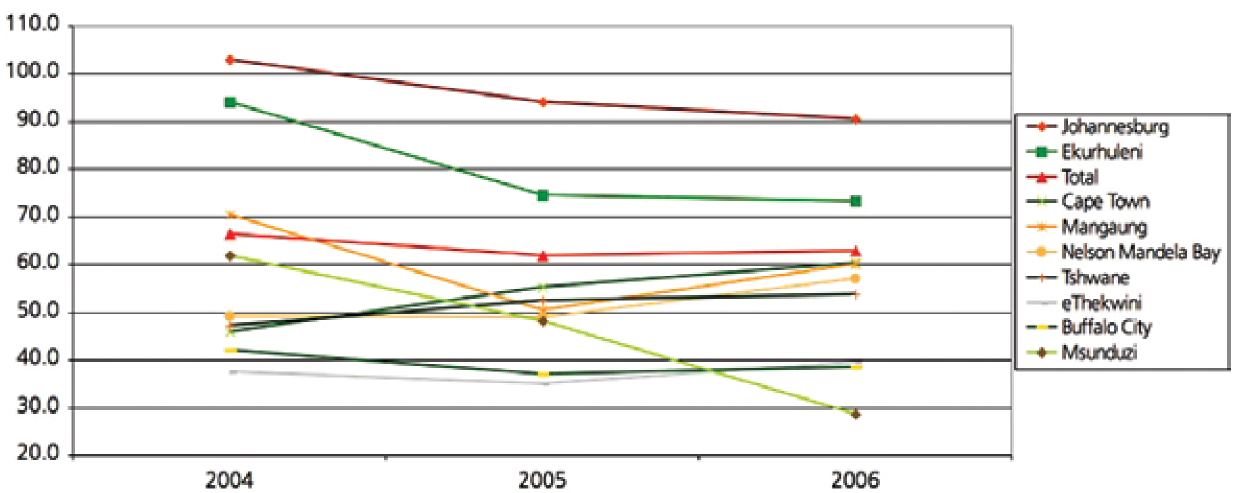
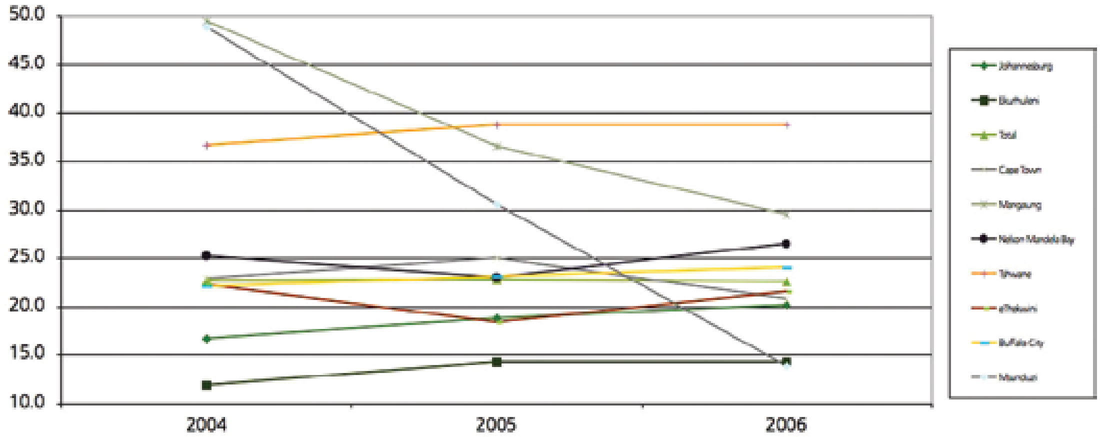


Chart 4 Net debtors to revenue: 2004–2006



A breakdown of the debtors by main customer classification at the end of June 2006 is provided for a selection of the cities in Table 17 and also graphically in Chart 4. Household debtors account for the majority of debtors balances outstanding (approximately two thirds) whilst commercial debtors account for just over one quarter. Government debtors, both national and provincial, are only responsible for 2–3% of debtor balances outstanding. However these ratios vary considerably across the different cities.

In summary, the implications for the cities of the trends in debtors are as follows:

- The level of provisioning is high and thus the adverse financial implications of non-payment by debtors are negated. Provided that the cities are able to maintain the current level of provisioning, the cash flow position of municipalities will remain sound.
- In some of the cities, data for the 2007 financial year shows that debtors collection levels are improving as more appropriate collection strategies are implemented. These strategies include piggy-backing the prepaid electricity revenue systems as a mechanism to manage customers overall and collect revenue due for other services, and more appropriate basic service packages that negate the need to collect debtors balances from indigent consumers.
- Growth in revenue, excluding government grants, is being collected from consumers, thereby improving the cash flow of the cities.

3.5 Investments in property, plant and equipment (capital assets)

A key function of municipalities is to invest in basic municipal infrastructure to:

- expand the extension of services
- replace existing ageing infrastructure to sustain services
- facilitate both social and economic development.

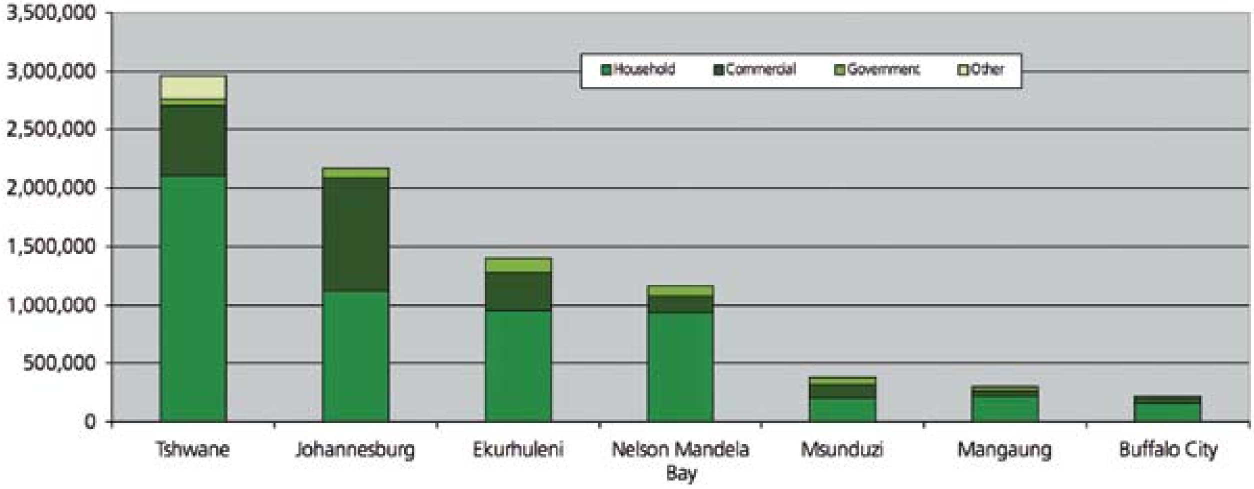
The level of capital expenditure in the cities has increased substantially in the 2004–2006 financial years. Table 18 below shows the level of capital expenditure for each financial year.[8]

8 For the purposes of comparability, investment properties have been classified as capital assets. Certain municipalities have separately disclosed investment properties, which are land and/or buildings that are held for capital appreciation or to earn a commercial return in the form of market related rentals.

Table 17 Analysis of debtors by Customer Classification, 30 June 2006

City	Household	Commercial	Government	Other	Total
	R'000	R'000	R'000	R'000	R'000
Johannesburg	1 116 279	969 312	87 455		2 173 046
Ekurhuleni	948 793	333 109	120 531		1 402 433
Tshwane	2 104 325	600 813	50 314	204 217	2 959 669
Nelson Mandela Bay	931 446	139 717	93 145		1 164 308
Buffalo City	157 720	47 564	12 563		217 847
Msunduzi	198 999	122 070	56 765		377 834
Mangaung	219 221	47 403	30 215		296 839
Total	**5 676 783**	**2 259 988**	**450 988**	**204 217**	**8 591 976**
Proportionate Allocation (%)	**66**	**26**	**5**	**2**	**100**

Chart 5 Analysis of debtors by customer classification, 30 June 2006



It should be noted that not all cities have published details of the broad categories of capital expenditure. In such instances, capital expenditure has been allocated between infrastructure assets and other assets, based on assumptions about the configuration of technical departments.

Measured as a percentage of operating expenditure, capital expenditure has increased from 13% in 2004 to 17% in 2006. This not only indicates that the cities are making substantial investments in capital assets, but also that the ability of the cities to generate financing has increased. This can be ascribed to the improvement in annual operating results, increased government grant financing and the relatively high provisioning of consumer debtors, all of which have improved cash flows.

The nature of infrastructure expenditure was analysed as it constitutes over half the spending on capital assets. There is not a common understanding or application of the definition of infrastructure. For purposes of this analysis, infrastructure has been defined as investment in roads and stormwater, electricity and water networks as well as sanitation.

Table 19 shows the infrastructure spending by type of infrastructure. The 2005 amounts were not always separately disclosed in the annual financial statements, with the result that there is a high unclassified amount. The same challenge arises with regard to the 2006 annual financial statements though not to the same extent. The analysis indicates that the highest spending is on roads, followed by electricity and water. It should be noted that roads are not revenue generating capital assets; thus the substantial investments in capital assets will not necessarily increase operating revenue significantly. It is also not possible to discern investment in replacing or rehabilitating existing infrastructure in the annual financial statements or budgets of the municipalities. This limits the ability to make a correlation between infrastructure investments and revenue generation.

Table 18 Actual Capital Expenditure

Additions	**2004**	**2005**	**2006**
	R'000	**R'000**	**R'000**
Land and buildings	275 788	519 414	889 530
Infrastructure	3 648 672	4 510 069	5 503 169
Community assets	127 281	295 664	373 794
Heritage assets	774	20 608	40 845
Specialised vehicles	0	62	498
Investment properties	283	5 043	1 171
Other assets	2 104 664	2 552 127	2 702 097
Total	**6 157 462**	**7 902 987**	**9 511 104**
Annual percentage increase (%)		**28**	**20**
Percentage of annual operating expenditure (%)	**13**	**16**	**17**

Table 19 Analysis of spending on infrastructure		
Type of infrastructure	2005	2006
	%	%
Roads	18	32
Water	8	18
Electricity	9	20
Sanitation	9	11
Unclassified	56	19
Total	**100**	**100**

Whilst there has been a sharp increase in capital expenditure, the level of actual spending in relation to the original budget spending is still relatively low, as shown in Table 20. There appear to be a number of reasons for this, including a lack of capacity to spend, poor planning and the unreliability of the grant system, especially in respect of low-cost housing. The low Cape Town expenditure as a proportion of the budget, for example, is substantially attributable to problems surrounding the N2 Gateway project – a major low-cost housing project. A budget adjustment process usually takes place after the legislated budget mid-year review process. The cities, particularly those that have significantly under-spent, then adjust their capital budgets to more realistically reflect actual capital expenditure.

3.6 Financing of capital assets

One of the disadvantages of the GAMAP/GRAP accounting standards is that it is not possible to determine how capital assets are financed based on a review of the annual financial statements. Table 21 below sets out certain information that is indicative of the financing of capital assets.

There has been a significant shift in capital financing from internal sources to government grants. This is confirmed by comparing historical sources of financing obtained from the annual financial statements that were prepared in terms of fund accounting for Tshwane, Ekurhuleni and eThekwini for the 2004 financial year. Of the total capital assets as at 30 June 2004, contributions from revenue and internal loans outstanding accounted for 36% of the financing of capital assets. A portion of internal loan financing had been used to finance capital assets as at 30 June 2004. This could not be identified in the annual financial statements. Government grant financing only accounted for 16% of the total capital assets of these municipalities as at 30 June 2004.

If a comparison is made to the budgeted financing sources, grants and subsidies have increased to 38% of capital asset financing. Internal income financing has declined to 27% of capital expenditure.

Table 20 Actual versus originally budgeted capital expenditure, 2006 (R'000)			
City	Budgeted Capital Expenditure	Actual Capital Expenditure	Percentage of Actual to Budget (%)
Nelson Mandela Bay	672 368	544 257	81
Buffalo City	456 165	203 215	45
Mangaung	277 468	251 731	91
Ekurhuleni	1 068 493	765 818	72
Johannesburg	2 806 896	2 742 657	98
Tshwane	1 640 529	1 228 238	75
eThekwini	2 701 500	2 087 339	77
Msunduzi	148 129	187 413	127
Cape Town	4 087 141	1 500 436	37
Total	**13 858 689**	**9 511 104**	**69**

Table 21 Summary of Asset Financing (as at 30 June 2006)	
Financing Source	R'000
Capitalisation Reserve	10 112 201
Government Grants Reserve	9 298 008
Donations and Public Contributions Reserve	2 032 998
Borrowings	17 537 966
Revaluation Reserve	1 323 791
Unidentified	15 296 403
Total	**55 601 367**

Table 22 Summary of Budgeted Financing Sources, 2006						
City	**Grants and Subsidies**	**Borrowings**	**Internal Income**	**Donations**	**Other**	**Total**
	R'000	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**
Johannesburg	523 867	1 931 760	225 490	125 779		2 806 896
eThekwini	963 700	900 000	807 800		30 000	2 701 500
Cape Town	2 174 494		985 310	927 337		4 087 141
Ekurhuleni	485 343		575 000		8 150	1 068 493
Tshwane	584 505	400 000	598 068		57 956	1 640 529
Nelson Mandela Bay	190 034		256 617	14 321	211 396	672 368
Buffalo City	271 876	151 437	23 645		9 207	456 165
Msunduzi	60 079		88 050			148 129
Mangaung	80 355		183 220	13 893		277 468
Total	**5 334 253**	**3 383 197**	**3 743 200**	**1 081 330**	**316 709**	**13 858 689**
Proportionate %	**38**	**24**	**27**	**8**	**2**	**100**

(National Treasury 2006)

Besides the change in accounting standards, a major reason for the reduction in the use of internal sources of financing is that the cash supporting the former statutory funds and reserves legislated in the former fund accounting system was eroded in some of the cities. This has already been explained in the analysis of consumer debtors, above. Prior to the cash being eroded, these funds were substantial financing sources. But the Capitalisation Reserve, which was the balance of internal loans outstanding as at the date of conversion to GAMAP/GRAP, still accounts for 18% of the total financing of capital assets. Over time, internal accumulated sources of financing will probably not be a major financing source for most of the cities. Instead, there will be a greater reliance on government grants and borrowings to finance capital assets.

3.7 Borrowing

The debt levels of the cities in relation to total revenue vary quite considerably but overall have reduced from 33% to 31% between the 2004 and 2006 financial years. This does not imply a lack of borrowing; borrowings increased by 11% in 2004, 7% in 2005 and 8% in 2006. The major reason for the slight reduction in the ratio of debt to operating revenue is that the increases in revenue have been significantly higher than the increases in borrowings.

At these levels, and depending on the context and financing strategy of the city concerned, there would appear to be room for cities to take on more debt to address infrastructure challenges. The reason that this does not appear to have happened deserves consideration:

- Firstly, the cities have quite high levels of capital expenditure (see earlier in this chapter) which do not appear to be constrained by a lack of financing. Constraints faced are likely to be a lack of capacity in the form of planning, procurement and project management rather than access to financing.
  The cities are able to sustain high levels of capital expenditure without accessing borrowings. This implies that there is no demand for borrowing to sustain capital expenditure programmes.
- Secondly, an analysis of historical trends of financing capital assets has indicated that internal reserves that had to be created in terms of the Provincial Ordinances were an important source of financing. These internal reserves have been depleted in certain of the cities and are no longer available to finance substantial amounts of capital expenditure. There is an expectation that cities would have to raise borrowings to replace the amount previously financed by internal reserves.
  This has probably occurred and may account for the

Table 23 Total Liabilities of the Cities				
	2003	**2004**	**2005**	**2006**
Long-term liabilities	12 439 166	13 955 751	13 917 421	16 203,662
Current portion	960 838	887 524	1 905 535	895 912
Total	**13 400 004**	**14 843 275**	**15 822 956**	**17 099 574**
Annual percentage increase (%)		**11**	**7**	**8**
Debt to operating revenue (%)		**33**	**31**	**31**

marginal increases in borrowings noted between the 2004 and 2006 financial years. But this analysis does indicate that cities are able to finance their capital expenditures without the need to borrow and despite a reduction in historical sources of financing.

- Thirdly, there is an indication that the high levels of capital expenditure are being financed from government grants, which reduces the need for cities to borrow. If accessibility to grant financing is reduced, the cities would probably have no other alternative than to raise financing from external borrowing if the current high level of capital expenditure is to be sustained into the future.

According to Table 22, 38% of total capital expenditure was expected to be financed from government grants in 2006, the highest single source of financing, 24% was expected to be financed by borrowings.

The following table, on the other hand, indicates the ratio of infrastructure grants, based on the Division of Revenue Act, to capital asset additions for the period 2004 to 2006. It should be noted that not all grants are included in the Division of Revenue Act; some grants are also disbursed by the Provincial Governments.

Table 24 Grant Financing (R'000)

	2004	2005	2006
DORA infrastructure grants	664 070	1 101 685	1 420 074
Total additions to capital assets	5 671 873	7 460 065	9 056 158
Ratio of grants to additions (%)	12	15	16

Chart 6 shows the current repayment profile of loans taken up by the cities. Just under half (R8.8 b) of the loans are repayable over the next 10 years (2007 – 2016) whilst 45% of loans (R8.0 b) are repayable after the period shown in the chart. There are no major loan repayment spikes except in 2012/13, when Johannesburg will have to repay just over a quarter of its loans outstanding as at 30 June 2006. With the improvements in cash flow during the period 2003 to 2006, the repayment of loans should not pose a cash flow or sustainability challenge.

There are two indications of the credit-worthiness of the cities.

- The first is the extent to which the cities are able to borrow without pledging investments, in the form of a zero coupon bond or other investment instruments.
- The second is the credit rating of the cities.

In respect of the pledging of securities for borrowing, Table 25 indicates which cities have secured borrowings.

Overall, the level of security that has been provided is minimal. A number of the cities have encountered some form of financial distress in the past ten years, and borrowings were relied upon to sustain capital expenditure programmes. Security had to be provided to secure these borrowings, for example, in the case of Johannesburg and Buffalo City. Both these cities have restructured their borrowings, with Johannesburg no longer providing security whilst Buffalo City has converted its secured investments into a guarantee.

If the current improvement in their financial position continues, all of the cities could raise substantial borrowings without having to pledge financial instruments as security. There is also a significant capacity to borrow. However, this depends on whether municipalities will need to consider borrowing as a financing source to sustain capital expenditure.

Chart 6 Consolidated debt repayment schedule of the cities to 2015/16

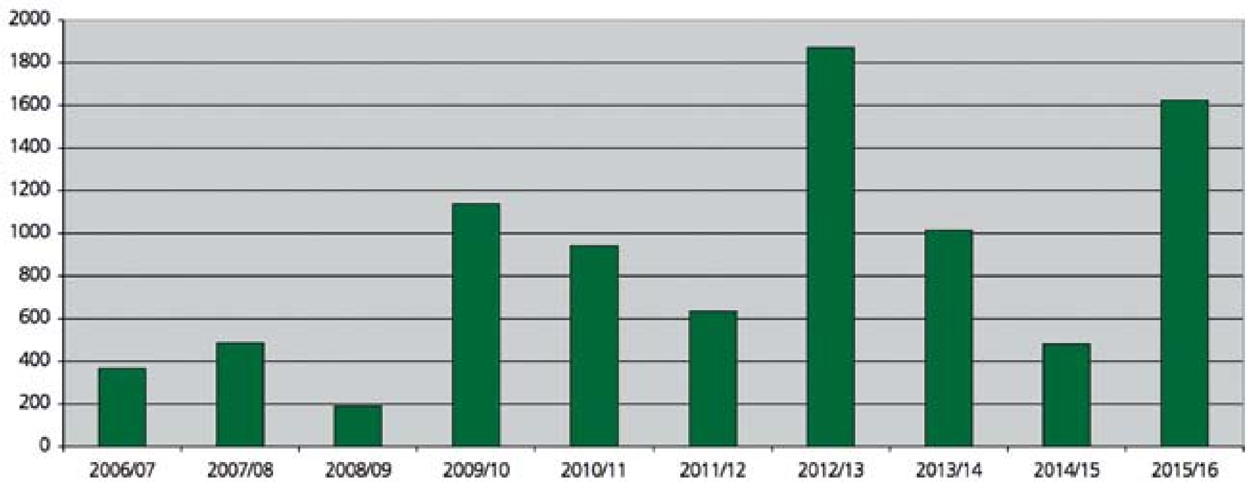


Table 25 Summary of Security Provided for Borrowings			
City	Total Borrowings	Security Provided	Comments
Johannesburg	5 884 064	0	Bonds are secured by asset retention undertakings
eThekwini	4 218 133		R800 million DBSA loans are secured by revenue streams of R20 million per annum
Cape Town	2 354 699	0	
Ekurhuleni	1 348 348	0	
Tshwane	2 198 142	1 244 225	Maturity value of amount invested as security for long-term liabilities
Nelson Mandela Bay	738 522	184 634	Security for a sale and leaseback agreement
Buffalo City	419 360	8 923	Guarantee obtained from the International Finance Corporation
Msunduzi	357 666	0	
Mangaung	19 032	0	
Total	**17 537 966**	**1 437 782**	**(8% of borrowings are secured by investments)**

An important consideration is that the Municipal Finance Management Act is quite rigid in respect of borrowings and only permits municipalities to borrow for the purpose of financing capital expenditure. It also limits the period of the borrowing to the useful life of the asset. Some of the cities that have substantial cash-backed reserves and strong operating cash flows will wish to use this cash to finance capital expenditure. When operating cash flow is eroded, the cities would then obtain general loan financing to replenish cash flow. Though this is a logical approach to cash flow management the legality of such an approach still needs to be tested. One effect is that it creates a disjuncture between borrowings and capital expenditure and can create the impression that there is not a significant demand for borrowing. Instead there is a delay between the point when the actual capital expenditure is incurred and the time when the demand for borrowings to finance such capital expenditure will occur. In these circumstances, incorrect conclusions could be made about the demand for borrowing. Unfortunately, it is not possible to determine whether this has indeed happened in any of the cities, or to quantify the demand for borrowings that has effectively been deferred to future periods.

3.8 Cash flow

The net cash/investment position of the cities has increased significantly over the period 2003 to 2006. This is despite relatively low levels of borrowing and high levels of capital expenditure. The significant increases are in respect of short-term investments as well as cash and cash equivalents. The improvements in the provisioning for consumer debtors and the increase in the net operating surplus have contributed to the improvement in these balances. The increased government grants have also contributed to the higher net cash positions.

Table 26 Summary of Net Cash and Investments				
Component	2003	2004	2005	2006
	R'000	R'000	R'000	R'000
Cash and investment				
Non-current investments	7 240 594	7 818 244	6 029 842	6 004 814
Short-term investments	903 127	2 266 923	3 856 693	4 342 343
Cash and cash equivalents	2 156 432	2 655 619	5 589 057	7 627 906
Sub-total	**10 300 153**	**12 740 786**	**15 475 592**	**17 975 063**
Liabilities				
Short-term loans	20 247	21 981	0	0
Bank overdraft	310 799	349 287	1 363 509	2 649 496
Sub-total	**331 046**	**371 268**	**1 363 509**	**2 649 496**
Net cash/investment position	9 969 107	12 369 518	14 112 083	15 325 567
Annual Change (%)		**24**	**14**	**9**

The improved net cash/investment position might have improved through short-term borrowings and the use of creditors' financing. In respect of short-term borrowings, only Msunduzi has raised short-term borrowings, which have been repaid before 30 June 2005. No other city has relied on short-term borrowing to sustain operating cash flow. An argument could be made that bank overdrafts are being used extensively. Most cities have more than one bank account and therefore some accounts may be overdrawn whilst other bank accounts have positive balances. However, due to stricter accounting rules, offsetting of bank overdrafts against positive balances in other bank accounts is not permitted. Only Tshwane and eThekwini have bank overdrafts that exceed the positive bank balances recorded in their balance sheets; but there are only marginal differences between the bank overdrafts and the positive bank balances in these two cities.

In respect of working capital, Table 27 sets out typical working capital components extracted from the balance sheets of the cities. It is evident that there has been a significant improvement in the working capital of the cities. It should be noted that a significant amount of capital expenditure is usually incurred in the month of June and paid to suppliers in July (the subsequent financial year). These unpaid amounts at 30 June will be included in creditors. The high level of capital expenditure in the years covered by this review has likely contributed to the increase in creditors. However, despite this increase, working capital has improved. Due to the high level of provisioning against consumer debtors, it is unlikely that working capital is being inflated through the inclusion of those consumer debtors balances that are unlikely to be recovered. The improvement in cash and cash equivalents, net of the increases in bank overdrafts, has contributed to the stronger cash flow.

One of the implications of GAMAP/GRAP is that municipalities in general will be required to provide for certain expenses that previously were not recognised in terms of fund accounting. These expenses include retirement benefits, post-retirement benefits, short-term employee benefits and rehabilitation costs (for example, of landfill sites). Municipalities will thus increase operating expenses to make the necessary provisions, and if the concept of a balanced budget is applied, also increase revenue. As provisions do not represent cash outflows, municipalities should be able to generate increased operating cash flow. This will be used either to create reserves that can be used temporarily to finance capital expenditure, or to finance capital expenditure directly from operating cash flows. This is also likely to reduce the demand for borrowing in the longer term.

3.9 Conclusion

Many insights can be gained from the above analysis of the finances of South Africa's nine biggest cities over the 2002/3 to 2005/6 period, including these four important conclusions:

- The new accounting standards mean that the financial statements reflect the real financial position of the cities more accurately than has previously been possible. We can therefore have considerable confidence in the financial picture presented here.
- The cities have made considerable financial progress over the last several years. This is true even taking into account the impact of the new accounting standards.
- The position regarding debtors has recovered substantially with better collection rates and much better provisioning for non-payment, although further improvements are still possible and indeed necessary.
- Still, several key financial risks remain, including the question of asset-stripping and its implications for service delivery, and the risks associated with the increasing reliance upon government grants.

These matters are discussed in more detail in the following chapters, with Chapter 5 addressing some of the expenditure-side challenges and Chapter 6 dealing with the revenue side.

Table 27 Summary of Working Capital

Working Capital	**2003**	**2004**	**2005**	**2006**
Cash and cash equivalents	2 156 432	2 655 619	5 589 057	7 627 906
Short-term investments	903 127	2 266 923	3 856 693	4 342 343
Consumer debtors	8 345 754	7 978 565	8 729 120	9 178 468
Housing rental debtors		529 751	261 052	240 406
RSC levy debtors		200 416	397 773	338 292
Sub-total	**11 405 313**	**13 631 274**	**18 833 695**	**21 727 415**
Less short-term loans	20 247	21 981	0	0
Less bank overdraft	310 799	349 287	1 363 509	2 649 496
Less conditional grants and receipts	400 220	935 979	1 378 438	1 526 536
Less creditors	8 927 140	10 344 639	11 649 284	12 276 171
Working Capital	**1 746 907**	**1 979 388**	**4 442 464**	**5 275 212**
Annual Change (%)		**13**	**124**	**19**

CHAPTER FOUR
EXPENDITURE-SIDE CHALLENGES: POVERTY, GROWTH AND MAINTENANCE

EXPENDITURE-SIDE CHALLENGES: POVERTY, GROWTH AND MAINTENANCE

4.1 Introduction

City governments have the responsibility to ensure a good working and living environment for all their inhabitants. This they do largely through the provision of key services and the enforcement of planning frameworks. They are charged with providing the services, addressing deficiencies or backlogs, planning for growth and expansion, and, crucially, for ensuring financing for it all.

Whatever the actual functional range of their responsibilities, all city governments in South Africa have three major financial imperatives:

a) Cities must operate and adequately maintain the existing service delivery infrastructure. This consists of systems of roads and storm-water drains, electricity distribution networks, water and sanitation systems, any public transport systems, as well as a myriad of other specific service delivery assets, which must be operated to deliver the services. The infrastructure must be maintained, so that service delivery life is optimised. The city cannot fail to look after its existing service infrastructure, since wasted assets will be very expensive to replace. The city must watch over its assets.

b) Cities must construct new infrastructure and provide new services for growth. New and expanded service delivery infrastructure must be constructed and installed as required. The need for such new infrastructure arises from the increase in the number of households requiring adequate accommodation. Most importantly it also arises from the increasing scale of economic activity, and all that is required to support this (including infrastructure and services for industry, retail and other commerce, tourism, etc). The city must provide the infrastructure required for growth.

c) Cities must provide housing and services for the poor. Given our history, South African cities are charged with a special developmental responsibility in respect of redistribution and service delivery to the urban poor. For city governments, this takes the form of ensuring the provision of subsidised or free municipal services and housing to poor households, as well as the more general municipal responsibility in respect of the urban environment. The city must provide subsidised urban services to the poor because of:
   - basic humanity
   - the rights of the poor
   - public health and safety considerations
   - the economic opportunities that such services provide for the poor.

   The city must provide for redistribution.

Much of the strategy of city financing in the South African context involves striking the correct balance between these three imperatives. Complexity arises not only because of the interaction between the three imperatives themselves, but also as a result of the expenditure- and revenue-side implications of each. If the dynamics underlying actual infrastructure decision making do not take these balances into account, the potential adverse consequences for city functioning could be severe.

There are overlaps between these imperatives. For example, a new low-income housing development and an expanded office capacity in adjacent areas may together require an expanded main water supply. A decision could be made to replace the entire pipeline because the existing pipe might be very old and frequently bursts due to a long history of inadequate attention and maintenance. The expenditure on the new pipeline involves all three elements (poverty, growth and maintenance). It would be artificial, and in fact impossible without considerable analytical work, to break down this scenario into three separate components.

This chapter uses this framework to consider some of the expenditure-side challenges facing South African cities. It starts off by looking at the financial implications of poverty for South Africa's cities from two sides, namely the capital side (which has to do with providing housing and infrastructure or 'eliminating the backlog')'; and the operating side (which relates to 'indigency policy', or the provision of free basic services). Then we turn our attention to the implications of growth- and maintenance-related spending on city infrastructure.

4.2 Poverty and indigency in the cities

Poverty is a multi-faceted phenomenon. It is fundamentally linked to the structure of the South African political economy, bearing a very human face with the potential of significant mitigation through appropriate and effective public policy interventions. Poverty has multiple dimensions, including low incomes, absence of land and capital, and, especially in the urban context, lack of access to adequate housing, services, and support. Following the Department of Provincial and Local Government (dplg) framework documents on indigency (Department of Provincial & Local Government 2004), one may adopt a broad definition of poverty or `indigency' as involving any lacks or insufficiencies in respect of the following:

- sufficient water
- basic sanitation
- refuse removal in denser settlements
- environmental health
- basic energy
- health care
- housing
- food and clothing

As a matter of public policy, the three spheres of government attempt to provide poor households with a comprehensive set of public services at little or no cost, with the cost of the services being carried on the books of the service provider concerned.

Local government has the constitutional responsibility to provide many though not all of these services. Municipal indigency policies must therefore ensure service delivery to, and take financial responsibility for, municipal services to indigent households.

What is required is a sense of the scale of poverty in our cities as it affects city governments. For, while city governments should play a significant role in the implementation of public policy towards the poor, other spheres of government and the private, voluntary and other sectors also have considerable responsibilities in this respect.

In overall policy terms, South African city governments are generally held responsible for the following:

a) Ensuring that all households are adequately housed, by making use of housing subsidy finance.

b) Ensuring that all households receive essential municipal services (notably, water, sanitation, refuse removal, and also electricity) through their normal municipal service delivery.

c) Ensuring that at least basic amounts of such services are provided free to those who cannot afford to pay for them.

d) In keeping with the imperatives of developmental local government, cities also attempt to promote local economic development in order to minimise the number of households requiring support as indicated above.

Housing provided through the formal market can adequately house some, but not all, households in a city. Of those who are adequately housed some, but not all, can afford to pay for services.

The challenge facing cities in this respect is two-fold. In the first place, poverty in the cities is a general developmental challenge facing city governments. They are required to ensure the provision of affordable housing of an acceptable standard for all their residents. Since market forces do not provide affordable adequate housing for these lower income market segments, this means that the state should provide sufficient housing stock to re-house any household living in substandard circumstances. It is also responsible for providing the bulk infrastructure required to support the new housing stock. Such new housing stock must be supported by all the necessary social services and amenities, and provide access to sufficient income-earning and work opportunities to create viable urban residential communities. The new housing stock must be provided fast enough to reduce the housing backlog to zero over a reasonable planning horizon. The formal target is to eliminate informal settlements by 2014. Although much of the financing for these housing programmes originates in national housing subsidies and grants, cities do incur significant costs and substantial responsibility for delivery.

The second challenge is that, once the new housing stock has been created, and in fact even while households are still living in substandard housing, city governments must ensure that municipal services are provided to the household, and specifically that a basic amount of such service is provided free to the household. This means delivering the services, which is often a significant challenge in high-density shack settlements which are supposedly not permanent, and taking financial responsibility for the services if households cannot afford to pay for them. City governments are assisted in this by the equitable share grant.

City governments also provide other specific services to poor households, notably those relating to health, scholar and pensioner transport, library services, and others. These services are not specifically examined in this report.

4.3 Backlogs and the need for city infrastructure and services

It is commonly held that South African cities face a backlog in infrastructure and service provision, particularly to the poor. This term is however not always understood by all roleplayers to mean the same thing. The purpose of this section is to clarify the term 'backlog' as used and intended here.

In practice it is useful to specify at least three kinds of backlog.

Firstly and most obviously, there is an apartheid backlog. This resulted in a lack of sewer and water connections, tarred roads, electricity connections, sports and social facilities, and other amenities, specifically in residential areas formerly reserved for Africans, Coloured, and sometimes Indians. These backlogs arose because of the nature of apartheid local government finance, as a result of which no black township area had services of the standard and level provided in white areas. Programmes to tar township streets, to eliminate the bucket system, or to upgrade single-sex township hostels, are aimed at addressing such backlogs.

An associated form of backlog is the housing backlog. Addressing this backlog broadly refers to ensuring that

all households in the city have access to housing of an approved standard. All residents of South African cities who are poorly or informally housed, whether living in shacks, in overcrowded inner-city blocks, or on the street, constitute the living face of this backlog. Ideally, public housing provision should have kept pace with new household formation. Such backlogs are a global phenomenon and third world cities generally are unable to generate adequate new housing on the necessary scale, hence the mushrooming of informal settlements everywhere. As such it is much more challenging than the apartheid backlog. This backlog is very hard to quantify because people move between different urban areas and between rural and urban areas.

The third form of backlog is a maintenance backlog. This refers to the inadequate maintenance history of many city assets required for service delivery, giving rise to a backlog in the maintenance and refurbishment of existing assets. Any asset not maintained according to schedule, such as a road, or the water reticulation network, or any such assets, will deteriorate more rapidly than planned, and will run the risk of having a shorter than planned useful life. The useful life of the asset can be extended to its original design life by making good on the maintenance work not carried out. A maintenance backlog implies that service delivery assets are at risk. Furthermore, even when regularly maintained, many municipal service assets will in fact require replacement and/or complete reconstruction at some stage. This applies particularly in areas relying upon the oldest service infrastructure. Finally, the maintenance backlog is aggravated due to pressure being placed on services built to cater for many fewer people

As discussed in the previous section, infrastructure must also be provided for growth. Many South African cities face requirements to provide bulk infrastructure on a new scale, such as the provision of new sewer outfalls, or new transport investments. The need for this infrastructure for growth arises from the rapid expansion of the cities, and new private investments in residential and commercial and industrial property. Should the cities be perceived to be slow to provide infrastructure 'where required', this form of infrastructure spending may be included in the 'backlog'.

Although a city may face real backlogs in all three of the expenditure categories set out in the previous section, any estimate of the scale of the infrastructure challenges facing the cities should start by considering the backlogs in housing and residential infrastructure. On the residential side, backlogs in engineering services are driven first and foremost by housing backlogs.

4.4 The scale of housing and infrastructure backlogs in the cities

The housing backlog includes all households living within city limits in accommodation that is substandard. This is commonly held to include households living in shacks, or overcrowded houses or flats, or housing that is otherwise not up to standard, although the formal definition covers those who do not already own property and have a monthly income of R3 500 or less.

Reflecting an international trend, most households in South African cities are among the poor. Income levels are too low to be accommodated in the formal private housing market, while the rate of public housing delivery has generally been an insignificant proportion of the actual requirement.

Table 28 Backlog and Poverty Indicators for South African Cities

City	No of households (2005)	Households without access to formal shelter (2004)		LFS unemployed (narrow definition) (2005)	
		%	No.	% unemployed	% unemployed applied to household numbers
Johannesburg	1 027 622	24	246 845	20	207 090
eThekwini	805 178	26	213 465	34	276 588
Cape Town	779 810	17	136 623	21	161 492
Ekurhuleni	760 236	26	200 177	28	209 441
Tshwane	577 839	21	124 662	20	115 155
Nelson Mandela Bay	285 298	23	66 416	31	87 807
Buffalo City	208 523	28	60 006	26	54 805
Mangaung	202 131	9	19 314	25	49 892
Msunduzi	133 223	27	35 994	24	32 081
Total/average	**4 781 864**	**23**	**1 105 507**	**25**	**1 196 357**

Source: SACN Almanac (2006)

The Almanac of the 2006 State of the Cities Report provides data on households with substandard service provision in South African cities. The scale of the backlog illustrated here is significant. Taking South African cities as a whole, it appears that in 2004 some 23% of households were inadequately housed; 13% did not have access to piped water on site; 15% relied upon Ventilated Improved Pit (VIP) latrines or lower standards of sanitation; 12% had no weekly refuse collection service and 11% were without electricity for lighting.

These average figures conceal considerable variation across services and cities. In Table 27 data is provided for housing backlogs per city; and unemployment rates (obtained in the 2005 Labour Force Survey (LFS) applied to city household numbers provide another comparator.

Table 28 provides a very stark picture of the housing and infrastructure backlogs facing each city (representing the capital budget implications of urban poverty[1]). It also helps to provide a clear picture of indigency implications (the operating budget implications of urban poverty), since those forced to rely upon the state for adequate housing are often also unable to pay for the accompanying municipal services required.

However, the housing and/or Integrated Development Plan (IDP) departments of the cities visited uniformly reported higher figures than expressed here, often because data has been updated and new estimates provided. For example, a 2006 internal estimate of services backlogs in Johannesburg suggested that the housing requirement exceeded 250 000 shacks, excluding backyard shacks; that 113 000 households (10%) were without adequate water supply; and that 207 000 (18%) were without adequate sanitation. Similarly, the 2007/8 IDP for the City of Cape Town refers to 'the estimated 350 000 families without adequate access to shelter' (City of Cape Town 2007a). However, the draft also uses a figure of 300 000; and another official Council report provides a detailed time series which suggests a 2006 figure of 265 000[2] (City of Cape Town 2006). The eThekwini Housing department estimates its current total housing backlog at 250 000 units, made up of 180 000 'project-linked' units, 30 000 social housing units (half each of conventional and urban restructuring zone units); 20 000 individual finance-linked (affordable) units, and 20 000 rural housing units (eThekwini Housing Department 2006). Nelson Mandela Bay works on the assumption that the housing backlog is some 80 000 units (Interviews, July 2007). Msunduzi reports that there are currently approximately 26 000 households in inadequate housing (Interviews, June 2007).

Taking such high figures into account, it is possible to conservatively surmise that South African cities must confront a housing and service delivery backlog of around one quarter of their residents. This ratio has, with the possible exception of Msunduzi, tended to increase rather than decline in recent years.

The insufficiency of housing delivery programmes

Housing delivery programmes are underway in all South African cities. In the period 1994–2004 the focus was on 'RDP houses', but subsequently the emphasis has been on informal settlement upgrading, with homes being built using a phased approach.

It appears to be characteristic of these housing delivery programmes of the cities that, for various reasons but mainly due to a lack of land, they are not at all on a scale necessary to make serious inroads into the housing backlog over the foreseeable future.

For example, recent documentation of the City of Cape Town reflects a currently much slower rate of increase in the housing backlog compared to the late 1990s, with the total housing backlog nevertheless still rising at around 2% per year over the last five years. The housing backlog was estimated to be approximately 265 000 in 2006. However, the rate of housing delivery in the city averages less than 5 000 dwelling units per year: the recent peak was 9729 units in 2002. At this rate, the backlog will not be eliminated for at least another generation to come.

At Nelson Mandela Bay, 5 440 units were constructed in 2005/6 and approximately 9 000 in 2006/7 (Interviews, July 2007). Against a backlog of only 80 000 units, this is a much better performance than those of other cities as it implies the elimination of the backlog in as little as eight years, unless more demand develops in that period.

The City of Johannesburg has delivered around 12 000 units per annum in the past, but recent delivery has been only around 5 000 per annum. Again, at this rate there is no hope of eliminating the backlog for a generation, if at all. However, the 2006–2011 IDP is targeting 100 000 units over five years (City of Johannesburg 2006). Specific IDP targets for 2007/8 total some 21 000 units. At this rate the backlog could be eliminated around 2020 at current rates of household growth.

1 Housing and infrastructure backlogs are capital budget backlogs, since meeting the backlogs will require a succession of capital budget allocations. Indigency on the other hand represents the operating budget implications of city poverty, since permanent operating budget allocations to cover free basic services will be required.
2 This appears to be the most reliable estimate since it is supported by time series information.

In the case of eThekwini, the average delivery rate per year is around 13 000. Set against an estimated backlog of around 250 000, this housing backlog, too, is likely to be with us until around 2025. However, the delivery targets for the Housing Department are at 16 000 per annum, which, if achieved, would eradicate the backlog at around 2020, given conservative assumptions regarding ongoing household formation rates.

The picture for most, though not necessarily all of South Africa's cities, is that the rate of low income housing delivery must be increased significantly if the housing backlog is to be eliminated.

4.5 The financial implications of a successful housing backlog elimination programme

Should a programme be implemented to address the housing backlog, it will have certain financial implications for the cities. The extent of the challenge will depend on the specific financial arrangements put in place for each project. However, the intention here is not precision per se, but rather to provide a sense of the scale of the challenges.

The overall structure of low-income housing finance for cities is as follows:

- The basic instrument is the housing subsidy of around R38 000 per unit. In practice this is increasingly budgeted to provide for the top structure only. This emergent practice, if not official policy, was encountered in each city.
- Costs of land are usually not factored in, since they are regarded as provided ('donated') by a government department (Land Affairs, or the province), or by the Council itself.
- The Municipal Infrastructure Grant (MIG) is heavily skewed towards distribution networks of the various services for low income housing.
- There is often a local or provincial 'top-up': local and provincial political sentiment is often geared towards higher standards and specifications, for example that new road infrastructure in the low income area should be comparable to that in adjacent middle income areas.
- Any new bulk infrastructure requirements, as well as anything not mentioned explicitly above (and of course, the overall project, financial, developmental and socio-political risks) are the responsibility of the city.

For example, Msunduzi's housing backlog elimination plan budget estimates the total cost of a low income house (top structure only) as R38 000, to be covered by the housing subsidy; and R25 000 per unit for 'servicing costs' (i.e. bulk and connector services), which the city must fund.

In the case of eThekwini, the city must pay for around R20 000 of the R30 000 unit cost for surfaced roads, stormwater drains, and waterborne sewerage. For an annual delivery target of 16 000 housing units, the Council must contribute R320 million per annum.

In Johannesburg projects exist where the overall cost of social housing units on a slab and with full services is of the order of R72 000 per unit (i.e. 40 square meters @ R1 800 per square meter). These are regarded as inadequate versions which will create high ongoing maintenance costs. Again, top-up funding from the province and city is added to the housing subsidy.

Part of the difficulty relates to the constant contestation about the standard of services to be provided. Basic services are often held to be limited to water, sanitation, electricity (or basic energy), refuse removal, and shelter (housing). However, municipalities and cities in particular must also factor in broader services, including access roads, sidewalks and foot paths, storm-water drainage, public transport infrastructure and services, greening and street numbers and names.

What then are the financial implications for cities of actually delivering housing and services to low income households on the scale suggested? In the absence of detailed project-level information it is hard to understand the long-term financial implications for the cities. The following is a useful way to illustrate the issue:

- Start with the proclaimed housing backlog for 2006 (or if not available,the 2004 SACN data).
- Assume a programme to construct that number of housing units over 15 years (for example, 2008 – 2023).
- Make no provisions for additional housing demand after 2004.
- Assume that Councils provide capital top-up funding of approximately R25 000 per unit.
- Assume that all inhabitants of the new housing will require free basic services; that this costs approximately R1 400 per household per annum, all inclusive (this is the figure used in eThekwini).

It will be noted that each one of these assumptions is 'conservative', that is, it is likely to be on the low side. This bias presumably prevents any accusation of alarmism. If mid-range or higher estimates are used, the scale of the costs envisaged balloons dramatically. Nevertheless, even with the conservative estimates indicated above, this would be a very substantial programme across the nine cities, as the following table indicates:

Table 29 Financial Implications of dealing with the housing backlog					
City	**Estimates of no. of households without formal shelter (2006)**	**Total cost of Council capex `top-up' (R m)**	**Required delivery rate for a 15-year programme**	**Annual cost of Council capex `top-up' (R m)**	**Cost of free services per year (R m)**
Johannesburg	250 000	6 250	16 667	417	210
eThekwini	250 000	6 250	16 667	417	210
Cape Town	265 000	6 625	17 667	442	223
Ekurhuleni	200 177	5 004	13 345	334	168
Tshwane	124 662	3 117	8 311	208	105
Nelson Mandela Bay	80 000	2 000	5 333	133	67
Buffalo City	60 006	1 500	4 000	100	50
Msunduzi	26 000	650	1 733	43	22
Mangaung	19 314	483	1 288	32	16
Total: 9 Cities	**1 275 159**	**31 879**	**85 011**	**2 125**	**1 071**

Source: Nelson Mandela Bay Municipality, Interviews July 2007; SACN Almanac (2006); Author calculations

The housing programme envisaged here does not seem unachievable in project management terms. Though the number of housing units to be delivered per year is higher than those achieved so far, it is feasible. However, the overall programme would be unprecedented:

- One and a quarter million housing units will have to be produced in the nine cities over the next 15 years (i.e. around 85 000 per year).
- The total cost to the cities would be just under R32 billion over that period, excluding financing costs.
- By the end of the programme, assuming all inhabitants of the new units required free basic services, the cities will collectively be providing such services to the value of over one billion rand per annum by the end of the period. This should be financed mainly through the equitable share grant, though the cities will be responsible.

The cities also carry all the residual risks, both on the capital side (any gap between actual costs and formal subsidies allocated) and the operating side (ongoing free basic services).

Such risks would not be mitigated by the likelihood that actual delivery of housing will be slower than envisaged, since this would require the provision of `temporary' services infrastructure to informal settlements, which is unsatisfactory from a service delivery perspective and raises overall costs.

However, several interviewees pointed to the risk that cities in particular might be undermined by their own successes in housing delivery, because the rate of migration into the cities is at least partly a function of the actual and perceived successful provision of opportunities and delivery of services.

Similarly, the nature of new household formation in our cities has strategic and financial implications. As a generalisation, whether as a result of in-migration or simple population growth, it appears that new households being formed are on average poorer than existing households. The ratio of households requiring city support in respect of housing and municipal services thus appears to be growing. Also, household formation is faster than expected because households are splitting up more than previously.

It is also worth noting that early housing programmes naturally tended to make use of easier and cheaper development sites. It is now necessary to move onto more difficult and more expensive sites. Costs per unit are therefore increasing.

4.6 Investments for growth in the cities

Although there is information available to provide a sense of the scale of the financial requirements relating to providing housing and services to the poor, it is much harder to obtain consistent information across the nine cities to provide the equivalent estimates in respect of growth and maintenance backlogs. For this reason the following sections provide discursive accounts for a selection of cities rather than a comprehensive comparative account.

When economic growth rates are relatively low, and when economic infrastructure has some excess capacity, city administrations can focus their budgets upon redress and poverty alleviation without paying much attention to the capacity and condition of the existing overall networks. However, the cumulative impact of the past decade of relatively steady economic growth has caught up with

the cities. With a few exceptions city administrations now have to grapple with the requirements of growth as well as the requirements of poverty.

Ideally, new and expanded service delivery infrastructure should be constructed and installed precisely as and when required. Infrastructure installed 'too early' is liable to be underused and therefore may not deliver the envisaged economic rate of return. Infrastructure installed 'too late' generates various symptoms of urban stress such as congested local junctions and streets, overloaded sewer lines or power substations, and delayed development (reducing local gross value added and delayed property tax income for the city government), all of which involve real economic costs. Delayed projects are also often more expensive projects. The time lag between when the new or expanded infrastructure should optimally have been in place, and when it finally comes on stream, is a backlog relating to growth rather than to poverty.

Most, though not all, South African cities are growing rapidly, both in population terms and in terms of business activity. The slowest average economic growth rates for the period 2001 – 2004 are 2.9% for Cape Town and Nelson Mandela Bay, Johannesburg showed a growth rate of 5.3% and the average economic growth rate was 3.9%. This is illustrated in Table 30, which shows the rate of growth of Gross Value Added per city, a measure of the annual economic product[3].

The growth challenges facing the cities can be well illustrated by the case of Msunduzi. The strong trends in recent economic growth in the Msunduzi area are shown across numerous indicators, including business turnover, commercial borrowing for expansions and new ventures, number of building plans approved (especially in respect of industrial space), heavy load vehicles registered, petrol and diesel consumption, electricity and water consumption, and even a declining trend in unemployment benefit claims (Coetzee 2006). The City Manager indicates that, over the past two years, turnover in Pietermaritzburg has doubled, insolvencies have halved and unemployment has declined (Haswell 2007). The city has benefited from increased consumer spending and from being a provincial capital, but also from an expansion in automotive and other manufacturing sectors and from increased benefits due to its strategic location on the N3. These developments give some credence to arguments that the Durban-Pietermaritzburg spine is developing into a city-region.

However, if such aspirations are to mean anything, it is clear that the infrastructure of the city will need to be upgraded and expanded. The city administration is very conscious of this constraint. The 2006–2011 IDP stresses that electricity demand is increasing at 14% per annum and that capacity is inadequate for continued economic growth (Msunduzi Municipality 2006). In an internal briefing document the City Manager stressed the need to upgrade road and electricity networks, to develop new serviced industrial sites and to confront certain features of apartheid spatial planning. The envisaged capital infrastructure spending is over R525 million, mainly on roads, bridges, industrial parks, and electricity infrastructure. Some of these costs will be carried by South African National Road Agency Limited (SANRAL), and other roleplayers, but some R465 million would need to be funded by Msunduzi itself. The challenge here is that the city is already relatively highly geared,

3 The relatively high economic growth rates can also be discerned in the RSC collection data by city, set out in Table 37 in Chapter 5. Since the actual rates levied have not changed in the 2002 – 2006 period, the dramatic annual increases in collections shown there must have been due only to economic growth and/or improved collections.

Table 30 Economic and Population Growth Rates by City

City	GVA per capita 2004 (Rand)	Average annual GVA growth 2001–4 (%)	Estimated mid-year population 2005	Average annual population growth rates 1996–2005 (%)
Cape Town	41 528	2.9	2 969 458	1.65
Ekurhuleni	28 370	4.7	2 528 303	2.49
eThekwini	30 612	4.5	3 161 844	1.56
Johannesburg	51 591	5.3	3 295 088	2.50
Tshwane	42 589	4.9	2 040 517	2.17
Nelson Mandela Bay	26 620	2.9	1 100 320	1.41
Buffalo City	15 978	3.1	765 343	1.28
Mangaung	20 798	3.5	705 156	1.74
Msunduzi	16 288	3.6	565 196	0.89
Average	**30 486**	**3.9**	**1 903 469**	**1.93**

Source: SACN (2006)

since it had interest-bearing debt of around R320 million as at the end of May 2007 (Msunduzi Municipality 2007). Furthermore, the existing capital programme of the city rises from R210 million in 2007/8 to R250 million in 2009/10 without taking such economic infrastructure requirements into account. At almost one third of the annual revenue of the city, Msunduzi cannot afford to finance the economic infrastructure programme envisaged in the City Manager's memorandum. Accordingly, the City Manager indicates that public private partnerships and other alternative approaches will need to be examined (Haswell 2007).

A similar situation appears to prevail in the case of Nelson Mandela Bay. The credit rating agency, CA Ratings, for example, has concluded that recent rapid economic growth, especially related to the auto industry, means that growth is outpacing infrastructure development, and that parts of the existing infrastructure network are aging and will need replacement or refurbishment (CA Ratings 2006). The bulk water and sanitation infrastructure requirement in Nelson Mandela Bay is estimated by the technical services

BOX 5 eThekwini Housing

The eThekwini Housing Department has estimated the scale of the programme required to deal with the housing backlog by 2011, assuming that the backlog does not increase. Such a programme will require that 36 000 project-linked units be delivered per year between 2007 and 2011, for a total of 180 000 units. In addition, 15 000 units of other categories of housing would be required each year from 2008 to 2011, for a total of 70 000 other housing units by the end of 2011.

This is an ambitious programme for a number of reasons. Delivery of project-linked housing between 2003/4 and 2006/7 has been of the order of 12 500 per year, though some 15 172 were completed in 2004/5 (eThekwini Housing Department 2007). It is not clear why it is regarded as a simple matter to increase this up to around 36 000 per year, as well as provide 15 000 other kinds of housing units per year.

However, should the eThekwini Municipality indeed be able to deliver such a housing programme, the financial implications would be significant. The total programme would require R12.640 billion in provincial funding between 2006/7 and 2010/11, supplemented by R2.319 billion in Council funded 'servicing top-up costs', incurred because the eThekwini Council requires higher than minimum standards for 80% of the sites involved. The Council contribution would rise from R403.2 million in 2006/7 to R529 million in 2010/11 (eThekwini Municipality 2006).

Having ensured construction of the 250 000 housing units, what will be the associated operating costs? The eThekwini housing department estimates that annual maintenance and depreciation costs for electricity, water and sanitation costs will be approximately R25.0 million per annum, and furthermore solid waste removal will cost some R5.0 million per annum.

The provision of free basic services will also be a significant cost. Assume that each project-linked site will be inhabited by a household that will be eligible to receive free basic services to the value of R1 400 per household per annum (the figure used by the eThekwini Housing Department). It is then possible to calculate that by 2011 the Council, having built 180 000 project-linked housing units, will be annually responsible for providing free services to the value of R252 million to these units alone (eThekwini Municipality 2006).

While it is correct that in principle some of these units are already receiving free basic services, which means that part of the R252 million is a cost that is already being incurred, it should be remembered that this calculation is based upon the assumption that the backlog will not change between 2007 and 2011. Yet eThekwini is well aware that the backlog grows every year.

In general, cities are not receiving grants on a sufficient scale to eliminate their housing backlogs by as soon as 2011 – much longer time-frames are envisaged. In eThekwini, for example, actual budget allocations for 2007/8 are less than half of the amounts envisaged by the Housing Department (eThekwini Municipality 2006)

Thus, in practice, the financial position of eThekwini and other city councils will not be burdened to the extent suggested, simply because this number of housing units will not be delivered.

departments to be at R500 million for sanitation and R1.5 billion for water (Interviews, July 2007). However a key issue for the city is the reliance of its motor manufacturers on the Motor Industry Development Programme (MIDP), and what will be put in place when the programme expires in 2012[4].

Buffalo City is something of an exception to the pattern described above. Recent economic growth has not been as pronounced as in the other cities: indeed, there has been a notable manufacturing decline and the public sector is now the lead employer. The city should perhaps be seen as 'a regional city experiencing stress' (Buffalo City Municipality 2006a). Buffalo City administration is very aware of the relationship between the infrastructure offering and economic development. It would therefore like to see an expansion of its river port to facilitate exports by its main auto manufacturer, an upgrading of road and rail links to Nelson Mandela Bay, and expansion and upgrading of the local airport. However, these are not investments which the city itself can undertake, and the stream of public investment into Coega (in Nelson Mandela Bay) is seen as a competitive threat. On the other hand, improved local road and bridge access to the motor manufacturer could help to retain this key industry in the city, and is within the competence of the city. But it is clear that this upgrading is beyond the ability of Buffalo City to finance at this stage.

Under the circumstances Buffalo City faces the considerable challenge that, while it is an important regional centre, it has had 'no foundational infrastructure investment in decades' and its future may well depend on its role in the strategies and decisions of the state-owned enterprises. Buffalo City therefore seeks to shift the strategic discourse to economic development rather than retaining the emphasis on welfare only. It is attempting to fashion a functional role for itself based on the economic potential of its four main nodes, including King Williams Town, Bisho, Mdantsane and East London. However, if this is to be achieved, it will require water-services expansion investments of up to R1.5 billion over the next few years.

The Buffalo City, City Development Strategy (CDS) process in 2006 yielded the following cogent observation relating to the dynamics underlying investment decisions in Buffalo City, which could possibly also apply to other South African cities. Pointing to data for population growth, household growth, economic growth, and employment growth, it was observed that none of these data were used in investment-decision making: instead, such decisions were almost exclusively backlog-driven. The reason for this is the required orientation of 90% of Municipal Infrastructure Grant (MIG) allocations, and the capital budget has contained very little other than MIG allocations. It appears that it is not only the city governments who may have been insufficiently growth-focussed.

4.7 Maintenance and refurbishment challenges

There is also a maintenance backlog. In the long term, asset maintenance is simply a matter of discipline. Assets must be properly maintained right from the beginning: budget allocations must be made, and the work must be carried out. The work is 'self-financing' in the sense that regular maintenance postpones the need to replace an asset (pipe, road, wire, substation, buses, etc)[5], or to incur substantial refurbishment costs. Cities should therefore always allocate sufficient funds for maintenance, and their managers should be assessed on the actual maintenance work carried out.

Unfortunately it is far too easy to skimp on such work. The failure to replace a valve, washer, ageing insulator or similar item may not be noticed for some time; indeed, possibly not until they have failed and caused a service delivery breakdown. Adequate maintenance will also be impossible if city administrations have lost track of where their assets are. This happens often when the assets are very old and original documentation has been misplaced during the repeated administrative reorganisations which city administrations have undergone since the assets were first installed. In some cities, financial constraints combined with inappropriate budget decisions may also have constrained maintenance work[6].

Whatever the reasons, it is clear that many South African cities do have substantial maintenance backlogs. For example, Buffalo City faces some critical maintenance challenges. Management assessments in September 2006 stated that there are 'clear indications that asset stripping is now beginning to bite' (Buffalo City Municipality 2006a). Some ageing infrastructure, particularly relating to wastewater, is beyond design capacity and design life already. This situation here is regarded by management as critical, and is already inhibiting development. The capital backlog to address these challenges is estimated at some R623 million (Buffalo City Municipality 2006b). Deferred maintenance in water supply infrastructure is estimated at

4 Buffalo City, Msunduzi, eThekwini, and Tshwane also face risks from this source.

5 Maintenance will be harder and more expensive if the original infrastructure is of an inadequate standard or quality.

6 Cities also facing rising losses from the theft of and damage to infrastructure (electric cables, road signs, traffic signals, hole covers and other specific items). Replacement of such losses is often a routine matter, part of the maintenance requirement, though cities have attempted to make the replacement items less susceptible to theft.

R200 million, and there is also a need for expanded bulk water treatment capacity. The condition of the city's roads is described as bad, and deferred maintenance of roads amounted to approximately R350 million (Buffalo City Municipality 2006c). Further, R400 million was required for solid waste services for fleet and landfill sites (Buffalo City Municipality 2006d).

The inadequacy of the existing electricity infrastructure (which in 2006 apparently required emergency work worth R200 million, besides an additional R500 million for expansion) is evident from the high levels of insurance claims for various kinds of breakdowns. The refurbishment of electricity infrastructure is a difficult exercise that is subject to very long lead times.

Management consciousness of these challenges has led to an assessment of city assets in terms of the engineering expected life, the asset condition, the remaining useful life and the cost to replace the asset.

The financing of the deferred maintenance and capacity expansions are sufficiently challenging for Buffalo City to seriously consider alternative sources to the internal resources, grants, and the general obligation borrowing which has been the standard approach thus far.

There are similar backlogs at Nelson Mandela Bay. In this case the technical departments prepared estimates of backlog-funding required, of which the most significant are as follows (Nelson Mandela Bay Municipality 2007):

Table 31 Infrastructure backlogs Nelson Mandela Bay

Infrastrucure type	Cost (R m)
Water rehabilitation/ refurbishment:	R319 m over three years
Sanitation rehabilitation/ refurbishment:	R132 m over three years
Road rehabilitation/ refurbishment	R294 m over three years
Road resurfacing backlogs:	R185 m over five years
Bridge repair and rehabilitation:	R28 m

This amounts to over R950 million, and it does not include significant maintenance backlogs across all the services.

The stormwater drainage system in eThekwini provides instructive lessons on the issues of aging infrastructure faced by many South African cities. The stormwater network was installed in one concerted effort some sixty years ago when the Umgeni was canalised through the city. It currently consists of some 2 200 km of pipes and culverts, and much of it is approaching the end of its design life. However, there are no records for nearly 40% of the network, and the city is undertaking a six-year programme of assessing the condition of the network. Similar circumstances apply in respect of much of the original municipal infrastructure installed in South Africa's cities.

4.8 Conclusion

It is clear that South African cities will require considerable financial resources in order to be able to adequately confront the challenges they face in respect of poverty, growth and maintenance. The following are the 'big ticket' items for the cities:

- housing backlogs (housing and infrastructure project top-ups)
- infrastructure for growth (notably roads, stormwater, water and sanitation); also the proposed new transport service infrastructure
- maintenance and refurbishment backlogs (notably roads, stormwater, water and sanitation)

The ability of the cities to address these challenges will depend, among other things, on their ability to generate sufficient financial resources, primarily from their own revenue sources. In principle city governments must charge tariff increases which will allow them to pay the costs of necessary infrastructure. The DBSA, in a recent study, estimated that municipal service delivery tariffs will rise by 4% above the rate of inflation to cover these costs (DBSA 2006).

BOX 6 City of Johannesburg: sanitation

The City of Johannesburg intends to have eliminated the services backlog by 2010. According to the Department of Infrastructure Services of the City of Johannesburg, around 206 000 households in informal settlements (i.e. about 17% of all households in Johannesburg) still require basic sanitation (City of Johannesburg 2007).

The City of Johannesburg's policy on service delivery is that permanent settlements should receive reticulated services, while non-permanent settlements will receive only interim, on-site services. Because the cost of installing water and sewer networks is so high, the limited available funds for sewer networks can only be used in permanent settlements.

This means that the rate of township proclamation limits the rate of backlog eradication. Until proclamation, only on-site services are provided.

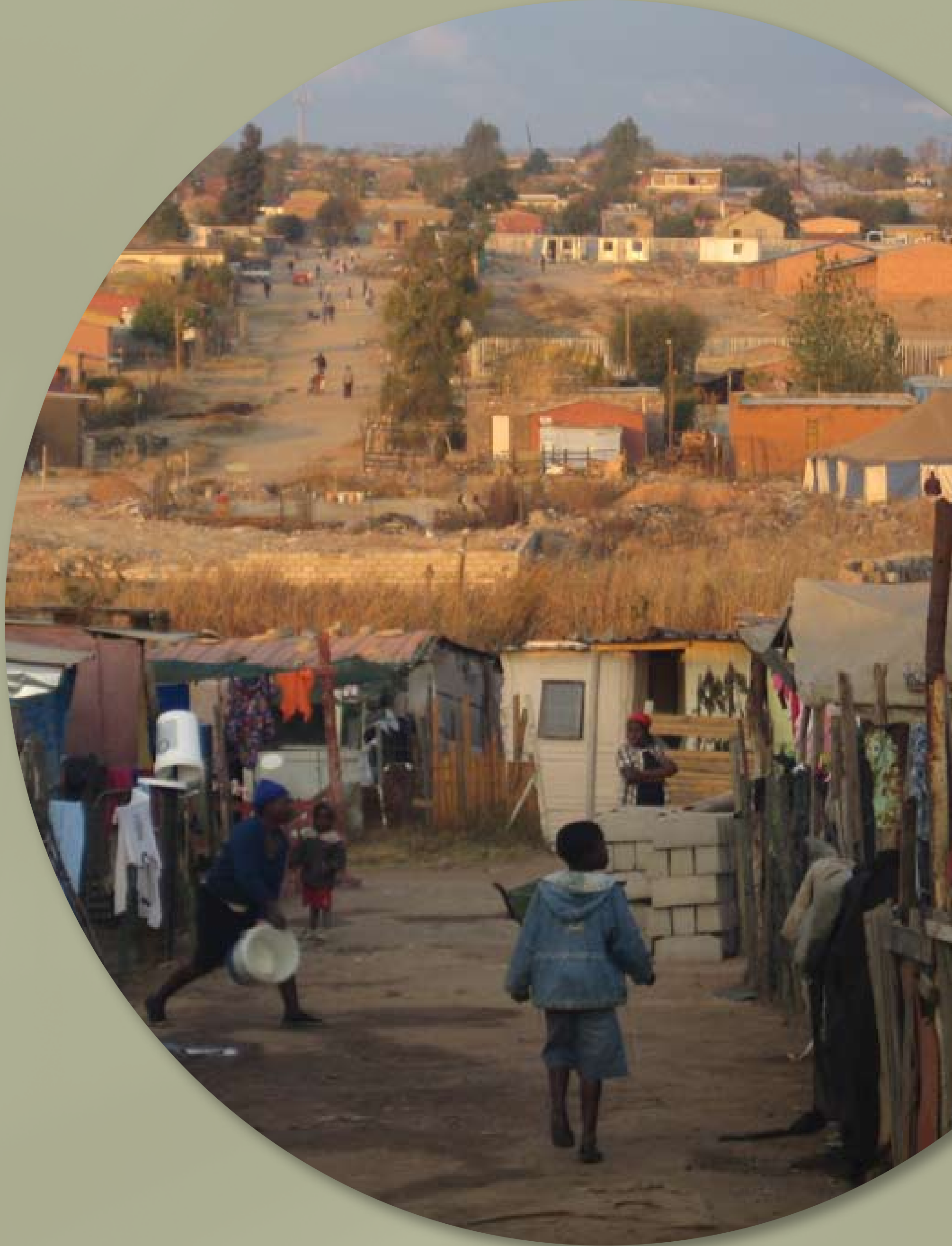
It would be ideal to upgrade directly from below basic services to permanent reticulated services. This would satisfy popular aspirations, and save having to upgrade all the VIP toilets in future. But it is seldom possible to do this (because land owners may not permit any services to be installed to avoid legitimising the occupation; or the settled land may be unsuitable for development, or alternative land might not yet been identified; or because existing sewer outfalls cannot service the settlement and development horizons are too far into the future, or funding is not available, etc). Accordingly, interim measures are used. These include providing communal chemical toilets (until there is clarity on the development trajectory of the settlement); and VIP toilets or equivalent per household, where there will clearly be no housing development within two years.

The 2010 backlog eradication target is within reach only because of the use of interim basic services. However, this will leave a legacy of challenges after 2010. For example, given the challenges of township proclamation and large-scale housing delivery, the interim measures are likely to be in use well beyond their intended life. This is unsatisfactory in service delivery terms, and is also costly.

Furthermore, the costs of the upgrade from basic to reticulated services will be substantial (internal sewer connections, water and sewer networks, and expanded wastewater treatment capacity) and will need to be funded from the City's general coffers, bearing in mind that there will be minimal new cash flows to the city associated with providing the reticulated services).

Because of the commitment to eradicating service backlogs by 2010, interim on-site services are an essential part of the service delivery strategy. The scale of the housing backlog suggests that VIP toilets will be relied upon for a considerable time to come. Yet VIP toilets are clearly not an appropriate default technology in dense urban settlements, nor the long-term answer to urban backlog challenges (City of Johannesburg 2007). For reasons of sustainability and long-term cost, cities are correct to aim for full reticulated services. But this means that the assumptions informing the MIG and equitable share allocations need to be reviewed.

The cities are caught in a web of contradictions between the standard of services that are politically acceptable, those that are technically feasible and those that are financially affordable.



CHAPTER FIVE
REVENUE-SIDE CHALLENGES: TAXATION, ACCOUNTABILITY AND REVENUE ADMINISTRATION

REVENUE-SIDE CHALLENGES: TAXATION, ACCOUNTABILITY AND REVENUE ADMINISTRATION

5.1 Introduction

South African cities receive revenues from a variety of sources, including taxes, grants, and fees and charges for services. On average the cities raised some 92 per cent of their revenues from their own sources over the period 2003/04 to 2005/06, although this fraction was falling noticeably as government grants increased[1].

The 'Taxes' indicated in Table 32 consist of property taxes and RSC/JSB levies. Both are very important revenue sources for cities and both are currently undergoing significant changes. Property tax is being standardised across the country in terms of the Municipal Property Rates Act (MPRA), which will mean some shifts in tax incidence in South African cities. The Regional Services Council (RSC) and Joint Services Board (JSB) levies, a local business tax based on turnover and remuneration, have been abolished with effect from 1 July 2006 – that is, after the period covered by these figures. So far the levies have been replaced only by a new national grant on an interim basis while new revenue instruments are explored.

The services supplied by South African cities can be divided into two broad categories, namely `public' services, which are provided for the benefit of the community as a whole, and 'private' services, which are for the benefit of the individual household. These categories of services have different characteristics which require different approaches to their funding.

For example, stormwater drainage, traffic policing and streetlighting are services to the community as a whole. No individual service charge can be collected for these services, and they should ideally be funded by means of a tax. The tax levied on individual taxpayers should be set based on a combination of assumed benefit and some determination of an ability to pay.

1 This is true even taking into account that capital grants now appear in the income statement: see Chapter 3.

However, the benefits of electricity or water consumption by a household accrue to that household only. Furthermore, the consumption can feasibly be measured and charged on an individual basis. These are the characteristics of a 'private' service, which can be funded by means of a consumption-related charge paid by the household.

The line between these two categories is not always obvious. For example, there are some services which are provided to individual households, but which have wider public benefit, such as refuse and sewerage services. These services are sometimes referred to as 'mixed' goods.

Certain goods and services conventionally defined as 'private' goods, such as the provision of water, also have public good elements for satisfying basic needs (particularly at low levels of provision).

Table 33 shows a selection of services typically provided by the cities according to the different categories of service. South African cities spend roughly 51% of their gross income on public services, 42% on private services, and 8% on mixed services.

Section 229 (1) of the Constitution[2], that deals with municipal revenue sources, reads as follows:

229 (1) Subject to subsections (2), (3) and (4) 2, a municipality may impose –

a) rates on property and surcharges on fees for services provided by or on behalf of the municipality; and

b) if authorised by national legislation, other taxes, levies and duties appropriate to local

2 Section (2) restricts municipalities from imposing taxes in ways which unreasonably prejudice national economic policies and economic activity and state that municipal taxes may be regulated by national legislation. Sections (3) and (4) deal with revenue sharing between municipalities in the same area.

Chart 7 City revenue sources 2003/4 to 2005/6 (R m)

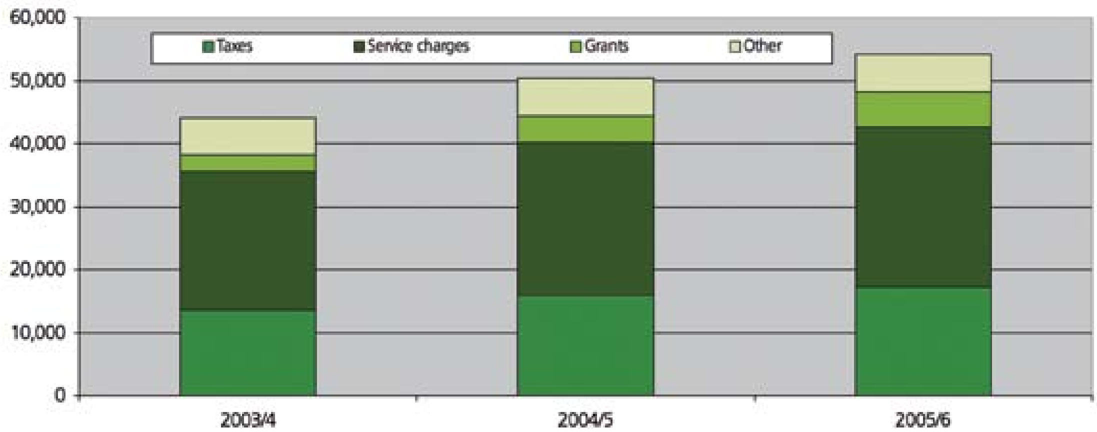


Table 32 Overall Profile of the Revenue Sources of SA Cities						
Revenue sources	**2003/4**	**2004/5**	**2005/6**	**2003/4**	**2004/5**	**2005/6**
	R'000	**R'000**	**R'000**	**%**	**%**	**%**
Taxes	14 188 999	16 759 364	18 088 081	30	31	31
Service charges	24 242 443	26 203 605	27 634 649	51	48	47
Grants	3 171 870	5 030 754	6 497 635	7	9	11
Other	6 141 413	6 447 246	6 421 638	13	12	11
Total	**47 744 725**	**54 440 969**	**58 642 003**	**100**	**100**	**100**

government or to the category of local government into which that municipality falls, but no municipality may impose income tax, value-added tax, general sales tax or customs duty.

South African cities accordingly fund their public goods and services through taxes, largely property tax. Until the end of June 2006, public goods and services were also funded by RSC and JSB levies. Various approaches are followed with regard to the funding of 'mixed' goods and services. Most common is to set a fee which bears some relationship to the amount of service used, but is qualified by a mechanism to take into account the ability to pay. Refuse services are often charged at a set amount per household, reduced for poorer households through rebates or other mechanisms. The fee or charge for sewerage services is often set on a similar basis to water consumption, with a stepped tariff which provides for a relatively low charge in instances where household water use is low. In some cases sewerage charges are partly or fully linked to property values. Finally, private services such as water and electricity are metered, and charged according to consumption. A free basic amount is provided either to all households, or to poorer households only, and financed partly through higher charges for higher usage.

Table 34 shows the major revenue sources by city for the period 2002/3 to 2005/6 based on the significance of revenue source. Electricity is the cities' largest single revenue source by a considerable margin, followed by property rates and water service charges. Government grants, mainly equitable share grants, are the fourth largest revenue source, and it is evident that their rate of growth over the period has been strong. The second most buoyant revenue source, the RSC/JSB levies, was an equally substantial source of revenue until the end of June 2006.

This chapter examines some of the salient aspects of city revenue flows. The next section examines the likely challenges to be associated with the implementation of the Municipal Property Rates Act of 2005 (the MPRA). Section 6.3 turns to the issues associated with the abolition of the RSC/JSB levies, and discusses some options for their replacement, arguing the need for a new, better-designed local business tax. Subsequent sections address respectively the challenges of city revenue administration, arrears and debtors levels, and the mechanisms of indigent support. The conclusion suggests an approach to effective revenue strategies for South African cities.

Table 33 Categories of Services		
'Public' goods/services	**'Trading' or 'tariff funded' services**	
	'Mixed' services	**'Private' services**
• General governance and administration • Town planning • Roads & storm-water drainage • Street-lighting • Environmental management • Disaster management • Regulation of street trading • Building regulations • Cleaning of public spaces • Traffic policing • Sports facilities, parks, halls & other amenities • Fire services • Cemeteries • Public transport facilities • Environmental health	• Refuse removal • Sewerage	• Water distribution • Electricity distribution

Table 34 City Revenue Sources 2003 to 2006: Total for all 9 cities (R'000)						
	2002/3	2003/4	2004/5	2005/6	% of total revenue 2005/6	& change in revenue 2003/4 to 2005/6
Electricity	11 189 470	14 702 360	15 993 619	16 776 677	29	14
Property rates	7 793 764	10 847 506	12 113 867	12 980 510	22	20
Water	4 367 640	5 696 581	6 240 459	6 826 042	12	20
Other	2 843 265	4 329 676	4 579 479	4 407 452	8	2
Government grants	1 457 464	3 171 870	5 030 754	6 497 635	11	105
RSC Levies	2 423 928	3 341 493	4 645 497	5 107 571	9	53
Sewerage	904 409	2 073 639	2 362 882	2 610 217	4	26a
Interest earned	1 153 525	1 811 737	1 867 767	2 014 186	3	11
Cleansing and other service charges	2 292 278	1 769 863	1 606 645	1 421 713	2	–20
Total	**34 425 743**	**47 744 725**	**54 440 969**	**58 642 003**	**100**	**23**

5.2 Implementation of the new Municipal Property Rates Act 2005

For some of the cities the revenue from property taxes has been fairly buoyant over the last few years. This is illustrated in the Table 35. These increases are attributable to increases in the rate in the rand as well as increases in the number of properties and new buildings.

Cities have relied upon property taxes for many years, but the legal framework governing the raising of property tax has varied across the country, depending on the applicable provincial ordinances. Legislation to standardise the raising of property taxes has been implemented, and the new Municipal Property Rates Act took effect on 2 July 2005. Cape Town has been the first city to implement the new legislation, with effect from 1 July 2007. The remaining eight cities are all currently undertaking general valuations, which will be used as the bases for new property taxes.

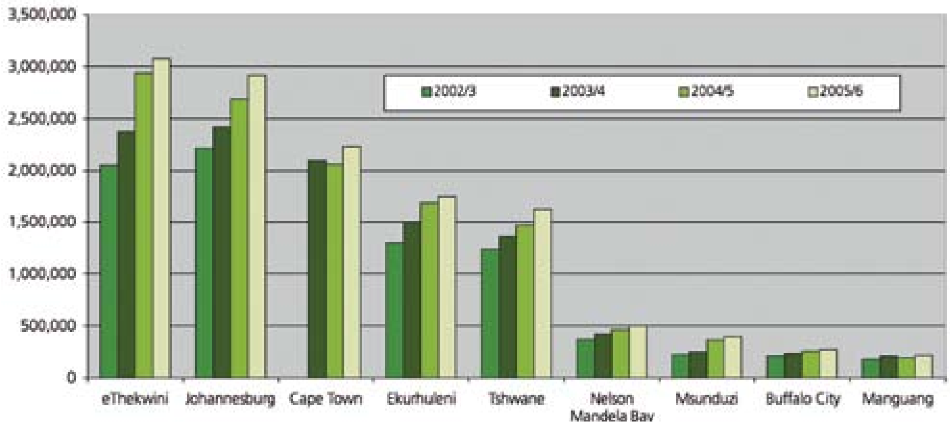
The legislation must be fully implemented across the country by 30 June 2009.

The implementation of the new legislation has the potential to result in significant shifts in the burden – or incidence – of the tax across ratepayers. This is driven by three main factors, namely:

a) A shift to a full market valuation basis, replacing all other approaches. In the three cities of the former Transvaal, property tax has so far been levied based on land values only; in eThekwini and Msunduzi the current system is to tax both site and improvement values, though at differential rates. The improvement is calculated as depreciated construction costs. Buffalo City and Nelson Mandela Bay also use a composite system, though on a slightly different basis. Mangaung uses a composite system, though this is heavily weighted towards site only. Cape Town is in the

Table 35 City Property Tax Revenues 2002/3 to 2005/6 (R '000)					
City	2002/3	2003/4	2004/5	2005/6	% change in revenue 2003/4 to 2005/6
Johannesburg	2 212 324	2 416 541	2 684 309	2 918 647	20.8
eThekwini	2 046 756	2 367 293	2 939 573	3 071 229	29.7
Cape Town	0	2 092 541	2 056 817	2 227 794	6.5
Ekurhuleni	1 302 397	1 503 776	1 681 077	1 753 716	16.6
Tshwane	1 242 043	1 363 697	1 468 347	1 624 061	19.1
Nelson Mandela Bay	376 322	419 188	466 715	498 867	19.0
Buffalo City	207 184	229 708	255 438	271 366	18.1
Msunduzi	225 115	244 969	363 973	396 485	61.9
Mangaung	181 623	209 793	197 618	218 345	4.1
Total	**7 793 764**	**10 847 506**	**12 113 867**	**12 980 510**	**19.7**

Chart 8 City property tax revenues 2003/4 to 2005/6 (R b)



fortunate position of having made this particular transition already, as it already taxes on the basis of full market value.

The MPRA requires that property tax be levied on the full market value of the relevant properties. From their disparate starting points, all the cities must achieve this transition by June 2009. In some cases, this will involve managing shifts in the incidence of property taxes, even if the introduction of the new system is not associated with any increase in the total rates levied. This is because property tax levied on the site value only will favour properties where the value of the land is relatively low in relation to the value of improvements. As the system shifts to a full market-value system, the tax on these properties will increase, while the tax on properties which have a high land value relative to the total property will decrease (assuming no change in the total amount of property tax levied over the whole city).

The impact of a shift in the basis of taxation from a site-only system to a full market-value system can be best illustrated with an example (see Box 7).

In most instances, the actual extent of the shifts in incidence is unlikely to be as marked as the model suggests. However, there will undoubtedly be significant shifts amongst a minority of properties, particularly in those cities which have previously based their property taxation on site value only. This will become a highly contentious issue if not well managed.

b) There have been significant changes in property values since the last valuations were conducted. Some of the current valuation rolls are relatively old. For example, Buffalo City is still using valuations rolls prepared for East London in 1991 and King Williams Town those prepared in 1994. This has partly arisen because of past practices of not valuing property regularly, combined with waiting for new legislation to be passed before incurring substantial expenditure on new valuations. Shifts in incidence will also take place due to the updating of the roll. Where all properties across a city have risen by the same proportion between old and new valuations, no shift in incidence will be experienced, other things being equal. However, differential increases are common, and over a period of, say, two decades, can be substantial.

BOX 7 Shift in property tax incidence arising from the change in valuation basis

Assume two properties. The site value of each property is R200 000. However, the improvements value of Property A is R1 000 000, while the improvements value of Property B is R200 000. Thus the total value of Property A is R1 200 000 and the total value of Property B is R400 000.

Assume the total property tax revenue from these two properties is R1000.

In a system based only on site values, each property will pay the same tax, i.e. R500. This is because the value of the land is the same in each case. But in a system based on the total value – i.e. site plus improvements – Property A will pay more. In this example it will pay R750, while Property B will pay R250. This is because Property A represents three quarters of the total value of the combined properties and Property B one quarter.

There has been no change in the total amount of tax collected by the municipality from the two properties combined. However, in shifting from a system based on only site values to one based on the full value of the property, the incidence has shifted significantly.

Source: SACN (2006)

In cities such as Johannesburg (last general valuation in 2001) and Ekurhuleni (last valuation in 2004) the forthcoming problem is less acute. The valuation in Cape Town implemented with effect from 1 July 2007 was done only five-and-a-half years since the previous valuation. Yet, during this time property values have increased on average 3.8 times. Some properties increased in value significantly more than this; others much less.

c) Changes in property rates policies, including changes in rate differentials among the different property categories, and new rates in the rand. Collectively these could amount to a significant public management challenge for South African cities. In terms of the MPRA the Minister of Provincial and Local Government, in consultation with the Minister of Finance, will set regulations on the relative tax rates that may be charged to different categories of property. In effect, the ministers will limit what has up to now been termed the 'residential rebate'. The residential rebate in some cities, such as Johannesburg, has been high. It is possible that any new regulations introduced will result in the differential having to be reduced. This will lead to a different set of incidence shifts (i.e. as a result of effective policy changes) which may also be challenging to manage.

The new legislation changes the way that the 'residential rebate' and other differential treatment for other classes of property is presented. Previously the main rate was the rate imposed on business property, on which residents and other roleplayers received a rebate which was set as a percentage of the main business rate. Thus, for example, in Johannesburg residential property is given a 58% rebate on the tax that it would have paid had it been a business property.

In terms of the new legislation this is effectively still possible, but differential treatment of classes of property is presented in relation to the rate on residential property. A ratio of 1:2 for residential to commercial property amounts to a residential rebate of 50%.

The residential rebate in Tshwane is currently 30%. Converted to the new presentation, this amounts to a commercial: residential tax rate ratio of 1:38. Ekurhuleni and Mangaung both have a 40% residential rebate, which is equivalent to 1:67. Johannesburg's current 58% residential rebate means that its commercial: residential tax rate ratio is as high as 2:38. Cities will need to adjust their tax policies on this point if the regulations set a ratio that is lower than their current practice.

Regulation of the treatment of vacant land could also require adjustments. Most cities currently do not give a rebate to vacant land; all land, whether residential or commercial, is charged at the commercial rate. In a system based on site-only taxation, a property pays no additional tax if the property is built upon. This effectively means that vacant land is highly taxed in relation to overall property value. By shifting to a system based on full market value, the effective taxation on vacant land falls. This can be countered by levying a higher rate on vacant land than on other categories of property. Cities argue that it is important to disincentivise the holding of vacant land, particularly if service infrastructure has been installed.

The treatment of public service infrastructure is also a contentious issue. This has been identified as a separate class of property in the MPRA with the objective of taxing it less onerously than other property. However, the definition of public service infrastructure is problematic in that it includes a number of property types that were previously never taxed, such as roads. In order to guard against large amounts of tax being levied on roads, the ratio of public service infrastructure taxation to other taxes has been kept very low. This has the effect, however, of drastically reducing the tax previously levied on other properties which should be taxed more highly, such as harbours, airports and power stations.

Finally, the introduction of new methods of valuing and taxing property will always be challenging. As with any new legislation of this nature, there are likely to be unforeseen legal issues which obscure implementation. One change being introduced is that sectional title properties are now taxed individually rather than as a block. This greatly increases the number of individual tax-payers and may have very significant impact in some municipalities when combined with the shift to full market value taxation.

In Cape Town, the City has discovered that the MPRA, read together with the MSA (which requires a 'cost-reflective tariff'), probably makes it impossible to continue charging for sewerage as before, where part of the sewerage costs were covered on the basis of property value. This is the type of unexpected result that often arises with the introduction of new and complex legislation.

5.3 The abolition of RSC/JSB levies and options for replacement

Until their abolition as from 1 July 2006, the second key source of general tax revenue in the local sphere, alongside property tax, were the RSC/JSB levies.

RSC levies were a form of local business tax, consisting of a small levy on turnover (the 'Establishment levy') and on the payroll (the 'Services levy'). They were introduced in 1985[3] in the context of racially based separation of black and white areas into different local authorities. As has been explained in Chapter 2, they were introduced mainly as a mechanism to distribute fiscal resources from wealthier areas (largely the former white local authorities) to those within the same local region where there were infrastructure backlogs (largely the former black local authority areas). An important characteristic of the levies were the low rates at which they were levied. With the reconfiguration of the system after apartheid, the six Metropolitan Municipalities and 47 District Councils (referred to as Category C councils) collected the levies. They were thus not payable to the three aspirant metropolitan councils or any of the other Category B municipalities, which were meant to benefit indirectly through the districts.

Figures for 2005/06 indicate that the six metropolitan authorities accounted for just more than two thirds of all levies collected in that year, while the 47 districts accounted for the remaining third.

Table 36 Distribution of RSC levy income 2005/6

Category of municipality	Budgeted RSC levy income for 2005/06 (R m)	% share by category of municipality of total RSC levy income
Metropolitan	4 472	68.2
Local (Category B)	0	0.0
District (Category C)	2 088	31.8
Total	**6 560**	**100.0**

Source: National Treasury (2006)

3 Joint Service Board levies are the equivalent in KwaZulu-Natal and were introduced in 1990.

The initial intention of the levies was to fund capital expenditure aimed at addressing infrastructure backlogs. Yet, the main pressure has been on operating revenues; capital finance has been relatively easily accessed. The result was a shift in the use of the levies, particularly in the metropolitan areas, to the point where it was viewed as a source of general tax income. Outside the metropolitan areas it was the only general tax income for District Councils. To the extent that these councils' operating expenditure was not covered by grants, the levies were used. For the local municipalities, including the three non-metropolitan councils of the Cities Network, revenue from RSC and JSB levies was largely restricted to capital grants.

For the metropolitan councils the levies have been an important and very buoyant source of tax income over recent years. Table 37 shows the levy income by metropolitan council as a proportion of property rates levied in 2005/06 – the last year in which RSC levies were collected.

The reasons given for the abolition of the levies include:

a) Administrative problems. A key administrative shortcoming was that municipalities had no right of access to company accounts, and so could not verify the amounts declared by tax payers. There were also other concerns, particularly in smaller councils, where outsourcing of collection led to numerous poor practices.

b) Economic distortions. It was argued that the cascading nature of the turnover element of the tax was distorting and that it penalised investment and growth, while the payroll portion of the levy was a penalty on employment. The turnover element of the levy was viewed as leading to heavier incidence on high turnover, low margin activities, which were often labour-intensive.

c) Constitutionality. Some commentators questioned the constitutionality of the levies, although legal opinions indicated that these doubts were invalid.

Chart 9 Aggregate city revenues 2005/6 (R57.4b)

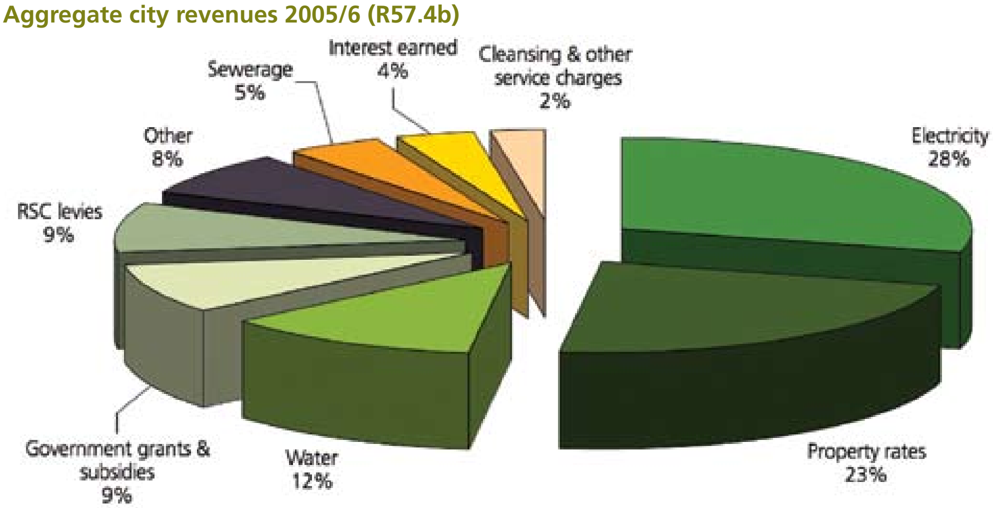


Table 37 Annual RSC levies collected by city, 2003 to 2006

	2003	2004	2005	2006	RSC levies average annual increase %	% of 2006 property tax revenues
Johannesburg	1 260 982	1 321 700	1 550 966	1 905 493	17.0	65
Cape Town		780 028	893 838	1 027 420	15.9	46
Ekurhuleni	541 400	551 588	608 663	691 290	9.2	39
Tshwane	447 323	494 170	628 266	644 611	14.7	40
eThekwini		435 833	500 851	570 029	13.8	19
Nelson Mandela Bay	174 223	194 007	229 258	268 728	18.1	54

d) Apportionment problems. Companies tended to pay their levies to the municipality in which their head office was located, thus favouring such municipalities unfairly.

While decisions are being made about a permanent replacement revenue source for the RSC levies, a temporary grant has been instituted. The amounts received in replacement grants for 2006/7 were in all instances less than RSC levy yields in 2005/6.

The 'zero-rating' of property tax for VAT purposes was introduced at the same time as the abolition of the levies. Previously property tax had not been subject to VAT. This meant that the VAT paid by municipalities on inputs to services provided by the municipalities, but financed by property tax could not be reclaimed. The change to 'zero-rating' of property tax meant that this tax could now be reclaimed by municipalities, but ratepayers still did not have to pay VAT on property tax. National Treasury sought to compensate for the loss of the levies through the introduction of this mechanism.

However, generally, the replacement grant has not fully compensated for the loss of RSC levies, particularly if the buoyancy of the levies in recent years is factored in. This illustrates the dangers encountered by local municipalities when they are dependent upon grants rather than their own tax revenues.

In the case of Buffalo City, Msunduzi and Mangaung, RSC levies were collected by their Districts rather than by themselves. It is not easy to establish how much of these revenues were indeed paid over to the three non-metropolitan cities since this is generally not recorded by the Districts, and certainly not according to the year in which they were generated. However, anecdotal evidence is that the amounts were very small, with most of the revenue being used to either fund the Districts themselves or being directed to smaller, poorer local councils. All the amounts received by the three non-metropolitan network cities would have been for capital expenditure. Given that most of the levy revenue in these districts is generated from within their core city, these three non-metropolitan Councils are bearing a redistributive burden which does not apply to the largest six metropolitan Councils.

5.4 Revenue administration, collection rates and arrears

Given that a very large proportion of the revenue of the SACN cities is generated locally, the effective administration and enforcement of revenue collection is critical to financial sustainability. However, municipal revenue collection has presented a serious challenge in the SACN cities, and indeed across the country, for at least the past two decades.

Chapter 2 has explained how the improvement of services in the former black local authority areas led to service charge increases and how communities refused to pay for these services partly because of an inability to afford them, and partly as an expression of resistance to apartheid local government. A further contributing factor to non-payment for services, and one which received little attention at the time, was administrative failure.

During the apartheid period revenue collection in most of the former white local authorities was generally well-executed and payment levels high. Enforcement was relatively stringent, while citizens usually had the capacity to pay. But with the changes introduced to combine black and white areas, the problems of revenue administration in the former black local authorities were inherited by the new combined local authorities.

To this were added two further challenges. Firstly, the relatively successful practices that had been developed over many decades in the wealthier white local authority areas were not necessarily appropriate in the new environment. Secondly, the massive institutional changes arising from the redrawing of boundaries often demanded extensive reconfiguration of revenue systems. This was sometimes poorly understood and poorly executed, resulting in a variety of problems, such as the corruption of data or the introduction of incomplete or poorly designed revenue systems.

In most, if not all, SACN cities the result was a decrease in payment levels across the whole city. Intensive work over recent years has begun to improve the situation, but there remains much to be done. The proposed creation of Regional Electricity Distributors (REDs) that will excise electricity from the municipal account poses a grave challenge to revenue administration.

This section seeks to provide some understanding of the nature of the challenges in revenue and arrears management, examines the collection records of the nine cities in this regard, and discusses some of the key strategic issues to be addressed. Many of the difficult revenue issues relate to the way in which collection from poorer households is managed. Key to this is the structuring of municipal taxes and tariffs to make the municipal account affordable to all.

The effective administration of income is extremely demanding, often requiring tight administration of complex logistics in a difficult and politically charged environment. Large numbers of households and businesses need to be billed each month (especially in the larger cities) and money must be collected from them.

The effective administration of income involves a number of steps:

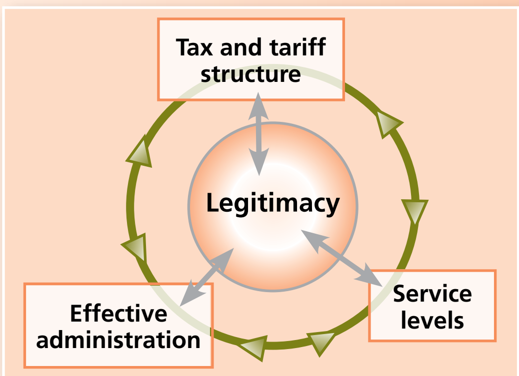
- Meters must be read accurately and regularly each month.
- Households and the person responsible for payment must be properly identified.
- Accurate property value assessments must be performed for rating purposes.

BOX 8 A comprehensive approach to a city revenue strategy*

Revenue strategy is often regarded as the administration of revenue collection. But it has been argued that building an effective revenue strategy requires a broader approach. This includes four key inter-related components, which must all be well-designed and well-managed.

These four key components are a) the package of services provided; b) the tax, tariff and grant structure; c) administration and enforcement; and d) legitimacy:

Chart 10 The `Revenue Wheel'



Readiness to pay is clearly dependent upon the provision of services. Citizens will demand that there be a reasonable relationship between what they pay and the quality of services provided. On the other hand, in some instances, households will not be able to pay for even a basic package of services; demanding that they do will inevitably lead to payment default. To the extent that costs are not covered by grants from national government, a degree of cross subsidisation from other households is necessary.

In order to ensure that total municipal expenditure is covered by total revenue, municipalities can adjust either the package of services provided or the tax and tariff structure, or both. By structuring taxes and tariffs to take into account ability to pay, with poorer households paying less and wealthier consumers cross-subsidising others, it should be possible to provide acceptable levels of services to everyone at rates which all households find reasonable. On the other hand, it may be necessary to reduce service standards to poorer households if a reasonable balance is to be achieved.

Even if an acceptable balance is found between the level of services provided and amount of taxes and tariffs levied across all households, payment will not be forthcoming if revenue administration is inadequate. It is important that the design of taxes and tariffs – including any grant system – is simple and practical to implement. The same applies to any sanctions in cases of non-compliance.

Lastly, even if all the above three components are successfully managed, it is vital that a critical mass of citizens view the approaches being taken, in respect of all the above three components, as legitimate. Following from this, there must be a widespread readiness to comply.

** This box is based on strategies developed by Philip van Ryneveld for various projects.*

- Where indigent grants are given, mechanisms are required to target these; unless well-designed, these grants may cause huge administrative burdens.
- Accounts must be generated timeously and accurately and be printed; they must be delivered to areas where the performance of postal services is often erratic; and they must often be explained to those people who cannot understand them, or who cannot read.
- Accessible locations must be provided where consumers can pay and revenue is collected safely.
- A sound receipting system must be in place to prevent fraud and ensure clarity in the case of disputes.
- Where pre-payment systems are in place, the infrastructure and administration of these systems must be managed, including the management of pre-payment vendors.
- And finally, those not paying timeously must be followed up and appropriate sanctions applied.

A failure in any one of these tasks is likely to have considerable knock-on effects, resulting in other failures and widespread non-payment. Acceptable margins of error are small.

The closest comparison to municipal billing systems in terms of scale and breadth of client base is probably the telephone revenue collection systems. However these are far simpler to manage. Telephone accounts are issued for a single service, are electronically generated and require no meter-reading, while disconnection is easily implemented in cases of non-payment.

A successful revenue function is dependent upon more than just effective revenue administration. An outline of the different elements required for a successful revenue function is provided in the accompanying Box 8.

South African cities arguably have historically not managed to achieve the necessary balances among the services provided; the tax, tariff and grant structure; administration and enforcement; and overall legitimacy. This is reflected above all in the debtors books of the city governments.

All of the cities have shown an improvement in collection rates over the last several years. To illustrate, the following charts show the pattern of crude monthly collection rates (i.e. this month's gross collections divided by last month's billings) for Ekhuruleni and Johannesburg since 2001. It will firstly be observed that the monthly crude collection rate oscillates sharply from one month to the next, depending on seasonal factors, the number of public holidays in a given month, and other technical matters. It will also be seen that there has been a steady upward trend over the long term. This is best illustrated by the 12-month moving average[4] line in Charts 11 and 12.

Unless collection levels are at or above 100%, the total arrears outstanding increases each year (unless some arrears are written off). In recent years cities have begun to provide much more adequately for non-payment of revenue, and in some cases have embarked upon quite substantial write-offs.

Table 38 shows gross debtors outstanding for each city at end 2006 (the figures include current debtors, which are not in arrears). It also shows the provision for bad debt, from which it is possible to generate a figure for net debtors outstanding. This is compared with total income to give a figure for debtors days based on the net debtors figure. A figure of 45 debtors days (i.e. about 6 weeks, since the first 30 days is not yet overdue) is considered an appropriate target for debtors days based on net debtors. Only Msunduzi and Ekurhuleni were close to this target as at the end of June 2006.

4 The 12-month moving average is the average over 12 months. It `moves' forward each month by adding a new first month and dropping the 12th month.

Chart 11 Crude monthly collection rates 2001 – 2006: Ekurhuleni

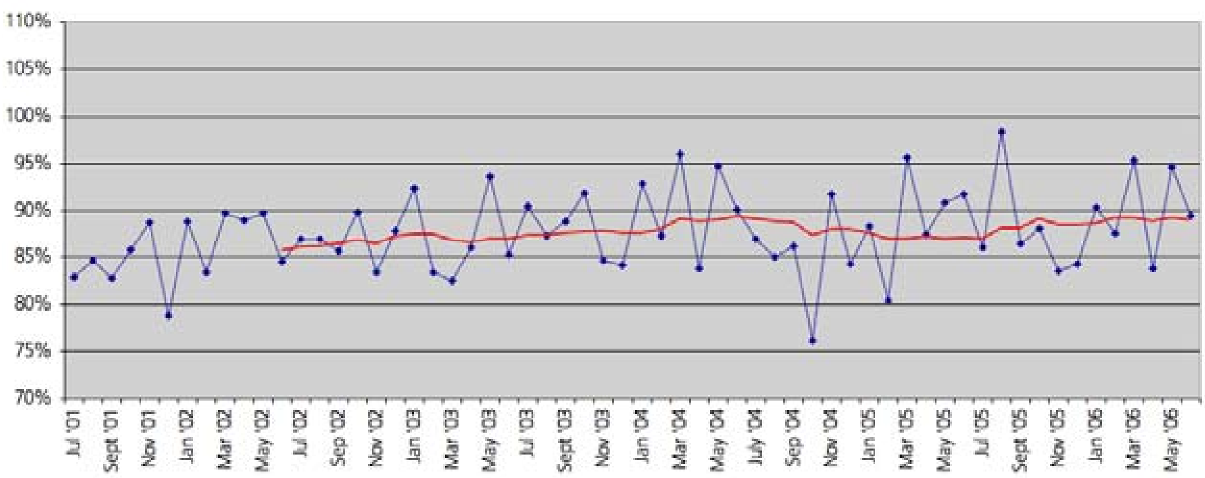
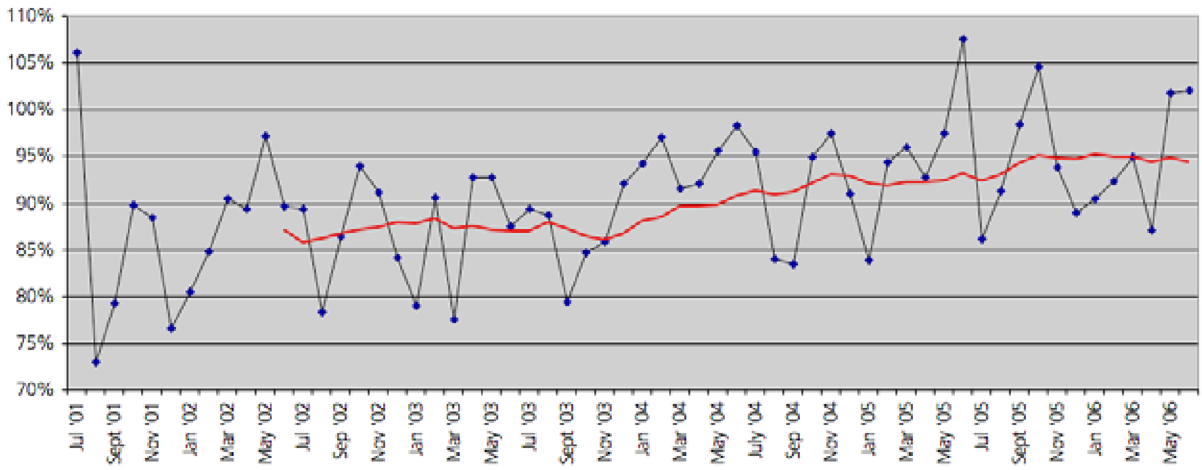


Chart 12 Crude monthly collection rates 2001 – 2006: Johannesburg



As is re-iterated below, it is important that bad debt is written off in a manner which encourages future good payment habits. This often results in fewer write-offs than might otherwise be the case, and the retention of large gross arrears figures together with a large provision for non-payment.

5.5 Tax and tariff structures and the design of indigent support

Box 8 outlines how critical it is that tax and tariff structures are appropriately designed in conjunction with the configuration of services and service standards to ensure that households receive appropriate services at affordable prices. An important part of this entails devising ways to support poor households as part of a wider approach to tax and tariff design.

Tax and tariff structures

In principle, there are two broad approaches to the design of tax and tariff structures in the context of significant poverty and income inequality. In both approaches total revenue must be sufficient to cover total expenditure, and there must be some mechanism to ensure that poorer households face lower charges to enable them to afford at least basic needs. The difference lies in how the differentiation across different income groups is constructed.

One approach is to levy taxes and tariffs that reflect the cost of delivery of services to each household, and then provide grants to poor households based on an assessment of household income in order to make the municipal account affordable. The other approach is to design taxes and tariffs to be 'progressive', meaning that poorer households are charged less for a given amount of

Table 38 Net Debtors, Annual Revenue and Debtors Days

Gross debtors (including current debtors not yet in arrears)		Provision for bad debt	Net debtors	Service revenue (i.e. excl. RSC levies)	Net debtors as proportion of revenue (%)	Net debtors days
Msunduzi	356 326	–184 258	172 068	1 243 647	14	51
Ekurhuleni	4 499 796	–3 622 626	877 170	6 152 135	14	52
Johannesburg	8 677 808	–6 738 901	1 938 907	9 585 085	20	74
Cape Town	3 932 631	–2 571 695	1 360 936	6 524 826	21	76
eThekwini	3 002 168	–1 372 154	1 630 014	7 581 992	21	78
Buffalo City	394 724	–147 717	247 007	1 027 771	24	88
Nelson Mandela Bay	1 157 671	–621 274	536 397	2 028 419	26	97
Mangaung	585 285	–298 312	286 973	972 666	30	108
Tshwane	2 959 669	–830 673	2 128 996	5 498 618	39	141
TOTAL	**25 566 078**	**–16 387 610**	**9 178 468**	**40 615 159**	**23**	**82**

Source: SACN Almanac (2006)

services provided[5]. Ideally, the latter approach obviates the need for the provision of grants to poor households. In reality, there tends to be a convergence between the two approaches, and, as will be seen below, all municipalities currently use a combination of both.

Property tax is a good example of a progressive tax structure, particularly as it is applied in the nine cities. The property tax payable by a household increases as property value increases. By exempting the first tranche of value (e.g. the first R50 000 of property value) from taxation, the tax becomes more progressive; as property value rises, the tax payable rises at a faster rate.

While taxes are traditionally more progressive in design, fees for services – here referred to as tariffs - tend to reflect the cost of service provision to each household. This is in line with the general notion that taxes are used to fund 'public', or community goods, while fees or tariffs are levied on 'private' or individually consumed goods.

Tariffs can, however, be designed to be progressive. The stepped water tariff is a good example of this. The first tranche of water is provided free of charge. Then, as water consumption by a household increases, the cost levied per kilolitre increases. Assuming that wealthier households consume more water than poor households – which is generally the case – wealthier households are charged more per kilolitre than poor households. The stepped water tariff creates an incentive to consume less water and is thus also environmentally constructive.

All of the nine municipalities have tariff structures for electricity whereby the first tranche – usually 50 kwh – is provided free. This is also an example of a progressive tariff structure, although less so than the stepped water tariff, which has several steps with increasing tariffs.

Refuse and sewerage services are charged differently amongst the nine municipalities. In some municipalities there is a flat charge per household. This is then softened by some form of rebate or grant to ensure that the charge is not too high for poor households. In others the cost of the service is included in property tax, which is itself progressive, thus obviating the need for rebates or grants.

Sewerage is often charged by piggy-backing on water consumption. The assumption is made that the amount of sewerage discharged is in proportion to the amount of water consumed. In the context of a progressive, stepped water tariff the tariff structure for sewerage is then also progressive.

In general, it is simpler and more progressive to cover refuse and sewerage charges through property tax revenue. There is also a good theoretical argument for this, in that both these services, while provided to individual households, have a strong 'public good' element[6]. The tradition of viewing refuse and sewerage as 'trading' services rather than 'public goods' developed in some former white local authorities and became more entrenched as a result of provisions in the Municipal Systems Act (Act 32 of 2000).

Currently only eThekwini includes refuse and sewerage charges in its property tax. Previously, Cape Town covered half of its sewerage costs through property-value related charges and half on the basis of water consumption. This changed with effect from 1 July 2007, and sewerage charges are now based entirely on water consumption.

'Indigent' grants and rebates

All municipalities offer a range of grants or rebates. The key challenge lies in targeting these accurately. In many cases these are provided supposedly on the basis of measuring household income. There is strong political benefit in being seen to provide additional rebates to poor households. However the administration required to accurately assess household incomes and to maintain this accurately as household circumstances change, is immense. In most municipalities which attempt to do so there appears to be evidence of inaccurate and incomplete 'indigent records', leading to a loss of coherence and legitimacy.

Increasingly, municipalities are attempting to introduce automatic targeting of grants, or some form of self-selection. Often grants are provided automatically to all households valued at less than a certain amount, or, in some cases, to households in a particular area. The principle behind a 'self-selection' approach is that grants are given to households automatically on the basis of certain consumption or other behaviour patterns.

While there are significant differences across the country, there is a general trend towards charging poorer households with lower levels of consumption less for municipal services overall. However, flat charges for water consumption are being phased out, and households where consumption has been high will face higher municipal accounts.

5 Technically, a tax structure is deemed to be 'progressive' where richer households pay not only more, but also a higher proportion of their income in taxes than poor households, as is the case with South Africa's income tax system. Here the term is used more loosely to simply mean that higher income households pay more for a given level of services consumed.

6 Were an individual household to decide not to use refuse or sewerage services the impact would be felt not just by that household, but by the wider community. This differs, for example, from decisions on electricity use.

In response to the challenge of urban poverty and the emerging national framework, all South African cities have implemented policies in respect of free basic services. These policies have taken various forms, although all are clearly attempts at providing a (more or less) comprehensive set of basic municipal services for poor households.

In eThekwini, for example, the following package of subsidised or free basic services is provided to indigent households:

a) The water tariff is structured so that the first 6 kl provided to a domestic connection every month is free.

b) The first 50 kwh of electricity is free to residents who use less than 130 kwh of electricity per month.

c) Properties valued below R30 000 are exempt from property tax, and a sliding scale applies for those between R30 000 and R100 000, after which only the normal residential rebate applies.

The **City of Cape Town** has established a budget provision, termed the Indigent Fund. This fund is financed from national government transfers and local property taxes, which is used to subsidise basic services. Their tariff policy makes provision for the free basic services, as follows:

a) 100% subsidy applies for up to 6 kl of water per household per month, and any consumption above this amount is charged at normal tariffs.

b) 50 kwh free basic allocation of electricity is provided to consumers who purchase a maximum of 400 kwh per month, averaged over the previous financial year (i.e. the total supplied does not exceed 450 kwh/month) (City of Cape Town 2007a).

c) No property tax is payable on the first R88 000 of residential property values: this is stated as being 'an important part of the Council's Indigent policy and is aimed primarily at alleviating poverty in households owning low cost property ...' (City of Cape Town 2007b).

d) In parallel with the arrangements for water, sanitation charges are not applied to the first 4.2 kl discharged into the system, as the conventional sanitation charge is based on 70% of water consumed.

e) Refuse removal for residential properties valued up to R100 000 is free, those valued between R100 000 and R150 000 receive a refuse rebate equivalent to 75% of the normal refuse charge; those valued between R150 000 and R250 000 receive a 50% refuse rebate and those valued between R250 000 and R300 000 receive a 25% refuse rebate

f) The 'rudimentary service' and 'basic bagged service' for refuse in informal settlements is provided without charge.

g) All residential properties valued at under R200 000 receive a grant of R30.00 per month towards water and sanitation charges. For properties valued at R88 000 or below this allows the consumption of a further 4 kl water at no cost to the resident.

The **City of Johannesburg** provides a social package consisting of the following elements:

a) Free basic water of 6 kl is provided to all households in the city. This is applied simply by means of a block tariff system in which the price is zero for up to 6 kl per month. The cost of this first 6 kl for every household is therefore carried by higher volume consumers further up the block tariff structure.

   The city is considering changing this arrangement to a system in terms of which 10 kl/month is supplied for free, but only to families registered as indigent.

b) Free basic electricity is provided to all households who elect to be on the lifeline tariff. Households on a conventional tariff structure pay a monthly access fee and a consumption charge: households on the lifeline tariff pay no access fee and receive 50 kwh for free, after which a (higher) consumption charge applies. Households consuming more than approximately 1 100 kwh/month would benefit by paying the conventional tariff.

c) No property tax is payable on properties whose site value is less than R20 000.

d) In addition, a Special Cases Policy applies, in terms of which indigent households (defined as those earning a monthly income of 'two state pensions + R1' or less, or meeting other special criteria such as being HIV positive) may register to receive free refuse and sanitations services. For a limited period the registration drive was supported by permitting registered indigents to write off accumulated service debts.

Cities have attempted to target their indigent programmes in different ways, usually by using a 'higher consumption' as a proxy for 'higher income'. However, some cities use a combination of an indigent register and targeting through consumption.

The indigent policies of cities have a number of common characteristics. These include:

- They are delivered to households.

They are financed through the income side, so that household can generally access the services only if they have a customer account.
- Non-target households can sometimes also access them.

On the face of it, the cities provide a comprehensive package of services for indigent households. It would appear that they fulfil their requirements in terms of national and provincial policy. However, in common with other cities, the cities face a number of specific challenges, such as:

- Free basic services as described in the official policies of the cities are generally delivered to 'households'; that is, a consuming unit, or account number as seen by the city administration. In poorer areas, consuming units are generally larger than in high income areas.
- One of the fundamental issues relating to the provision of free basic services is that this is done through the revenue side of the books. Households can therefore receive free basic services only if they are registered on the billing system of the city. With some exceptions, (for example, when a city delivers water to an informal settlement via tanker, or collects refuse from the settlement) the services are delivered directly and no charge is levied. However, a household may be resident in the city and entitled to the free services, and yet not receive those services because the household is 'invisible' to the city as it is not registered on the billing system.

As a result of these challenges considerable energy is being devoted to reviewing and reassessing city indigent policies.

5.6 Conclusion

Cities manage large and complex revenue streams, based partly on their authority to tax, and partly on services provided. The long-term challenge is to maximise collection rates, and cities have generally made progress on this matter. This chapter concludes by outlining some of the more important mechanisms and instruments used by cities to enhance revenue collection:

- **Establish effective billing systems and well-organised and well-resourced revenue departments.** Municipal revenue systems cannot function effectively without effective billing systems. However, billing technology alone does not, in itself, provide a solution. The entire revenue value chain must be well-designed and well-organised. There must be consistency between the billing technology, the business processes and the revenue organisation. It is of paramount importance that the system as a whole generates and maintains accurate data. Once billing data becomes inaccurate the legitimacy and effectiveness of the system deteriorates drastically. The nine cities are increasingly conscious of the necessity to devote considerable resources and attention to the billing function, although it could be argued that some municipalities continue to lag in this regard.
- **Use of pre-payment mechanisms.** Modern pre-payment systems, which were pioneered in South Africa for the electricity distribution sector, have now become widely used across the globe for mobile phones. They offer an extremely effective mechanism for enhanced revenue collection. Generally the use of pre-payment meters in the municipal sector has been restricted to the electricity service, although in some instances they have been used for the collection of water revenue. Opponents to pre-payment systems for water argue that this implies that water supply is cut off in cases where people are unable to pay, and that this approach should not be allowed. However, this potential dilemma can be managed. Firstly, by providing sufficient amounts of free water each month, and secondly, by ensuring that even when the system does allow for water cut-offs, a low pressure flow is still permitted.
- **Convenient mechanisms to restrict consumption.** Households often do not have convenient mechanisms to restrict consumption, resulting in the generation of accounts by month-end that are unaffordable to consumers. In the electricity sector the pre-payment meter system has proven effective in enabling households to exercise close control over consumption. In the water sector pre-payment systems offer similar scope. Some municipalities place restrictors in the water supply systems of those in arrears. Approximately 6 kl per month is delivered free of charge, which meets the minimum demand of ensuring a free basic service. However, the low pressure is inconvenient for households. Devices have also been developed which allow a certain amount of water to flow each day at full pressure and then restrict further consumption. In some municipalities a yard tank is provided and filled each day so that households can limit and manage consumption.
- **Use of electricity cut-offs to enforce payment for all services.** For many years South African municipalities have issued combined accounts for all municipal services. Any payments received are set off against the various services, with payments allocated finally to electricity. This means that, should there be a shortfall on any of the accounts paid, it will be recorded as non-payment of electricity. Disconnection of electricity is much easier to implement technically, socially and politically than eviction and re-possession of property for non-payment of property tax, or disconnection of water for non-payment of water accounts. Some municipalities have used the electricity pre-payment system very effectively in their

management of payment for other services. The pre-payment meter is linked to other service accounts. Where payment for other services is in arrears, the purchase of pre-payment electricity can be restricted to minimum levels until the matter is resolved. Payment for other services can also be surcharged onto electricity. As electricity is purchased the additional amounts are collected and allocated to other services, or to arrears.

- **Ensure quick responses in cases of non-payment.** Where households fall into arrears, or otherwise fail to comply with their obligations, early responses are required from municipalities. A delay of more than 60 days in following up tends to aggravate the problem. This means that a practical, feasible and well-designed system of sanctions and rewards is required. If the only sanctions that the officials have at their disposal are relatively drastic, such as eviction or the complete cutting off of water supply, they cannot legitimately be implemented at the initial stage of default. The result is that the arrears position tends to worsen, until only drastic solutions remain an option. As indicated, the electricity pre-payment system can be used as a mechanism to ensure quick follow up in cases of non-payment by limiting the purchase of electricity until arrears issues have been resolved.
- **Manage customers in an integrated way.** Service departments negotiating different and sometimes contradictory arrangements with a household around payment for services is time consuming and leads to confusion and inefficiency. Many municipalities have found that an important principle of customer or citizen management is that there should be a single, integrated approach from the various departments within the municipality.
- **Encourage good payment habits.** Municipalities now appreciate the importance of creating good payment habits to ensure payments and manage arrears. When action is threatened against households heavily in arrears there is a tendency for them to make a once-off special effort, possibly even by borrowing money. The single payment eases the pressure from the municipality, but there is often no follow-through until the next threat of action. A well-founded system cannot be based on management of payment by crisis. The regular payment of smaller, more affordable amounts is preferable in order to develop good payment habits. Write-offs of arrears can also undermine good payment habits if not well handled. Many poorer households have religiously met their payment obligations over the years, while others have ignored them and run up arrears. To write off the arrears of the latter undermines the legitimacy of the system and the conscientious behaviour of those that have been paying. Some municipalities have instituted systems where arrears are written off over time based only on sustained and up to date payment of current municipal accounts.
- **Ensure clear accountability for revenue functions.** In many municipalities all responsibility for revenue collection lies with the Revenue Service within the finance function. Arrears which have accumulated have been regarded as a responsibility of the municipality as a whole and only impacted on individual services' budgets in indirect and obscure ways. In terms of newly introduced accounting approaches non-payment for services increasingly impacts directly on the budgets of the services, which have to set aside provisions to compensate for non-payment. This results in other services demanding stronger accountability from the Revenue Service. It is critical that the structures of accountability be designed to enhance overall responsibility and an appropriate sharing between Revenue and other services.
- **Ensure accurate information on property ownership.** Successful revenue collection is dependent upon having an accurate understanding of who is responsible for payment. Often changes in property ownership are not efficiently recorded, resulting in incorrect accounts. Sometimes the process of transferring new low cost houses from the state to individual recipients is severely delayed, resulting in an accumulation of delayed accounts. Amongst large sections of the poorer population the formal mechanisms for registering ownership do not function optimally. Because of high costs, or for other reasons, effective changes in ownership are not registered in the Deeds Office. A number of municipalities are devoting considerable attention to these issues. Some of these matters should be addressed by municipalities as well as the National Department of Land Affairs, which is responsible for deeds registration processes.
- **Ensure efficient meter reading.** Irregular or inaccurate meter reading is one of the major causes of deterioration in the relationship between the citizen and the municipality. It often impacts on indigent households. Where meter readings are not physically performed, they are estimated. When the readings are carried out the estimations have to be reversed and adjustments made. This often results in significant and unaffordable payments being demanded from consumers. Poor meter reading reduces the legitimacy of the municipal account. New technologies are being investigated to make meter reading easier and more accurate, such as remote meter reading.

If cities are able to continue to develop their experience and expertise along the lines suggested by their own experience and capabilities, they will be able to further improve their collection rates and reduce their debtors books, thereby generating additional resources for the provision of services.

CHAPTER SIX
FINANCIAL ADMINISTRATION IN THE CITIES

6.1 Introduction

Most of the report so far has focused on patterns of resource generation and allocation. Yet, the cities have also undergone profound changes in financial administration in the course of restructuring, and still face considerable challenges in this regard.

The magnitude of the restructuring processes and the intense demands it placed on the cities are seldom adequately appreciated. Administrative reorganisation of the national and provincial spheres only occurred once, while, as indicated in Chapter 2, restructuring within the local sphere happened twice. In 1995[1] a two-tier system was created in metropolitan areas, which was replaced in late 2000 by amalgamation into a single-tier metropolitan government. Not only did this involve the major challenge of combining the former black and white local authorities, but it was accompanied by a very substantial reconfiguration of the administrations of the former white local authorities themselves. The initial step in 1995 saw the unbundling of the former core administrations of the major established cities into separate local and metropolitan transitional administrations. Some of the smaller municipalities within the new metropolitan areas were amalgamated with the unbundled components of the cities to form the core of other transitional local councils. With the creation of single-tier metropolitan councils in 2000, all transitional local administrations were re-amalgamated.

The three non-metropolitan network cities did not undergo the extensive two-tier reorganisation experienced by some of the metropolitan cities. A simpler amalgamation process was undertaken with some of the surrounding councils. Nelson Mandela Bay metropolitan council also did not have to endure this extensive process since it was not initially declared a metropolitan area. Nevertheless, after the initial amalgamation of black and white local authorities in 1995, the re-organisation of 2000 saw a major extension of boundaries leading to the amalgamation of a number of other authorities into the core administrations in these non-metropolitan cities.

Tshwane was created by the amalgamation of Pretoria, Centurion and Akasia North, which had themselves combined with former black local authorities and smaller councils to form the nucleus of the interim administrative substructures. In 2000, these were amalgamated into one city.

The division of the core Durban administration was prevented by an agreement that this administration would service the Durban North Central and South Central Transitional local councils as well as the Durban Transitional Metropolitan Council after the 1996 boundary reconfiguration. It was thus ideally placed to form the core of the new single-tier eThekwini Metropolitan Municipality when this was created in 2000. The more limited administrative reorganisation in eThekwini, when compared with most other major cities, has been to its advantage.

Major two-stage reorganisations occurred in Johannesburg and Cape Town. Johannesburg had to deal with added complexity because the amalgamation of previous administrations to form the single metropolitan council was accompanied by a re-decentralisation along functional lines, which entailed the establishment of single-function separate service utilities (see Box 11).

Despite the destabilisation wrought by the two-step change, most of the nine cities retained a clearly identifiable dominant administration around which most reorganisation took place. The exception has been Ekurhuleni, which consisted of approximately 11 medium-sized municipalities, making the creation of a single metropolitan municipality with a single, integrated administration particularly challenging.

These administrative changes took place primarily as a result of the legislated reform programme (propelled by the need for racial transformation and the general modernisation of public administration and systems), starting with the Local Government Transition Act (209 of 1993) but more notably the Municipal Demarcation Act (27 of 1998), the Municipal Structures Act (117 of 1998), the Municipal Systems Act (32 of 2000), and the Municipal Finance Management Act (56 of 2003).

6.2 Modernising organisational and financial administration

The Constitution devolves significant power to the local sphere, but also provides for national legislation to create standard administrative processes in order to underpin a coherent governance framework. The introduction of the Municipal Systems Act (MSA) and the Municipal Finance Management Act (MFMA) necessitated a dramatic organisational and financial modernisation in the local government sphere.

The MSA is intended to:
- encourage community participation
- institute a system of integrated development planning that is supported by a system of performance management
- define the role of the Accounting Officer or Municipal Manager and establish formalised systems of

1 1996 in Western Cape and KwaZulu-Natal

delegation between the council or political executive and the administration
- establish processes for formulating tariff and credit control policies
- set out the process to assess and change the way that municipal services are rendered
- enforce the codes of conduct for both councillors and officials.

Whilst focused on internal administrative matters, the MSA does have implications for financial administration and is complemented by the MFMA. For example, the MSA requires municipalities to have formal policies on tariffs, credit control, and indigency.

Furthermore, the MSA and the MFMA together require that municipalities develop integrated development plans which are supported by medium term budgets, broken down into monthly and quarterly tasks in the form of a Service Delivery and Budget Implementation Plan, and finally linked to a system of rewards and penalties in the form of a performance management system.

The Municipal Finance Management Act

The Local Government: Municipal Finance Management Act (Act 56 of 2003), which came into effect from 1 July 2004, is the key legislative mechanism governing financial administration, but also impacts significantly on wider governance issues.

Broadly, the Act requires a more strategic approach to financial management based on clear accountability, transparent processes and provision for public consultation and monitoring.

The intentions of the MFMA are, inter alia, to:

- clarify accountability between political and administrative heads
- bring a more strategic approach to financial administration
- introduce budget monitoring and political oversight
- address financial emergencies
- harmonise and modernise financial administrative systems and accounting
- tighten controls.

Of particular importance is the attempt to clarify and separate the roles and responsibilities of the mayor, executive and non-executive councillors and officials. The mayor (or executive committee) is empowered to 'provide political leadership by being responsible for policy and outcomes' while the municipal manager and other senior managers are held 'responsible for implementation and outputs'. Non-executive councillors are to 'play a key policy-approval and monitoring role through the municipal council'. The Act seeks to 'enable managers to manage, but make them more accountable, by introducing regular and consistent reporting requirements'.

Thus, some of the key provisions of the Act, within the context of co-operative governance, include:

- the delineation of the role of mayors to provide political governance and oversight over fiscal and financial matters, and the confirmation of the municipal manager as the accounting officer responsible for financial management
- the definition of common accounting and reporting standards
- defined responsibilities of the chief financial officer
- annual reports, including consolidated annual financial statements, and audit reports for the municipality and municipal entities within timeframes prescribed by the Minister of Finance
- requirements to address issues raised by the Auditor-General
- approval of annual budgets before the commencement of financial years, with capital budgets covering a period of up to three years, within the framework of IDPs
- the avoidance of the financing of recurrent expenditure through borrowing, except for short 'bridging' periods
- processes for addressing financial emergency and bankruptcy in municipalities through 'financial recovery' plans
- reporting requirements, including monthly and mid-year reports to council by the accounting officer
- the establishment of a budget and treasury office by every municipality
- the establishment of a primary bank account for each municipality
- supply-chain management specifications
- specifications for the establishment of municipal entities

Some of the provisions have been particularly innovative. For example, the setting out of clear procedures in cases of financial emergencies is highly unusual internationally. However, it is an important measure underpinning the credibility of the approach of avoiding loan guarantees by national government. This approach is intended to place accountability for decisions taken by municipalities firmly with the municipality. Such measures create a clearer context for lending by the private financial institutions to municipalities and ensure that the financial institutions monitor municipal finances more closely, rather than relying ultimately on the absorption of risk by national government.

In implementing the MFMA, the National Treasury has adopted a phased approach. Different elements of the Act are to be implemented according to different time frames based on defining municipalities as 'high', 'medium' or 'low' capacity. A number of circulars have been issued by National Treasury to support the practical understanding and implementation of the MFMA. These give an indication of the range of issues addressed by the Act (see Box 9).

The MFMA has had significant ramifications for SACN cities. Implementation has required the development of a complex skills-set and in some cases has been extremely demanding. The lack of familiarity with the new procedures has sometimes led to slow decision making and other institutional challenges. It would appear that these problems are diminishing gradually, although the full implications are still unfolding.

Budget reform

Budgeting has undergone important reforms arising from the MFMA. Previously budgeting was focused on control through the setting of expenditure limits on a wide range of detailed items. However a sense of strategic intent behind the allocation of scarce resources was largely absent.

The new approach to budgeting introduced by the MFMA seeks – through a variety of mechanisms - to enhance its strategic content while still offering a basis for financial control.

The new elements in the budgeting process include:

- drawing up integrated development plans to provide a strategic framework for budgeting
- linking expenditure to outcomes and goals
- reducing unnecessary line item detail and achieving standardisation
- placing greater emphasis on consultation with the public and other spheres of government, including through public meetings and the incorporation of sub-council and ward committee views
- passing a draft budget four months before the new financial year to facilitate comprehensive consultation by political office bearers as well as the public prior to finalisation

Box 9 Circulars issued in terms of the MFMA

- *Circular 1* — *Introduction to the MFMA*
- *Circular 2* — *Supply Chain Management*
- *Circular 3* — *Supporting Materials*
- *Circular 4* — *Specimen Annual Financial Statements*
- *Circular 5* — *Implementation Checklist*
- *Circular 6* — *Workshops Supply Chain Management*
- *Circular 7* — *Implementation Plan*
- *Circular 8* — *Forbidden Loans*
- *Circular 9* — *Training*
- *Circular 10* — *Budget Process 2005/2006*
- *Circular 11* — *Annual Report Guidelines*
- *Circular 12* — *Definition of "Vote"*
- *Circular 13* — *Service Delivery & Budget Implementation Plan*
- *Circular 14* — *2005 Division of Revenue Bill and Municipal Budgets*
- *Circular 15* — *Budget Submission 2005/2006*
- *Circular 16* — *Supply Chain Management Training*
- *Circular 17* — *Qualifications and Training*
- *Circular 18* — *Implementation of New Accounting Standards and Format of Annual Financial Statements*
- *Circular 19* — *Budget Process 2006/2007*
- *Circular 20* — *Delegations*
- *Circular 21* — *Dispute between organs of State Section 44*
- *Circular 22* — *Model Policy Supply Chain Management*
- *Circular 23* — *Bulk Resources for Municipal Services*
- *Circular 24* — *Training*
- *Circular 25* — *Supply Chain Management Guide and Bid Documents*
- *Circular 26* — *Long Term Borrowing*
- *Circular 27* — *Medium Term Budget Policy Statement 2005*
- *Circular 28* — *Budget Content and Format 2006/07*
- *Circular 29* — *Supply Chain Management Issues*
- *Circular 30* — *2006 Division of Revenue Bill*
- *Circular 31* — *Budget Tabling and Adoption*
- *Circular 32* — *The Oversight Report*
- *Circular 33* — *Supply Chain Management Issues*
- *Circular 34* — *Supply Chain Management Issues*
- *Circular 35* — *Interactive Multimedia Learning*
- *Circular 36* — *Annual Financial Statements for 2005/06*
- *Circular 37* — *Municipal Public Private Partnerships*
- *Circular 38* — *Implementation Priorities*
- *Circular 39* — *MFMA Learning - DVD Launched*
- *Circular 40* — *Supply Chain Management Implementation Checklist*
- *Circular 41* — *MTREF Budget Circular 2007/08*
- *Circular 42* — *Funding a Municipal Budget*
- *Circular 43* — *Restriction of suppliers and BBBEE Objectives*
- *Circular 44* — *Preparation of Annual Financial Statements*

- tabling formal adjustments budgets
- estimating revenue realistically based on what is likely to be actually collected rather than on merely what is billed

Collectively, these changes represent substantial improvements to the usefulness of the budgeting process in allocating resources strategically while retaining financial controls.

Cities had already started to develop budget processes which involved community participation as a result of the passing of the MSA. The MSA and MFMA have also led cities to introduce performance management systems. With the MFMA in place, cities have refined their planning and budgeting processes further. The MFMA stipulates the need for Service Delivery and Budget Implementation Plans (SDBIPs), which are a management, implementation and monitoring tool, promoting the concept of ward-based information and planning through end-of-year service delivery targets stipulated in the budget and IDP. SDBIPs are intended to provide a practical link between the strategic direction set by council and the services provided to the community, as articulated in the budget.

The scope of this report does not extend to an assessment of the effectiveness of planning and budgeting processes. While the cities have the formal administrative mechanisms and documents in place (i.e. the IDP, the SDBIP, City Manager Scorecards, `popular versions' of the budget, budget consultation meetings, etc.), there is room for further development, for example, of the techniques of public participation.

Procurement reform

The key changes in procurement reform introduced by the MFMA include:

- development of key procurement policies are in terms of the regulations issued in terms of the MFMA
- exclusion of all political representatives from the procurement process
- establishment of tender committees (bid specification, bid evaluation and bid adjudication committees)
- a stipulation that specifies formal competitive bidding for the procurement of all goods and services above R200 000,00

The procurement reforms in particular have received significant attention (negative and positive) both at political and administrative level, because of the fundamental changes to former procurement policies.

Initially, there were significant delays in procurement processes but these appear to have been increasingly overcome, with more emphasis now being placed on proper and timely planning where large procurements are required.

6.3 Municipal entities

A very important section of the MFMA deals with the governance and reporting of 'municipal entities'. Previously municipalities were free to create independent entities such as section 21 companies, trusts, etc. While the independence was in some instances beneficial, it held the risk of important transactions being undertaken outside of the regulations and reporting requirements that governed municipalities. In many cases these activities led to significant liabilities, which ultimately became the sole responsibility of the municipalities.

Box 10 Perceptions of the MFMA

City finance officials interviewed in the course of producing this report were generally strongly supportive of the MFMA, especially once the necessary changes to policies and procedures had been made subsequent to the introduction of the Act, and after the inevitable teething problems and learning processes had been worked through.

The supply chain management processes in particular have received the support of finance officials. The requirement to implement asset management policies and procedures to support the introduction of the new accounting standards was highlighted as an area that had significant financial implications for the larger cities in particular.

Generally, interviewees were of the opinion that the MFMA has led to tighter controls and improved financial administration processes.

On the negative side, the provisions for onerous personal sanctions in cases of misconduct or even error have curtailed creativity within the administration. In some city administrations there is great reluctance to take decisions which might contain any element of risk, and a desire to obtain legal opinion on a range of matters which previously were considered routine. This tends to slow decision making, inhibits innovation, and greatly reduces levels of work satisfaction amongst key officials.

The legislation on municipal entities seeks, in essence, to ensure that the same financial regulatory framework that governs municipalities also applies to municipal entities, and that all assets or liabilities are reflected in the financial statements of the municipality. Key decisions cannot be taken by municipal entities without the governing municipality being fully aware of, and agreeing to, such decisions. In addition, councillors may not be members of the boards of municipal entities.

The general intention of the legislation is clearly both important and laudable. The key drawbacks, however, are that the freedom that was sought in establishing external bodies is now quite significantly curtailed. In general, reservations expressed about this legislation are no more valid than those expressed towards other regulations, such as those governing supply chain management.

Perhaps the biggest constraints lie in the establishment of partnerships with other organisations or municipalities. The rigorous requirements to ensure that councillors take responsibility for all financial decisions affecting the municipality mean that multi-jurisdictional municipal entities should get support from all participating municipalities on a wide range of decisions. This can be a serious impediment to quick and flexible decision making.

6.4 Financial IT systems

Institutional reorganisation has placed substantial pressure on information technology and related systems. This has led to significant information technology projects, particularly in instances where expenditure and revenue systems had to be so significantly altered to accommodate boundary changes that it became more logical to modernise systems simultaneously, rather than attempt to reconfigure existing systems.

The implementation of new IT systems in large diverse organisations is an extremely challenging exercise and the nine SACN cities all find themselves in varying stages

Box 11 Johannesburg's iGoli Model

Johannesburg's iGoli model was established in 1999 in the face of a major financial crisis, and before most of the new legislation governing municipal administration became law. The model sought to create service utilities which were owned and fell under the ultimate control of the municipality but would be more independent of the core administration and council. The objective was to enable each service, such as water, power and refuse removal, to focus on its core business. They would thus be less bound by the general administrative procedures and constraints of the main municipality. Council was to direct the activities of the utilities through service delivery agreements rather than through direct control.

The utilities were established as companies under the Companies Act, with boards made up of independent specialists in the respective service delivery areas. Councillors were not appointed as board members. This approach foreshadowed the general approach taken in the MFMA which sought to make councillors responsible for policy and overall strategy, but to distance them from the management of operations.

Johannesburg did achieve a remarkable financial turnaround, and the innovations introduced by the iGoli model clearly helped to create an energy and dynamism that contributed to this success.

Yet, the model created three key sets of tensions. Firstly, councillors were unable to escape public criticism for performance failures. They were also constrained from taking the actions they felt were necessary to correct such failures, since this was the responsibility of the boards. This led to tension between the boards and the executive councillors and a gradual erosion of the board's effective power and responsibility.

Secondly, each independent entity began to introduce its own systems and processes, including those relating to information technology. Regrettably there was insufficient recognition of the relationships between the entities. Processes that ran across the different entities were disrupted, and there was no single authority to coordinate these. This fragmentation was reflected in particular with regard to information technology and management.

Thirdly, there were practical concerns regarding centralised cash management, billing and revenue collection. Significant attention had to be given to the emerging interactions and inter-dependencies between the City and its municipal entities concerning these issues.

Whilst none of the other SACN cities have followed this model, it has been scrutinised by numerous cities and has influenced some of the restructuring changes that have occurred.

of the process. Some of the advances that have been made, however, represent important achievements in the modernisation and enhancement of public sector financial management in the country.

Various approaches have been followed by different municipalities. In some of the nine cities the emphasis has been on integrating the smaller municipalities into the systems of the largest and most dominant municipality, with initially relatively little change to the core systems. In some cases modernisation and the replacement of old systems was undertaken.

Given its relative stability and the fact that it already had a reasonably modern core IT system based on JD Edwards software, eThekwini was able to embark on an incremental modernisation process, combined with an attempt to expand IT capabilities in the metropolitan area. The focus in eThwekwini has been on building its own software based on an analysis of its own business process needs and using open source platforms. This software is being implemented mainly in the revenue function.

The circumstances in Cape Town necessitated a very different approach. The previous IT systems in the old Cape Town City council were very old. Furthermore, the initial reorganisation in 1996 saw the creation of a variety of different IT systems across the transitional councils, none of which were sufficient to provide for the IT needs of the new single metropolitan council created at the end of 2000. Thus the city decided to align the amalgamation process with a major and comprehensive modernisation of its IT systems. This also entailed the implementation of a new SAP 'enterprise resource planning (ERP)' system across most functions (see Box 12).

Tshwane initially amalgamated its systems around the systems of the old Pretoria City Council, but subsequently embarked on a modernisation process by implementing a SAP system largely based on the Cape Town configuration. By building on the work already done in Cape Town costs were reduced significantly. Initially, this implementation suffered from data problems. Tshwane did not establish a permanent in-house support centre, as was done in Cape Town. This did result in savings, but the internal capability to continually enhance the system was sacrificed.

In Johannesburg the introduction of new systems occurred simultaneously with the establishment of the iGoli model. The emphasis was on each utility adopting 'best-of-breed' technology, which often differed across utilities, and transferring information and process management from the previous municipal systems onto each of the various new systems on a function-by-function basis.

In 2005 this approach began to be reconsidered: it was concluded that a single software application should be used to manage billing and customer relations management (CRM) across all the service utilities and the core administration. The application chosen was SAP, primarily because it had already been fully implemented at one of the utilities, and the core administration was already using the SAP HR module. The new billing and CRM modules are being implemented together with a new finance module and an upgrade of the HR module, for the core administration. It would appear that, to address issues of fragmentation, Johannesburg is moving incrementally towards a comprehensive ERP system serving all of its municipal-owned entities as well as its core administration.

The Johannesburg SAP implementation is being configured based on full analysis of Johannesburg's own processes and needs. While this is more costly than the

BOX 12 The implementation of Cape Town's ERP system

In 2001 Cape Town took a decision to implement a new SAP Enterprise Resource Planning (ERP) system. The strategy was formulated prior to 2000 elections when different metropolitan local councils were run by different political parties. This facilitated the implementation of the project through multiple political and administrative changes in the ensuing three years.

ERP systems seek to integrate all processes and information onto a single platform. While in some cases the functionality of individual components of the system may not match best-of-breed alternatives, the crucial advantage of well-designed and well-implemented ERP systems lies in their integrating capabilities. This permits strategic management and the integration of processes which are not available in more fragmented systems. It means that data is collected once and used throughout the system, ensuring greater accuracy and removing the possibility of contradictory or inconsistent data. A full ERP system seeks to incorporate the real activities of all functions and is not limited to the financial functions in the manner of traditional municipal financial systems.

All IT systems depend upon sound integration of the technology with business processes and organisational structure. The flows of information must be aligned with the processes through which activities occur. The organisation must be designed so that the distribution of decision making and responsibilities is consistent

Cape Town runs its ERP management and support capabilities from a single large hall, enabling ready interaction between 'process owners' across all municipal functions. Given the cross-cutting nature of city activities, this is important for the ongoing management of change and the introduction of enhancements to operations

with these flows and processes. Without this the most sophisticated IT systems are likely to be dysfunctional. But getting this right is a massive challenge in a large municipality with many thousands of employees and a huge variety of cross-cutting processes and information.

In order to achieve this alignment the introduction of such systems generally requires major changes to business processes and organization. In Cape Town the ERP was implemented concurrently with the creation of the new single-tier metropolitan authority out of the seven municipalities that existed prior to the 2000 elections. Indeed, the ERP implementation served as the key enabler of this at the administrative level. Against a background of a diversity of systems and processes in the amalgamating authorities the standard processes embedded in the SAP system were able to be used to guide decisions around adoption of new municipal processes. Not only did this make it easier to reach agreement, but ensured that a large proportion of the adopted processes was consistent with the standard versions of the SAP system. This has advantages for system functionality and ongoing system maintenance and improvements.

An additional dimension was the ability to introduce the new GAMAP accounting standards simultaneously. GAMAP is better aligned than the old fund accounting approach with the international accounting standards around which the embedded SAP processes have been designed.

The SAP implementation in Cape Town was one of the largest ever done in local government anywhere in the world. The new system replaced 112 legacy systems and 72 interfaces. Approximately 300 end-to-end business processes were designed, documented and implemented. These related to a very wide range of functional areas, including all aspects of finance as well as functions such as Plant Maintenance, Materials Management, Real Estate Management, Customer Interaction Centre, Human Resources, and many of the utility-related functions. The system currently processes approximately 1.7 milion transactions per day, with about 3 000 users logged on at any one time.

The successful implementation of a modern, highly advanced and integrated SAP ERP system for the single-tier metropolitan government of Cape Town, based on modern internationally recognised accounting standards represents an important achievement which is relatively uncommon internationally. In 2004 the Cape Town ERP project was awarded the prestigious international annual Smithsonian Institute/Computerworld Honours Prize for the most significant IT project in government and non-profit organisations in the world.

Table 39 Summary of financially related IT developments in city administrations	
Johannesburg	Currently undertaking major SAP implementation across key functions
Cape Town	Completed comprehensive implementation of SAP in 2003
Tshwane	Completed comprehensive implementation of SAP in 2005
eThekwini	Developing open source tailor made systems through the Smart Exchange; mainly focussed on revenue systems so far.
Ekurhuleni	Venus was used as the preferred financial system after 2000
Nelson Mandela Bay	Generic system, developed in-house – implemented many years ago. Currently assessing modernisation options
Msunduzi	Completed implementation of Promis in 2004 for all financial systems
Buffalo City	Venus was introduced in the former East London municipality in 2000, and extended to the whole of Buffalo City from 2003.
Mangaung	Replaced old COBOL-based legacy system from 1 July 2005 with Venus system covering all aspects of revenue and expenditure except salary payments for which Payday is used.

Tshwane approach, it ensures the system is better tailored to the administration's needs.

The smaller scale of the three non-metropolitan councils has enabled them to use the IT accounting systems built for the South African municipal sector prior to the major institutional changes. Msunduzi, for example, has successfully implemented a Promis system across the new council, representing a significant modernisation and integration compared to the previous system.

Table 39 summarises IT developments across the nine cities:

6.5 Audit reports

Tables 40 and 41 provide information on the audit reports on the annual financial statements of the cities for the 2005/6 financial year. Table 40 shows the formal opinion and the basis of qualification, while Table 41 summarises the emphasis of matter points raised.

Qualifications mean that the financial information presented in the annual financial statements may be unreliable for one or more reasons that are highlighted in Table 40. An unqualified opinion means that the financial statements are a fair reflection of the financial affairs of the city based on the accounting standards that have been used by the city concerned to prepare its financial statements.

One of the key matters in the 2006 audit reports is the basis of accounting. The Auditor-General has qualified most of the cities for not fully complying with the SA GAAP accounting framework for those transactions and events that are not covered by GAMAP/GRAP. This matter

Table 40 Audit opinions and basis of qualification for 2005/6

City	Audit opinion	Basis of accounting	Asset management	Internal & accounting control	Legislative non-compliance	Revenue, debtors & other
Johannesburg	Qualified	X	X			X
eThekwini	Unqualified					
Cape Town	Unqualified					
Ekurhuleni	Qualified		X			
Tshwane	Qualified	X	X	X		
Nelson Mandela Bay	Qualified - adverse	X	X	X		
Buffalo City	Qualified - adverse	X	X	X		X
Msunduzi	Qualified - adverse	X	X	X		
Mangaung	Qualified		X	X		

Table 41 Emphasis of matter for 2005/6					
City	**Basis of accounting**	**Asset management**	**Internal and accounting control**	**Legislative non-compliance**	**Revenue, debtors & other**
Johannesburg	3 matters	1 matter	3 matters	10 matters	1 matter
eThekwini			6 matters	5 matters	
Cape Town			6 matters	4 matters	6 matters
Ekurhuleni			3 matters	3 matters	1 matter
Tshwane			2 matters		4 matters
Nelson Mandela Bay			13 matters		4 matters
Buffalo City	1 matter				1 matter
Msunduzi			5 matters	5 matters	
Mangaung			9 matters	10 matters	3 matters

has resulted in a number of the cities engaging with National Treasury on the basis that the new requirements are unreasonable – particularly where GAMAP/GRAP standards do not yet exist but SA GAAP standards are inappropriate. Consequently, an amended basis of accounting has been recently gazetted by the Minister of Finance for the 2007 and 2008 financial years.

A further key matter is asset management. Preparing fixed asset registers that contain information on the completeness and valuation of property, plant and equipment is the main reason for these qualifications.

The Auditor-General may identify other matters that impact on financial management or legislative compliance and these are stated in the audit report as 'emphasis of matter'. Whilst these do not imply that the financial statements are inaccurate, these matters may impact on accountability and financial management and are highlighted for public interest and oversight purposes. An emphasis of matter does not necessarily detract from the audit opinion that has been issued.

Identifying the emphasis of matters recorded in Table 41 involved an element of subjectivity due to differing audit report structures and the manner in which certain matters are recorded by the Auditor-General.

It is clear that there is still some way to go before many of the cities can be satisfied with their audit reports. Some of this has to do with the legacy of long administrative restructuring and transition: city officials and auditors have both had to go through a substantial learning curve in respect of the new legislation and new accounting standards. Nevertheless, it is clear that, even in respect of audit opinions, cities have been making progress.

6.6 Conclusion

The challenges facing the cities from a financial administrative perspective have been significant and are ever-evolving. Much of the regulations that are required to be developed by National Treasury in terms of the MFMA are not yet in place and the existing systems, processes and procedures need to be further developed.

The considerable pressures that arise from these changes are often underestimated. Compared to the national and provincial spheres of government, cities are in most respects far advanced from a budgeting, reporting, information technology and accounting perspective.

Cities will need to continue to work on their implementation of the new legislation and standards until satisfactory audit reports are achieved.

CHAPTER SEVEN
CITY FINANCES AND INSTITUTIONAL CHANGE

7.1 Introduction

The connection between city finances and how institutions function has been noted repeatedly throughout this document. In particular, it has been argued that cities that are funded by taxes rather than grants will tend to be more responsive to local citizens. These cities will also have an incentive to act in ways which support the growth of their tax base, with favourable implications for economic growth and the creation of jobs.

This chapter focuses on three other important institutional issues which have relevance to city finances. First, there is a discussion on the division of functions between cities and other spheres of government. This is linked to the issue of how funds flow to cities. Next, the chapter examines the potential removal of the electricity function from the cities. Finally, the discussion touches briefly on the new legislation relating to the possible introduction of a single public service.

7.2 The division of functions and the flow of funds

One of the most important cornerstones of democracy is accountability. If there is no clarity about which entity is responsible for a specific function, it becomes problematic to enforce accountability and to correct poor performance when it arises. As it is also then not clear where funding responsibilities lie, it becomes difficult to structure the system of fiscal decentralisation.

Related functions should be combined, if possible, within a single governing institution so that synergies between functions can be utilised and trade-offs made. Where related functions are distributed across different spheres of government, contradictory decisions are often made and opportunities lost.

Improving co-operation between spheres of government is clearly important. However, the starting point needs to be a clear and rational division of responsibilities upon which to base co-operation. As is explained below, recognising city governments as the key locus of responsibility for all functions relating to the built environment has the potential to significantly enhance intergovernmental relations.

The division of functions between different spheres of government is currently leading to significant frustration. On the one hand, cities are subjected to provincial involvement in a number of functions better left to the cities. On the other hand they criticise 'unfunded mandates', in terms of which the cities are forced to fund activities which are the responsibility of other spheres.

Inappropriate provincial involvement

The functions in respect of which cities complain of inappropriate provincial involvement include the key ones of housing and public transport. Cities are responsible for a number of functions that are closely intertwined with the delivery of housing, including infrastructure and land-use planning functions. Thus, for a number of years national government has sought to devolve more of the housing functions to the cities through a process of 'accreditation'. This would make delivery simpler in cities where delivery capacity exists. A key advantage is that the cities would then receive housing subsidies directly from national government instead of via the provinces. However, accreditation decisions are left to the provinces, and so far no city has been accredited.

National government has also sought to devolve public transport responsibilities to the cities. This would be in line with the Constitution, which makes 'municipal public transport' a municipal function. Mechanisms for this devolution include creating a Transport Authority in terms of the National Land Transport Transition Act (22 of 2000) and, more recently, through amendments to the Act which strengthen the commitment to devolution of public transport responsibilities, especially to metropolitan government. However, provinces continue to remain heavily involved in the public transport area.

Housing and transport are both critical delivery areas which are being seriously undermined by conflicts between city and provincial governments.

Shortcomings in grant funding flows from provinces

The lack of clarity around the division of functions is exacerbated by the nature of grant funding flows to the cities from the provinces. There is a marked difference between the management of the flow of funds from national to city government on the one hand, and from provinces to cities on the other. The mechanisms by which funds flow from national government are generally clear and compare favourably with global best practice. All grants for each recipient province and municipality are published in a Government Gazette not only for the current financial year, but also for the next two years. While grants in the subsequent years can change, they

have so far not been reduced – other than when conditions placed on conditional grants have not been met. Sometimes there are difficulties relating to judgements over whether conditions have indeed been met. However, most grants are paid over relatively predictably.

This is not generally the case with grants received from the provinces, which are quite often unclear, unpredictable and capricious. This makes it extremely difficult to plan properly, or to spend the funds timeously when they are received. The large number of small grants exacerbates the problem and increases administrative burdens (see Box 13 listing the different grants received by Buffalo City municipality).

Unfunded mandates

'Unfunded mandates' occur where cities perform the functions of other spheres of government and bear significant costs out of their own revenue sources. The most significant of these functions is in the health sector. Most city governments have a fairly long history of running primary health services. This however used to be funded to a very substantial degree by national government via the provinces. Since the early 1990s the amount received in subsidies by the cities has fallen well behind the costs incurred. However, it has not been feasible in the face of rising primary health challenges to scale back services to match the shortfall, with the result that the cities have increasingly had to fund these services from their own rates and other general income.

Part of the dispute arose from contestation around the definition of 'municipal health', which in terms of the Constitution, is a municipal function. Approximately five years ago a ruling was made by national government

BOX 13 Grants received by Buffalo City

The following list of grants is provided in the Buffalo City financial statements. The statements indicated that the unspent balance on these grants as at 1 July 2005 was R133.3 million, and the new receipts totalled R211.5 m in 2005/6

NATIONAL GOVERNMENT

- *Transitional Grant*
- *Financial Management Grant*
- *Land Affairs*
- *Restructuring Grant*
- *IMEP*
- *CMIP*
- *MSIG*
- *KWT: Grants Government*
- *Project Consolidated-Billing System-MSIG*
- *Equitable Share Grant*
- *Energy Efficient Technology*
- *DWAF-funded Projects - Sewerage*
- *DWAF-funded Projects - Water*

PROVINCIAL GOVERNMENT

- *Gompo Survey*
- *Upgrade Watersupply*
- *Mdantsane Upgrade - Water & Sewerage*
- *Local Government Housing*
- *Compost Waste Management*
- *Disaster Relief Fund*
- *Local Economic Development Fund*
- *Map Preparation & Planning*
- *Gompo & Mdantsane Art Centres*
- *Environmental Project John Dube*
- *Pilot Housing Project*
- *Reeston Development - Land Affairs*
- *Leiden Trust Account - Redevelop Duncan Village*
- *Mdantsane Urban Renewal Project (Mnt Ruth Node)*
- *Ikhwezi Block 1 Development*
- *Mdantsane Upgrade - MD/PD:Area Planning*
- *Mdantsane Upgrade - PD: Survey*
- *Mdantsane Upgrade - MD Assessment Study*
- *Mdantsane Upgrade - Art Centre*
- *Planning and Map Preparation*
- *Upgrade Kwaklifu Settlement - Phakamisa*
- *Needscamp Planning*
- *Potsdam Village - Plan Survey & Upgrade*
- *Ilitha Informal Settlement Upgrade*
- *Kwa Tshatshu Settlement Upgrade - Zwelitsha*
- *Mdantsane Human Settlement Program*
- *Planning Kanana Settlement*
- *DWAF Funded Projects - Water*
- *Mahlangu Village : Planning and Survey*
- *Mdantsane Infill Areas: Planning and Survey*
- *Phakamisa Clifton PH2:Bongweni:Plan and Survey*
- *Health Management System*
- *Aids Training and Info Centre-ATIC*
- *Yellowwoods-Kei road-survey*
- *Yellowwoods-Kei road planning*
- *Dept of Sports Recreation, Arts & Culture*

Source: Buffalo City Municipality (2007): Annexure G that 'municipal health' referred to 'environmental health' – thus placing the obligation for providing primary health services on provincial government and clarifying that the range of health services to be provided out of local funds was relatively limited. However, the gap between services provided and funds received by local government remains substantial.

Another significant area is in respect of libraries. While provinces were often responsible for library services in many of the smaller municipalities, most cities ran their own municipal libraries with limited financial support from provinces. However, the Constitution classified 'libraries other than national libraries' as an exclusive provincial function. While the cities have continued for more than a decade with the funding of libraries, the tighter fiscal environment has led them increasingly to complain that they are being forced to provide for a service which is not their 'mandate'.

Figures on unfunded mandates are subject to contestation, since the delineation of mandates is generally not exact. The figures in Table 42, compiled by IMFO and through interaction with some cities, should be regarded as estimates intended to give a rough idea of the scale of the problem.

These are significant costs – if properly addressed they would make a considerable difference to the financial position of cities.

Constitutional approach to the division of functions and finances

In any system of government there will be complexity around division of responsibilities between levels or spheres of government. The South African Constitution deals with the division of functions in four broad ways. Firstly, in Schedules 4 and 5 it gives a list of functions for which provincial governments have exclusive legislative responsibility, or hold that responsibility concurrently with national government. Each of these schedules is divided into two parts – Part A and Part B, with local government having 'executive responsibility and the right to administer' those functions listed in Part B of Schedule 4 and Part B of Schedule 5.

Secondly, there is a general 'subsidiarity' clause in section 156 (4). This states that, in addition to local government having responsibilities for functions listed in Part B of each schedule:

156(4)The national government and provincial governments must assign to a municipality, by agreement and subject to any conditions, the administration of a matter listed in Part A of Schedule 4 or Part A of Schedule 5 which necessarily relates to local government, if

a) that matter would most effectively be administered locally; and

b) the municipality has the capacity to administer it.

Thirdly, the Constitution requires that different spheres of government are assigned revenue concomitant with their responsibilities. And fourthly, the different spheres of government are required to work 'co-operatively' with one another.

Conceptually the framework is sound. However, difficulties arise in contestation around interpretations and definitions, particularly where the Constitution requires changes from how responsibilities are currently divided between provinces and cities. Many of these divisions were established during the apartheid period when local government was very fragmented.

Emerging thinking on division of functions

A vigorous debate on the future of provinces is currently underway, and this also impacts on local government. One proposal gaining significant ground is that, as a starting point, cities should be clearly recognised as the key locus of responsibility for all functions related to the built environment. This includes all services related to the management of urban space and movement across urban space, and encompasses responsibility for housing, public transport and land use planning, together with the

Table 42 Estimated annual cost of unfunded mandates for selected cities

	Housing & hostels	Health	Museums	Libraries	Total
eThekwini	R152m	R244m	R29m	R121m	R547m
Johannesburg		R135m			R135m
Ekurhuleni	R113m	R215m		R63m	R391m
Cape Town		R170m	R9m	R145m	R324m
Nelson Mandela Bay		R3m			R3m

Source: IMFO

accompanying infrastructure and services.

It is important that these services be integrated so that synergies can be realised and trade-offs made. For example, housing needs to be planned in conjunction with public transport. Where new housing is located on low-priced land far from the urban centre, it impacts on the cost of transport. By combining planning for both services in a single entity overall benefits can be maximised and costs minimised.

Built environment functions have always lain at the heart of city governments. They are clearly the key authority responsible for land use planning issues, while property tax – which is essentially a land and built environment tax – is and always has been a local government tax according to the Constitution.

Such an approach is consistent with the constitutional provision noted above. Indeed, it could be argued that, given local government's current responsibilities, all built-environment related functions are 'necessarily related' to local government and thus must be devolved where cities have the capacity to perform the function.

This approach allows for provinces to be the key locus of responsibility in decentralised government for social services – in particular health, education and social welfare. This does not prevent provinces from devolving certain of these functions to cities by agreement, or cities from performing some of these functions for provinces on an agency basis.

It is most likely that an asymmetrical approach would be most appropriate, in terms of which the division of functions differs between key urban centres and rural areas and small towns. This position is also in line with constitutional provisions.

City governments and functional regions

City governments have been demarcated with wide boundaries. However, there are functional regions, such as the city region in the Gauteng area, which extend across metropolitan and city boundaries. These regions need special attention. But while provinces have a role to play in helping to co-ordinate the provision of some functions across such regions, given the relatively small number of municipalities involved, the built environment functions are likely to be much more effectively managed through co-operation across the municipalities rather than by shifting powers to provincial level. Shifting key built environment functions to the provincial level will break the crucial link between macro- and micro-management of the built environment.

7.3 The restructuring of the electricity distribution industry

Electricity was introduced into South Africa by municipal government in the late 19th century. In many ways it has been the backbone of service delivery in South African cities ever since. After initially using it to power street-lighting, Kimberley was the first municipality to establish its own reticulation service in 1890, followed by Johannesburg in 1891, Pretoria in 1892, Cape Town in 1895, Durban in 1897, East London in 1899 and Bloemfontein in 1900.

Table 43 Share of electricity in city budgets

City	Total operating budget 2004/5 (R'000's)	Electricity operating budget 2004/5 (R'000's)	Electricity operating budget as % of overall operating budget
Buffalo City	1 334 882	386,154	28.9
Cape Town	11 325 505	2 302 728	20.3
Ekurhuleni	7 279 307	2 762 922	38.0
eThekwini	8 556 855	2 921 000	34.1
Johannesburg	11 935 796	3 217 221	27.0
Mangaung	1 414 272	436 722	30.9
Msunduzi	1 191 682	444 472	37.3
Nelson Mandela Bay	3 133 567	1 018 500	32.5
Tshwane	6 757 428	2 343 000	34.7

Source: National Treasury (2006:34)

Most residents view electricity supply as a responsibility of city government, holding the city accountable for supply interruptions, even where these are caused by failures in generation and transmission, which is the responsibility of Eskom. This state of affairs is reflected in the Constitution, which makes 'electricity reticulation' a local responsibility.

Currently around one third of all city municipal operations consist of electricity services, as illustrated in Table 43. In some cities, the percentage is as high as 38%.

But the significance of electricity to cities extends beyond this. Crucially, electricity has been pivotal to the management of revenues and credit control: electricity service terminations are the most effective means the cities have to enforce payment for all services. Furthermore, cities have traditionally generated significant financial surpluses from their electricity undertakings, which have been used to cross-subsidise other services. This is illustrated in Table 43[1]. Finally, the large share of electricity in the cities and the size of the surpluses generated means that a very substantial proportion of daily cashflow of the cities derives from electricity.

However, it should be noted that not all electricity distribution services within city boundaries are provided by the city electricity undertakings, as Eskom provides these services to some parts of some of the cities. Since the Constitution and the MSA provide that municipalities are the service authorities for electricity distribution in their areas, Eskom's services within city boundaries should be governed by service level agreements between the cities (as authorities) and Eskom (as service provider)[2]. Such arrangements have not been put in place in any city. Electricity distribution should play an even more important role within the cities than it does at present.

It should also be noted that the cashflow implications of electricity distribution are not automatically positive, as this depends on the effective collection rate for electricity.

Since the late 1980s there have been ongoing attempts by key stakeholders in the electricity sector to remove electricity from the control of municipal sector and create independent Regional Electricity Distributors (REDs). This is currently being actively pursued despite significant opposition expressed by officials from all nine cities of the network.

There are of course shortcomings in the electricity distribution sector, including in the cities, as has been the case across many municipal and non-municipal services in recent years. For example, the surplus made on electricity that is used to cross-subsidise other services amounts to an invisible tax on electricity consumers, to the benefit of users of other services. Good public finance and accountability call for greater transparency in such arrangements.

Of more importance, is the fact that some cities have not always had a good track record in maintaining their electricity distribution infrastructure. Sometimes cities have effectively treated their electricity departments as revenue sources, without ensuring long-term sustainability. In some cases, electricity distribution to established areas has suffered as the focus has shifted to addressing electricity backlogs and the other service needs of poor households.

1 The surpluses shown probably underestimate the value extracted from city electricity departments. For example, electricity departments may carry more than a proportionate share of charges for internal shared services such as human resources services, billing and collection services, and others.

2 Section 81 of the MSA specifically provides for a service level agreement to be put in place. However, the impetus to establish such agreements has been weakened by the impending transition to the Regional Electricity Distributors (REDs).

Table 44 City electricity surpluses (R'000)

City	2006				2005			
	Revenue	Expenditure	Surplus	%	Revenue	Expenditure	Surplus	%
Johannesburg	3 825 943	3 505 153	320 790	8.4	3 577 663	3 225 243	352 420	9.9
Tshwane	2 575 965	2 460 133	115 832	4.5	2 496 487	2 263 821	232 666	9.3
Cape Town	2 909 316	2 790 159	119 157	4.1	2 770 686	2 669 387	101 299	3.7
eThekwini	3 179 745	2 754 655	425 090	13.4	3 057 391	2 703 437	353 954	11.6
Nelson Mandela Bay	1 132 729	991 871	140 858	12.4	1 052 537	917 228	135 309	12.9
Ekurhuleni	2 895 496	2 487 470	408 026	14.1	2 871 726	2 576 802	294 924	10.3
Buffalo City	Not disclosed							
Msunduzi	612 210	469 751	142 459	23.3	480 286	469 816	10 470	2.2
Mangaung	Not disclosed				489 228	384 540	104 688	21.4
Total	**17 131 404**	**15 459 192**	**1 672 212**	**9.8**	**16 796 004**	**15 210 274**	**1,585,730**	**9.4**

Source: SACN Almanac (2006)

BOX 14 Summary of NERSA assessments of city electricity undertakings

In late 2005 and early 2006 a study was conducted by international experts under the auspices of the National Energy Regulator of South Africa (NERSA) into the performance of some of the country's largest electricity distributors. It included seven of the nine network cities.

The following tables summarise the findings on electricity network management as well as the overall management of the distributor.

Network management

Distributor	Security of supply	Network reliability	SCADA control	Refurbishment planning	Maintenance systems	Outage management	Actual maintenance	Network condition
eThekwini	Good - very good	Good	Very good	Good	Very good	Good - very good	Very good	Very good
Tshwane	Good - very good	Good	Very good	Good	Good	Very good	Needs improvement	Good - very good
Cape Town	Very good	Good	Good - very good	Good	Good - very good	Needs improvement	Needs improvement	Good - very good
Nelson Mandela Bay	Very good	Good - very good	Good - very good	Needs improvement	Needs improvement	Needs improvement	Good - very good	Needs improvement
Mangaung	Good - very good	Needs improvement	Needs improvement	Good - very good	Good	Needs improvement	Needs improvement	Needs improvement
Ekurhuleni	Good	Needs improvement	Needs improvement	Needs improvement	Good	Needs improvement	Needs improvement	Good
Msunduzi	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Needs improvement

Overall management

Distributor	System Data	*NRS 048	Technical skills base	HR	Procurement	Financial information	Funding
eThekwini	Very good	Needs improvement	Good	Needs improvement	Good	Very good	Good
Tshwane	Good	Needs improvement	Good	Needs improvement	Good	Good	Needs improvement
Cape Town	Good	Needs improvement	Good	Needs improvement	Good	Very good	Good
Nelson Mandela Bay	Good – very good	Needs improvement	Good	Needs improvement	Good	Good	Good
Manguang	Good	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Good	Needs improvement
Ekhuruleni	Good	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Good	Needs improvement
Msunduzi	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Needs improvement	Good	Needs improvement

These tables suggest that the bigger cities are generally performing adequately to well, while there is significant need for improvement in the smaller municipalities. Ekurhuleni's performance may well reflect the fact that the city was created in 2001 out of a number of smaller municipalities.

Note the contrast between the overall management findings for the quality of financial information, which ranged between 'good' and 'very good' and those for Human Resources, which 'need improvement' across all cities.

**** NRS (National Rationalisation of Standards) 048 refers to issues of quality of supply***

Part of the under-investment by municipalities in their electricity undertakings undoubtedly also arises from an assumption that they will probably lose electricity distribution to the REDs.

A recent study undertaken under the auspices of the National Energy Regulator of South Africa (NERSA) into a selection of larger distributors indicates both shortcomings and strengths in the electricity undertakings of a number of the nine cities, with quite considerable variation across the different undertakings (see Box 14). The picture that emerges is that, while there is a need for improvement in some cities, many cities are in fact managing their electricity distribution services reasonably well. It is probably fair to say that as cities have become more established, the need for investment in the maintenance of existing infrastructure and new extensions to support growth have increasingly been recognised.

Arguments regarding the creation of REDs

Proposals to restructure the electricity distribution industry into regional electricity distributors have been developed and argued over at least 15 years. The motivations for doing this have evolved somewhat over time. The 1998 White Paper on Energy envisaged a phased transition to competition in electricity supply, and the establishment of the REDs was seen as necessary to realise the benefits of this (Department of Minerals & Energy Affairs 2001).

More recently, the following five points are advanced as deficiencies of the current electricity distribution industry which will be addressed by the establishment of the REDs:

- inefficiency owing to industry's current fragmentation
- inadequate maintenance of networks
- inequitable treatment of consumers across the country
- inconsistent performance on electrification
- slow and inconsistent roll out of free basic electricity (Electricity Distribution Industry Holdings 2007)

There is clearly a need to restructure the electricity distribution industry. Perhaps the most compelling reason to do so is that many smaller distributors are at risk of failure due to their inability to collect sufficient funds to pay their bulk supply accounts (Department of Minerals & Energy Affairs 2001). But from the perspective of city finances, several comments can be made about the objectives as stated:

a) The electricity distribution industry is indeed fragmented, and this is clearly a cause of inefficiency. The arguments for economies of scale are generally strong, especially in the face of current skills shortages. Bigger organisations are usually able to attract better skills while also providing a better environment for skills transfer. Knowledge is more institutionalised rather than dependent upon a few key individuals.

Box 15 Revenue collection and electricity

For many years most South African municipalities have been issuing a combined municipal account. This means that electricity can be cut off unless all services are fully paid for. This is a much more feasible penalty than repossessing furniture or houses for non-payment of rates or disconnecting water.

More recently the pre-payment system for electricity has been used extremely creatively to manage other accounts. Instead of cutting off electricity, the purchase of pre-payment units can be restricted to a basic amount per month if payment for other services is not forthcoming. Other accounts can also be piggy-backed on the electricity pre-payment system. This is a very useful mechanism in the case of households which do not respond to accounts delivered by post, or where postal services are erratic. Much of the success of Buffalo City, for example, in turning around its finances in recent years can be attributed to better revenue collection flowing from the creative manner in which they have begun to use the electricity pre-payment system to facilitate payment across all services.

Some small distributors in South Africa perform quite well, though these are the exceptions. But fragmentation can be addressed without removing electricity distribution from the cities. City electricity departments are already large enough to achieve the benefits of economies of scale. The current RED proposals will introduce fragmentation at city level, so that efficiency gains in electricity distribution will be offset by efficiency losses in the cities, notably in billing and collection, customer relationships, cashflow, and debt-raising and servicing. Policy makers should be aware that by establishing efficiencies for electricity distribution they are introducing inefficiencies for city governments.

b) Some though not all cities have been guilty of not maintaining their networks adequately. However, this can be ascribed largely to the long transition and re-organisation process in city government (see Chapter 2), and also to the uncertainty regarding the future of electricity distribution. Improvements in institutional capacity and stability, the experiences of electricity blackouts in some cities, and the increasing attention of NERSA to these issues, have ensured that city governments increase their attention to maintenance and refurbishment (see Box 14). Again, there is no need to remove electricity from the cities to address these issues.

c) It may be that there is inequitable treatment of customers across the country in terms of tariffs and service standards, but again this is no reason to remove electricity distribution from the cities. The thinking is that the REDs will enable cross-subsidisation into rural areas, where electricity is generally more costly to distribute to more dispersed, poorer consumers. But it is an elementary principle of public finance that redistribution should be funded at national level, rather than regionally (Fiscal & Financial Commission 2002). It is evident, for example, that RED 3, which will depend essentially on cross-subsidisation from Nelson Mandela Bay and Buffalo City into the rural Eastern Cape, will not be viable without complex transfers that will fundamentally undermine the logic of the REDs model. Indeed, this is evident from the modelling done by EDIH (Electricity Distribution Industry Holdings 2007).

d) Inconsistent and slow performance on electrification and the roll-out of free basic electricity should also be addressed without weakening the cities by removing their electricity distribution function.

Under the circumstances it is perhaps understandable that cities perceive an underlying motive for the restructuring, namely for electricity distribution to be removed from the municipal sector altogether. This may be ascribed to a desire to prevent uncontrolled cross-subsidisation of other services from electricity revenues, and also to liberate the sector from municipal systems and processes[3].

The removal of electricity from the municipal sector needs careful thought. In the first place, direct accountability of electricity distribution to the public through electoral means will be removed. Secondly, while it may be that creating single purpose bodies dedicated only to the distribution of electricity will make them more focused and better able to tailor processes to suit their requirements, it is not clear that, as public entities, they will necessarily be more flexible and free of public sector constraints than if they were to remain part of the municipal sector. In many cities the fact that the key power outages have been caused by failures from Eskom, rather than the municipalities, also suggests that a more nuanced view is required. There is also an argument that a close relationship between cities and electricity undertakings will be very important in managing energy in a more environmentally sustainable way.

The restructuring of the sector into six REDs is unlikely to improve accountability, especially to residential consumers and those with less purchasing power. It is interesting that, despite the constraints in the municipal sector, free basic electricity to poor households was implemented in most of the bigger municipalities well before Eskom did so.

3 However, EDIH indicates that this is perception rather than fact (Electricity Distribution Industry Holdings 2007).

The cross-subsidisation of other services out of electricity revenues does need to be handled with more transparency. While, within limits, it is an acceptable practice, a transparent tax on electricity is preferred to the hidden basis upon which cross-subsidisation currently rests. The Constitution provides for such an approach.

Financial threats to the cities

The restructuring of the electricity distribution industry, at least as currently proposed, is a threat to the financial strength and standing of the cities for at least the following reasons:

a) Most importantly, the electricity cut-off (i.e. service termination) is by far the most powerful instrument that cities currently have at their disposal for enforcing payment for all municipal services. It is not often appreciated just how critical this lever is for enforcing the current high collection rates achieved by cities. It is a certainty that collection rates for all services will decline once the lever of the cut-off is removed[4].

b) The loss of the effective electricity surplus, i.e. the subsidy for other services which is imposed on electricity consumers. The proposed surcharge is a poor substitute for this surplus. What used to be a matter of council policy and careful budget balancing, reflecting the buoyancy associated with economic expansion, is now transformed into a matter of historical and audited surpluses. Dividends, too, are an inadequate substitute. Indeed, it is highly probable that there will be no dividends at all for many years. However, there is good reason to replace the surplus with an explicit and transparent tax on electricity consumption

c) The cash implication of the loss of the revenue flow is that cities' cash cushions will be removed, and in future cities are likely to make greater use of overdraft facilities.

d) Several cities may find that their target debt/income and interest/expenditure ratios have been breached once the ring-fenced electricity function joins the RED. This becomes a serious matter if these ratios used to be included in covenants which will now be breached. This will result in a need to unwind some of the debt, or to reduce future capital expenditure, until the city is again within safe financial parameters.

4 The importance of electricity terminations in enforcing payment for all municipal services (as well as several other points made here), was stressed by the FFC five years ago (Fiscal and Financial Commission 2002). However despite this, the six-RED model has no mechanism to address this fundamental point).

Box 16 Johannesburg and the REDs: a case study

All city restructuring processes must decide on the degree of centralisation or decentralisation of authority and the decision-making envisaged, as well as the basis on which accountability for business processes is arranged. The iGoli 2002 restructuring process centralised political authority, provided for centralised planning and budgeting frameworks, and also devolved considerable operational autonomy to single-function business units operating across the city. Such business units (the most relevant being City Power, Johannesburg Water, and Pikitup) were established as companies with City-appointed boards and full corporate governance structures.

Originally it was envisaged that the municipal utilities would, over the medium term, take transfer of full responsibility for the management of their customers. This implied the transfer of responsibility for managing the customer data, including billing data. As customer files were transferred from the centre to the devolved operating units, new lines of fragmentation developed in a billing-and-collection value chain that was still struggling with multiple systems for data relating to planning approval, land transfer, and billing processes.

The customer queries arising from errors generated under these circumstances had continued for some years. But the intensification of credit control measures in the latter half of 2003 triggered a customer service crisis. This peaked in March 2004, when 8% of the City's customers called to complain about their accounts. Thereafter a series of immediate administrative changes saw a reduction in the number of queries logged, and an improvement in the rate of query resolution.

Yet the fragmentation remained. The integrity of the business processes and databases which were used to generate bills to customers were not being adequately maintained. Fragmentation occurred in the business processes that supported billing and collections, and also in the business processes related to the handling of customer queries overall.

Johannesburg consequently initiated an approach which requires much greater coherence in the revenue and customer interface processes of the core administration and municipal entities. In terms of this new approach, all revenue and customer handling functions are to be performed by a centralised department of the City, and utilities and departments will cede these functions to that department.

The benefits will include ensuring the integrity of the relevant business processes, achieving economies of scale in IT and other systems, and developing a `single view of the customer'. Underlying this thinking is a recognition that residents of the City hold the Executive Mayor accountable for service deficiencies, including deficiencies in billing.

Johannesburg is undergoing a long iterative process of finding the correct balance on these issues. Having initially established utilities without a sufficiently tight IT and business-process framework, Johannesburg is now revising its arrangements, leaving the utilities in place, while also establishing a single view of the customer across all its services.

This will work well with a 'six plus one REDs' model where there are metropolitan REDs, but a 'six REDs' model will again fragment the City.

e) All of the above will certainly put the cities' credit ratings under pressure[5]. Each city entity will now be approximately a third smaller than previously, having lost its most buoyant own revenue source, its most effective credit control lever, and its cashflow support. It will also be proportionately more dependent upon grants, and cities which are heavily dependent on centrally determined grants are inherently less creditworthy. Weaker credit ratings mean more expensive borrowing, less capital spending and/or a corresponding greater dependence on capital grants.

f) There is a risk that significant shared costs (billing and revenue, financial systems, HR services and systems, etc) will be left stranded in the cities[6]. The proposed transition framework may cater for electricity's fraction of these costs, and surcharges and dividends should cover the rest. Yet the cities will carry the risks associated with this item.

5 EDIH disputes this, saying that their research indicates that there will be no impact on city credit ratings 'provided the transaction is structured in such a way that it does not impede on the ability of the municipality to collect sufficient cash in order to meet its debt obligations and if there is not a major change to the governance structure of the Municipality' (Electricity Distribution Industry Holdings 2007). Yet on current proposals this is exactly what will happen.

6 'Stranded' in the sense that the cities will continue to incur the costs, but will now no longer be able to charge them to their electricity departments

g) There is also the loss of functionality associated with splitting up the shared services. One of the most significant long-term effects involves the forgone potential to obtain a `single view of the customer' where all customer interactions with the city across multiple services are captured and processed. For example, the person who fails to pay the municipal services bill may also have traffic fines and library books outstanding.

h) Cities will have significantly reduced their flexibility to manage the overall basket of tariffs and charges facing the consumer and ratepayer, and hence keep the overall impact on the household under control.

In addition, certain important features of these envisaged transactions are still completely unknown. The asset transfer framework, for example, is still being developed, and the different options may make a big difference to the end result for cities.

Way forward on electricity restructuring

There is a need to address the problems in the electricity distribution sector. However, it is clear that a fresh approach is required. The current proposal to create six REDs represents a high risk approach entailing massive organisational change, in return for very uncertain national benefits. Eskom distribution will be divided up and existing municipal distributors, including the large metropolitan ones, changed beyond all recognition. This will be a challenging process for the electricity sector, and will also be highly disruptive to the local government sector, weakening it in strategic areas of operation.

An approach which recognises municipalities as partners in bringing about improvements is likely to be more effective than forced re-organisation into 6 REDs. Moreover, unless the Constitution is changed, a voluntary approach is the only permissible approach.

Once this is recognised by all stakeholders it should be easier to develop models for reform that are much more practical; models that improve electricity distribution without weakening municipalities in general, or city finances in particular. Many of the smaller and more troubled municipal distributors might decide to hand over provision in their areas to others who have the financial strength, the systems and the economies of scale to manage the task better. This could well result in one national RED and ten to fifteen municipal REDs. But at least this would emerge as a result of addressing the real problems, and so would be a far more robust approach than placing reliance on a massive and uncertain process of institutional restructuring[7].

7.4 The single public service

The third important area of institutional change that impacts on city finances is the initiative to establish a 'single public service'. This issue has far-reaching potential implications for local government – which are not necessarily positive. Yet little is known about it or understood within local government circles. The tenor of the strategic documentation that has been released, as well as the draft Public Administration Management Bill (2006), suggests a very superficial understanding of local government and what is required to enhance efficiency. Indeed, given that the impact of the new initiative is primarily on local government it is astonishing that this has been so little discussed in local government circles. In interviews conducted for this report there were few, if any, senior officials interviewed who had a thorough understanding of the legislation and the rationale for it, or who had been involved in discussions about it.

Content of the proposed bill

The proposed Public Administration Management Bill will not, in fact, establish `a single public service' in the sense of establishing a single employer. It is explicitly provided that multiple employers remain in place. However, the Bill does propose to establish a `public administration' which embodies all three spheres of government. This is presumably done to avoid having to change the Constitution, in which the 'public service' encompasses only national and provincial government.

A reading of the legislation and the strategy document released by the Department of Public Service and Administration suggests that the two main objectives of the Bill, and even of the single public service as a concept, are:

a) to facilitate transfers of functions between municipalities and the public service; and

b) to facilitate the deployment of individuals to administrative components requiring their skills

7 Prof Anton Eberhard of the Graduate School of Business at the University of Cape Town , a longtime proponent of electricity distribution industry restructuring, recently proposed a model in which the twelve largest municipalities retain their electricity businesses (with support to develop ring-fenced, corporatised, effectively regulated and well-managed utilities), and Eskom transfer its networks, staff and systems serving customers within the twelve municipalities, Eskom retains the balance of its distribution business, smaller municipalities are offered financial incentives to transfer failing electricity businesses to Eskom, and medium-sized municipalities that are providing a reasonable level of service to their electricity customers are left alone (Eberhard 2007). Such a model, if arrived at through a negotiated process, and provided it permits continued use of electricity terminations to enforce payments for all municipal services, could address many of the issues raised above.

Box 17 Are City Managers overpaid?

Media reports often imply that City Managers and senior local government officials are overpaid. None of the documentation released by the Department of Public Service and Administration makes reference to this. However, the debate around the creation of a single public service is also informed by the suggestion that it will enable the remuneration of city officials to be harmonised with that of senior national and provincial officials.

The following table provides information on the total remuneration paid to the City Managers of each city. The total remuneration of the Chief Executive Officers (CEOs) of three parastatals is also provided for the same year, as well as the remuneration scale applicable to Directors-General of national government departments. The figures include salaries, allowances, employer-contributions to pension funds and medical aids, and bonuses, except in the case of Directors-General, where bonuses are not included.

Table 45 City Manager/DG/CEO remuneration 2005/6

Institution	2005/6 total remuneration	Notes and sources
Transnet	R 7 994 000	Annual Report, 2007
Eskom	R 6 165 000	Annual Report, 2006
South African Airways	R 6 850 000	Annual Report, 2006
Eskom	R 6 165 000	Annual Report, 2006
Tshwane	R 1 135 000	Annual Financial statements
eThekwini	R 1 089 000	Annual Financial statements
Johannesburg	R 1 071 000	Annual Financial statements
Mangaung	R 1 040 000	Annual Financial statements
Directors-General	R 922 491 – R 993 492	Bonuses not included.*
Ekurhuleni	R 975 000	Annual Financial statements, 2006
Cape Town	R 935 000	Annual Financial statements, 2006**
Buffalo City	R 894 000	Annual Financial statements
Msunduzi	R 832 000	Annual Financial statements
Nelson Mandela Bay	R 716 000	Annual Financial statements

*Source: DPSA circular 5 of 2006

**Up to February 2006, i.e. for 8 months only.

But the manner in which the initiative seeks to address these objectives refers explicitly to the creation of a single framework for employee remuneration. The Bill includes the following provisions:

- It empowers the Minister responsible for Public Administration to make determinations and issue regulations on any aspect of administration, including the functions of public administration institutions, their organisational structures, conditions of service, human resource systems, labour relations, information management, electronic government, etc.
- The Minister may make determinations on the remuneration of any category of employee in any sphere of government. Due consideration must be given to budget constraints, bargaining chamber agreements may not be abrogated, and in some cases the Minister of Finance must be consulted.
- Deployments (transfers, secondments and assignments) are facilitated. The principle is that deployments should take place with the consent of the employer and the employee, but public interest can override the consent or non-consent of the employee. Terms and conditions of employment remain unchanged in such cases. The original employer remains responsible for the `career events' (i.e. promotions, transfers, etc.) of the employee.
- A senior management service is established, that consists of the heads and other prescribed employees of administrative institutions. In this case the Minister's powers to set terms and conditions do not seem

to include the requirement to consult the Minister of Finance. (Department of Public Service and Administration 2000)

The legislation could be used to facilitate the transfer of functions between spheres of government, to regulate local government IT strategies, spending, and platforms, to regulate local government organisational structures, levels and remuneration; etc.

The Minister's powers will be extensive, and just how they will be used depends on the Minister. For example, the legislation would permit the Minister to regulate all city IT systems, strategies, purchases and contracts.

Key risks

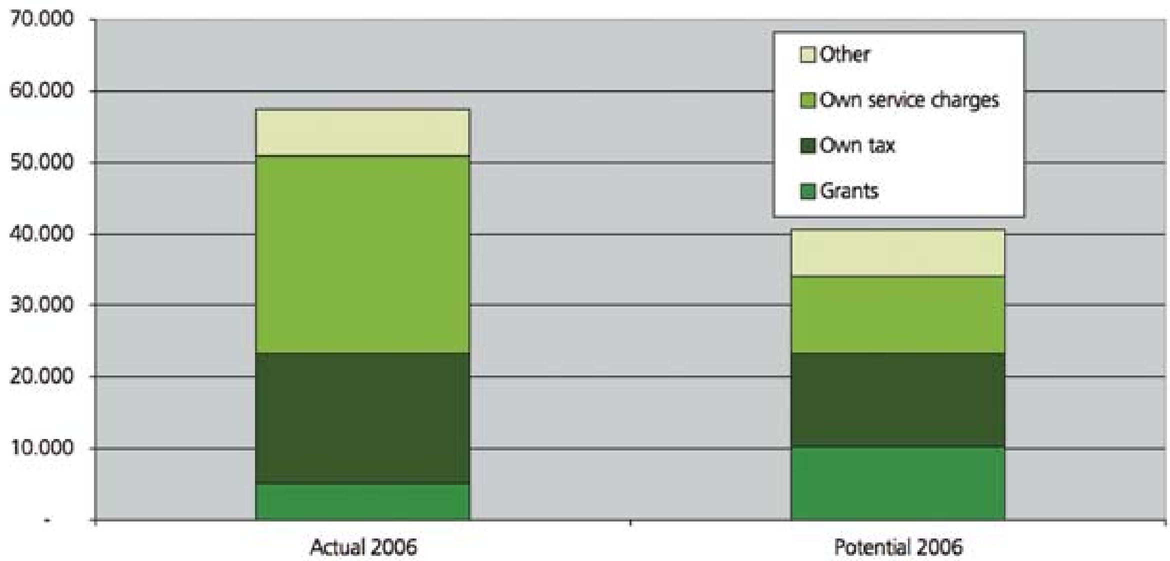
There can be no argument with measures that facilitate the transfers of functions and associated personnel between spheres of government, provided the original decision to transfer the function is sound. Thus, for example, if built environment-related functions such as housing and transport are to be shifted to city level, or social services-related functions such as health moved to provincial level, it would be important to have legislation in place which facilitates such shifts.

However, there are a number of critical risks for cities. These include

- weakening of the skills base as remunerations scales are flattened
- redeployment of whatever skills remain
- lack of individual commitment to a post or a locality
- risk of delayed procedures to approve organisational structures; IT purchases, etc.
- risk of imposition of inappropriate systems, procedures, decisions
- weakening of local accountability and governance in respect of municipal entities

It is of great importance that a thorough debate on the initiative to incorporate local government within a single public administration is held, and that any changes that go ahead are to the advantage of the cities. In particular, it is critical to differentiate between the needs of small towns and rural areas and the challenges of managing massive and complex urban centres.

Chart 13 Actual revenue 2005/6, potential revenue 2005/6



7.5 Conclusion

This chapter has dealt with three issues which are critical to the future of local government. They are of great importance from a financial perspective, but their impact goes well beyond that, in that they relate to the country's very approach to the decentralisation of the state. In all three areas there is an underlying tension evident between an approach which views local democratic accountability as critical to effective government, and an approach which seeks to drive solutions from the centre.

Within these debates crucial decisions are being taken which threaten to weaken city finances, and also to weaken local government in general. This is not necessarily a deliberate intention: on the contrary, it is more likely that the changes are being driven without a full understanding of their implications for cities and city finances.

Chart 13 attempts to illustrate only the revenue aspects of the impact of these changes. The first column shows the actual aggregate revenue data for the nine cities for 2006. The second column indicates approximately what the position would have been had the RSC levies already been replaced by a national grant, and had electricity already been removed from city revenue streams. There are three important implications:

a) The aggregate income of the cities would have been almost 30% lower than the actual total of R57.4 billion.

b) National grants, which in actual fact were less than 10% of the aggregate income, would have made up over 25%, assuming introduction of the changes.

c) Own service charges, which in actual fact were almost half of the aggregate income, would have made up only just over one quarter had these changes been in place in 2006.

It is not hard to see that the changes will leave cities substantially smaller and financially weaker than they are at present. If one adds to this the risks and implications associated with proposals regarding the single public service, as well as the long-standing issues regarding the division of functions, unfunded mandates, and the flow of funds, it is clear that city governments will collectively need to pay close attention to what is happening to them. Rigorous attention by the cities to the institutional changes that are underway, all of which look very likely to weaken the cities, is needed to ensure that appropriate approaches are adopted.

CHAPTER EIGHT
A CITY FINANCIAL AGENDA

A CITY FINANCIAL AGENDA

This report has described the history of the development of municipal finance in South Africa and the immense challenges it faced, particularly as the country reformed its racially divided local institutions and redirected spending to overcome apartheid legacies.

Based on a detailed analysis, the report has also shown how – contrary to widespread belief – the finances of the nine cities of the Cities Network have improved considerably since 2003 as the new local dispensation was consolidated. This relative financial strength is not necessarily shared across the whole of the local government sector. However, the fact that the nine Network Cities represent over two thirds of all municipal expenditure means that this is indeed of great significance for the country as a whole.

The report has also given some indication of the immense challenges that lie ahead in addressing the needs of poor households, while at the same time maintaining existing infrastructure and extending it to provide a platform for new economic growth and development.

Though there is still much to be done in building implementation capabilities at local level, the financial improvement of recent years gives significant encouragement that these challenges can be successfully overcome.

At the same time, the report has identified a number of key issues that should urgently be addressed if the potential of the cities is to be realised. The analysis suggests that city governments should collectively work together to ensure that these issues are taken up and resolved. Without collective action by the cities on their own behalf, there is every prospect that the issues will not be satisfactorily addressed:

Replace the recently abolished Regional Services Council and Joint Services Board levies with a new local business tax.

The report has shown how important the RSC and JSB levies have been to the stabilisation of city finances. It has also emphasised the advantages of replacing the levies with a new tax rather than with grants.

The previous levies were a form of local business tax, but had a number of administrative and other shortcomings. A new local business tax is needed which will help build local accountability, provide the resources and incentives required to strengthen local economic growth and thus jobs, and will be simple to administer.

A local, broad based tax on all factors of production, administered by the South African Revenue Services, is the most favoured option. This would be similar to one of the key options suggested in a 2005 discussion document by National Treasury.

The tax should be payable to metropolitan and local councils. It should recognise that in poorer parts of the country it will generate relatively little revenue and that these areas need to continue to be assisted with adequate equitable share grants.

Such a tax will need to be introduced in a phased manner.

Review the current approach to the restructuring of the Electricity Distribution Industry, so that it can be restructured in a manner that avoids fundamentally undermining city finances.

The current approach to create six Regional Electricity Distributors (REDs) has serious shortcomings. It is a high risk endeavour entailing massive organisational change for very uncertain benefits. It also threatens to seriously undermine city finances.

While it is recognised that institutional arrangements are required which support sound operations, prevent cities from extracting unreasonable surpluses and ensure proper investment in the electricity undertakings, this can be achieved in a way which does not damage city finances.

Of particular concern to the cities from a financial perspective is the immense damage the proposed changes will do to municipal revenue collection efforts, thereby threatening city cash flows, balance sheets and surpluses.

The current approach will require a change to the Constitution, which will be damaging and divisive. A fresh approach is needed.

Improve the coherence of the relationships between the three spheres of government and the effectiveness of city government by recognising cities as the key locus of responsibility for all built environment-related functions and address the question of unfunded mandates.

By recognising city governments as the key locus of responsibility for all services related to the built environment, critical synergies can be realised, trade-offs made, and delivery greatly simplified and accelerated.

These services include all services related to the management of urban space and movement across urban space. It encompasses responsibility for housing, public transport and land use planning, together with the infrastructure and services linked to these.

City government has always been key to the management of the built environment, due to its planning functions, responsibility for property tax, and the nature of services it has traditionally provided. Through the creation of widely drawn boundaries to create single-tier municipalities encompassing the whole city, the scope for even more effective management has been strengthened since the end of apartheid.

Section 156 of the Constitution requires that the administration of all services 'necessarily related' to local government 'must' be devolved to municipalities if they have the capacity to perform the function. Implementing this across the larger metropolitan and city governments will go a long way towards addressing the current malaise in the inter-governmental system.

This does not exclude the possibility of some of the social services, where provinces are the key locus of responsibility, being devolved to cities. This may include, for example, certain elements of the health services.

Adjustments to the alignment of functions amongst spheres of government require adjustments to the assignment of revenue sources. Unfunded mandates must be addressed if accountability and effectiveness are to be enhanced. This can only be done in the context of clarity on the division of functions.

Cities must put in place better institutional mechanisms to facilitate co-operation across city regions.

While the widely drawn municipal boundaries have enabled much better city governance, there remain key instances where the urban area extends across city boundaries. This occurs most significantly in Gauteng, where three metropolitan councils adjoin one another. Although of lesser significance, it is also a feature of the eThwekwini-Msunduzi area.

Seeking to ensure integrated management across these regions does pose the danger of crucial decision-making powers being shifted to the provincial level. This will lead to serious disjuncture between the management of the micro- and macro-issues related to local functions.

Municipal governments comprising city regions should address these challenges by playing a leading role in the creation of institutional arrangements across regions. Provinces must allow the cities themselves to drive regional co-operation regarding city functions if success is to be achieved.

Cities need to explore how they can be much more pro-active in this regard.

City governments must develop a much deeper understanding of current initiatives to create a single public service in order to ensure that measures are adopted that strengthen rather than weaken city administration.

There is a tendency to underestimate the complexity of managing city government. City governments are large institutions with a wide range of responsibilities. They deal with considerable implementation challenges in a very demanding environment. The key to successful city administration lies in skilled city management driven by loyalty to the institution and a commitment to improving the quality of life for all local citizens.

Moves to create a single public service could have a fundamentally negative impact on the character of city administration, and significantly weaken the ability of cities to attract the human resources they require.

While there is a need to improve particular aspects of city administration, facilitate the adjustment of the division of functions between spheres, and find ways of attracting scarce skills into rural areas, the measures prioritised by government focus mainly on increasing national control over local administration. This could undermine the key tenets of building a strong local developmental state.

City government has a far too superficial understanding of current intentions and needs to greatly improve its understanding of and involvement in the debates.

Administrative and financial regulations and processes must be reviewed with the objective of simplifying them and making them less onerous, while retaining good corporate governance.

There have been significant improvements in corporate governance and the regulatory framework governing financial administration at local level. Much of this has been driven by the implementation of the Municipal Finance Management Act.

Many of the measures were initially experienced as unnecessarily burdensome for local government. However, greater familiarity has made implementation easier and the merit of the new measures more apparent.

That said, there is a need to gain a greater understanding of how regulations and processes can be adjusted to reduce unnecessarily onerous controls, allow for greater creativity amongst officials and speed up implementation. Inter-governmental administrative procedures could play an important role in this respect.

The impact of measures to hold officials personally liable in cases of error needs to be better understood and possibly reformulated to reduce constraints on creativity while maintaining proper responsibility for actions taken.

Cities should continue to work to improve their audit opinions and credit ratings as they seek to improve their service delivery.

While the progress on audit opinions and credit ratings is evident in the report, cities continue to face considerable challenges from a financial administration perspective. Although cities are in many respects ahead of national and provincial departments in respect of budgeting, reporting, information technology and accounting, National Treasury will continue to issue necessary regulations, and city systems, processes and procedures will accordingly need to continue to be improved.

Cities will need to continue to improve their implementation of new legislation and accounting standards until satisfactory audit reports are achieved.

Cities should strengthen their voice in national debates.

As is evident from this document, many national decisions are taken which impact fundamentally on city government. Yet the voice of city government is weak and fragmented.

The cities account for a large proportion of the country's population, including many of the poorest citizens, and for two thirds of the economic activity. Yet local government in general, and cities in particular, are inadequately represented at key national decision making fora.

The South African Local Government Association (SALGA) must take the lead in representing the interests of local government as a whole. However, there is huge diversity in the needs of different local governments across the country from small rural farming areas to large metropolises. SALGA, national government and, in particular, the cities themselves, should pay far more attention to understanding the common circumstances of the key urban areas and articulating their needs within national policy making.

Conclusion

Taken together, these points amount to a medium-term agenda for cities regarding financial matters – a city financial agenda. An energetic pursuit of this agenda by the cities would go a long way towards ensuring that South Africa sustains its cities into the future, to great benefit of national economic and social development.

INDEX OF TABLES, CHARTS AND BOXES

Tables

Chapter 1

Table 1: Estimated city populations in 2005
Table 2: Significance of city economies in the 2004 national Gross Value Added
Table 3: Expenditure by city 2005/6

Chapter 2

Table 4: Domestic currency credit ratings of South African cities 2002 – 2007

Chapter 3

Table 5: Summary of the dates on which GAMAP was implemented
Table 6: Summary of net assets
Table 7: Analysis of changes in the accumulated surpluses of the cities (cumulative 2003 – 2006)
Table 8: Summary of operating results
Table 9: Sources of revenue (metropolitan municipalities)
Table 10: Sources of revenue (non-metropolitan municipalities)
Table 11: Summary of equitable share allocations
Table 12: Summary of government grants included in revenue
Table 13: Summary of revenue from government grants
Table 14: Analysis of operating expenses
Table 15: Summary of gross and net debtors' balances
Table 16: Summary of debtor ratios
Table 17: Analysis of debtors by customer classification, 30 June 2006
Table 18: Actual capital expenditure
Table 19: Analysis of spending on infrastructure
Table 20: Actual versus originally budgeted capital expenditure, 2006
Table 21: Summary of asset financing (as at 30 June 2006)
Table 22: Summary of budgeted financing sources, 2006
Table 23: Total liabilities of the cities
Table 24: Grant financing
Table 25: Summary of security provided for borrowings
Table 26: Summary of net cash and investments
Table 27: Summary of working capital

Chapter 4

Table 28: Backlog and poverty indicators for South African cities
Table 29: Financial implications of dealing with the housing backlog
Table 30: Economic and population growth rates by city
Table 31: Infrastructure backlogs Nelson Mandela Bay

Chapter 5

Table 32: Overall profile of the revenue sources of SA cities
Table 33: Categories of services
Table 34: City revenue sources 2003 to 2006: total for all 9 cities
Table 35: City property tax revenues 2002/3 to 2005/6
Table 36: Distribution of RSC levy income 2005/6
Table 37: Annual RSC levies collected by city, 2003–2006
Table 38: Net debtors, annual revenue and debtors days

Chapter 6

Table 39: Summary of IT developments in city administrations
Table 40: Audit opinions and basis of qualification for 2005/6
Table 41: Emphasis of matter for 2005/6

Chapter 7

Table 42: Estimated annual cost of unfunded mandates for selected cities
Table 43: Share of electricity in city budgets
Table 44: City electricity surpluses (R'000)
Table 45: City Manager/DG/CEO remuneration 2005/6

Charts

Chapter 1

Chart 1: Expenditure by city 2005/6

Chapter 3

Chart 2: Operating expenditures of the cities 2006
Chart 3: Gross debtors to revenue: 2004 – 2006
Chart 4: Net debtors to revenue: 2004 – 2006
Chart 5: Analysis of debtors by customer classification, 30 June 2006
Chart 6: Consolidated debt repayment schedule of the cities to 2015/16

Chapter 5

Chart 7: City revenue sources 2003/4 to 2005/6 (R m)
Chart 8: City property tax revenue 2003/4 to 2005/6 (R b)
Chart 9: Aggregate city revenue 2005/6 (R57.4 b)
Chart 10: The 'revenue wheel'
Chart 11: Crude monthly collection rates 2001 – 2006: Ekurhuleni
Chart 12: Crude monthly collection rates 2001–2006: Johannesburg

Chapter 7

Chart 13: Actual revenue 2005/6, potential revenue 2005/6

Boxes

Chapter 1

Box 1: The significance of South Africa's cities

Chapter 2

Box 2: Recent Credit Ratings

Chapter 3

Box 3: The Replacement of Fund Accounting with new GAMAP/GRAP accounting and financial reporting standards
Box 4: Explanation of items in Table 6

Chapter 4

Box 5: eThekwini housing
Box 6: City of Johannesburg: sanitation

Chapter 5

Box 7: Shift in property tax incidence arising from the change in valuation basis
Box 8: A comprehensive approach to a city revenue strategy

Chapter 6

Box 9: Circulars issued in terms of the MFMA
Box 10: Perceptions of the MFMA
Box 11: Johannesburg's iGoli model
Box 12: The implementation of Cape Town's ERP system

Chapter 7

Box 13: Grants received by Buffalo City
Box 14: Summary of NERSA assessments of city electricity undertakings
Box 15: Revenue collection and electricity
Box 16: Johannesburg and the REDs: a case study
Box 17: Are City Managers overpaid?

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GLOSSARY OF TERMS

ANC	African National Congress
CDS	City Development Strategy
CFO	Chief Finance Officer
CRM	Customer Relations Management (uses of IT software applications that permit a comprehensive approach to managing customer relations and interactions)
DBSA	Development Bank of South Africa
dplg	Department of Provincial & Local Government
DWAF	Department of Water Affairs & Forestry
EDI	Electricity Distribution Industry
EDIH	Electricity Distribution Industry Holdings
ERP	Enterprise Resource Planning
FFC	Fiscal and Financial Commission
FMG	Financial Management Grant
GAAP	Generally Accepted Accounting Practice
GAMAP	Generally Accepted Municipal and Accounting Practice
GRAP	Generally Recognised Accounting Practise
GVA	Gross Value Added (a measure of the economic product produced in a local area, sometimes used instead of gross geographic product)
IDP	Integrated Development Plan
JSB	Joint Services Board
LFS	Labour Force Survey, a statistical series of Statistics South Africa
LGNF	Local Government Negotiating Forum
LGTA	Local Government Transition Act (209 of 1993)
MFMA	Municipal Finance Management Act (56 of 2003)
MIDP	Motor Industry Development Plan
MIG	Municipal Infrastructure Grant
MIIF	Municipal Infrastructure Investment Framework
MPRA	Municipal Property Rates Act (6 of 2004)
MSA	Municipal Systems Act (32 of 2000)
MSIG	Municipal Services & Infrastructure Grant
MSS	Metropolitan Substructure
MTEF	Medium Term Expenditure Framework
MTREF	Medium Term Revenue & Expenditure Framework
NERSA	National Energy Regulator of South Africa
NRS	National Rationalisation of Standards
NT	National Treasury
RDP	Reconstruction and Development Plan
REDs	Regional Electricity Distributors
RSC	Regional Services Council
SALGA	South African Local Government Association
SANRAL	South African National Roads Agency Limited
SDBIPs	Service Delivery and Budget Implementation Plans
TLC	Transitional Local Council
TMC	Transitional Metropolitan Council
TRC	Transitional Rural Councils/ Transitional Representative Councils
VIP	Ventilated Improved Pit (good quality pit latrine)

JOHANNESBURG (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	2,212,324	2,416,541	2,684,309	2,918,647	9	11	9
Service charges	5,166,284	5,730,533	6,275,055	6,666,438	11	10	6
Electricity	2,490,327	2,852,079	3,255,876	3,381,998	15	14	4
Water	1,262,182	1,513,866	1,717,316	1,826,910	20	13	6
Sewerage	774,700	838,675	897,699	1,015,407	8	7	13
Cleansing	472,321	413,885	321,339	336,047	-12	-22	5
Other	166,754	112,028	82,825	106,076	-33	-26	28
Interest earned	152, 934	368,060	409,719	465,175	141	11	14
Investments	22,515	177,469	290,134	338,405	688	63	17
Outstanding debtors	130,419	190,591	119,585	126,770	46	-37	6
Government grants and subsidies	217,397	280,085	599,689	884,952	29	114	48
Fines	90,885	169,176	167,363	193,030	86	-1	15
Public contributions		1,125	89,660	133,481		7,870	49
RSC levies	1,260,982	1,321,700	1,550,966	1,905,493	5	17	23
Other	232,565	749,457	1,278,907	774,119	222	71	-39
TOTAL	**9,333,371**	**11,322,093**	**13,505,968**	**14,427,248**	**21**	**19**	**7**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	2,630,530	3,132,998	3,057,727	3,467,390	19	-2	13
Remuneration of Councillors	39,129	42,649	45,180	50,056	9	6	11
Bad debts	862,460	691,476	980,420	844,645	-20	42	-14
Depreciation	350,119	790,958	872,163	909,050	126	10	4
Repairs and maintenance	150,370	152,395	205,523	241,009	1	35	17
Interest	638,735	521,655	671,268	775,344	-18	29	16
Bulk purchases	2,656,124	3,116,616	3,242,530	3,490,303	17	4	8
Other	2,470,662	2,627,139	2,972,805	3,520,805	6	13	18
TOTAL	**9,798,129**	**11,075,886**	**12,047,616**	**13,298,602**	**13**	**9**	**10**

SURPLUS	2003	2004	2005	2006
Revenue	9,333,371	11,322,093	13,505,968	14,427,248
Expenses	9,798,129	11,075,886	12,047,616	13,298,602
Surplus	-464,758	246,207	1,458,352	1,128,646
Less: Other adjustments	191,608	91,083	-121,705	-252,333
Less: Unknown difference			-212,720	
TOTAL	**-273,150**	**337,290**	**1,123,927**	**876,313**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	500,047	1,957,667	8,081,535	10,786,880
Capital Reserves	4,466,650	2,201,389	1,761,133	2,187,653
Revaluation Reserves		1,198	226	3,984
Housing Development Fund	209,229	106,178		
COID reserves	12,991	20,661	29,935	38,596
Accumulated (deficit)/surplus	-4,188,823	-371,759	6,290,241	8,556,647
NON-CURRENT LIABILITIES	6,180,131	6,899,905	6,419,100	7,641,129
Long-term liabilities	3,686,529	4,729,701	4,594,119	5,770,475
Non-current liabilities	1,595,205	1,677,074	1,824,981	1,799,106
Other liabilities	505,834			
Deferred taxation	392,563	493,130		71,548
CURRENT LIABILITIES	3,869,135	4,364,107	4,943,876	4,829,138
Creditors	2,962,605	3,491,221	3,601,084	3,541,178
Conditional grants and receipts	223,660	303,800	286,344	362,522
Provisions	32,342	53,141	58,646	464,336
Consumer deposits	269,378	251,799	310,485	327,122
Current portion of long-term liabilities	370,977	244,717	672,743	113,589
VAT		15,095		12,107
Short-term loans				
Bank overdraft				
Taxation	10,173	4,334	14,574	8,284
TOTAL NET ASSETS AND LIABILITIES	**10,549,313**	**13,221,679**	**19,444,511**	**23,257,147**
NON-CURRENT ASSETS	7,873,347	8,878,531	14,154,892	18,102,755
Property, plant and equipment	6,271,153	7,014,102	13,274,501	16,913,135
Intangible assets	382,375	363,204	82,314	95,804
Non-current receivables	151,371	136,100	152997	138,437
Investments	822,959	1,036,332	562,828	955,379
Investments in Mun Entities/associates				
Other		13,557		
Deferred taxation	245,489	315,236	82,252	
CURRENT ASSETS	2,675,966	4,343,148	5,289,619	5,154,392
Cash and cash equivalents	745,407	134,546	57,787	60,781
Current portion of non-current loans				
Short-term investments	106,350	1,149,630	2,423,035	2,293,478
Consumer debtors	1,243,914	1,361,897	1,681,716	1,938,907
Housing rental debtors		345,397	31,280	26,760
RSC levy debtors		148,789	154,610	207,379
Other debtors	483,099	1,096,397	848,516	542,945
Inventory	82,446	73,619	85,619	84,142
Other	14,750	32,873	7,056	
TOTAL ASSETS	**10,549,313**	**13,221,679**	**19,444,511**	**23,257,147**

TSHWANE (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	1,242,043	1,363,697	1,468,347	1,624,061	10	8	11
Service charges	2,711,132	3,247,553	3,709,223	3,874,557	20	14	4
Electricity	2,004,925	2,166,857	2,457,731	2,513,150	8	13	2
Water	706,207	718,075	835,878	905,434	2	16	8
Sewerage		169,677	194,398	215,935		15	11
Cleansing		192,944	221,216	240,038		15	9
Other							
Interest earned	**120,180**	**124,745**	**168,237**	**153,880**	4	30	-5
Investments	120,180	12,350	104,901	103,545	-90	749	-1
Outstanding debtors		112,395	57,336	50,335		-49	-12
Government grants and subsidies	170,118	235,047	701,609	785,258	38	198	12
Fines		41,287	37,910	22,896		-8	-40
Public contributions			86,079	146,434			70
RSC levies	447,323	494,170	628,266	644,611	10	27	3
Other	875,722	383,928	420,005	699,754	-56	9	67
TOTAL	**5,566,518**	**5,890,427**	**7,213,676**	**7,951,451**	**6**	**22**	**10**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	1,662,200	1,836,928	2,069,898	2,160,602	11	13	4
Remuneration of Councillors	28,862	31,838	33,255	34,795	10	4	5
Bad debts		128,212	315,161	332,941		146	6
Depreciation	540,909	619,715	465,337	509,426	15	-25	9
Repairs and maintenance	730,570	861,307	863,252	1,095,351	18		27
Interest	249,608	257,027	232,506	266,630	3	-10	15
Bulk purchases	1,302,483	1,507,935	1,628,481	1,853,026	16	8	14
Other	674,877	623,390	1,010,420	1,383,326	-8	62	37
TOTAL	**5,189,509**	**5,866,352**	**6,618,310**	**7,636,097**	**13**	**13**	**15**

SURPLUS	2003	2004	2005	2006
Revenue	5,566,518	5,890,427	7,213,676	7,951,451
Expenses	5,189,509	5,866,352	6,618,310	7,636,097
Surplus	377,009	24,075	595,366	315,354
Less: Other adjustments				
Less: Unknown difference	2	-1	-1	-2
TOTAL	**377,011**	**24,074**	**595,365**	**315,352**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	2,423,277	5,547,204	6,186,278	6,501,630
Capital Reserves	2,264,471	5,350,845	5,711,710	6,012,657
Revaluation Reserves				
Housing Development Fund	108,350	110,520	115,770	150,464
COID reserves		56,193	64,980	70,051
Accumulated (deficit)/surplus	50,456	29,646	293,818	268,458
NON-CURRENT LIABILITIES	1,525,497	1,496,230	1,740,683	2,141,601
Long-term liabilities	1,525,497	1,496,230	1,740,683	2,138,732
Non-current liabilities				
Other liabilities				2,869
Deferred taxation				
CURRENT LIABILITIES	1,907,156	1,946,545	2,439,873	2,326,215
Creditors	1,245,732	1,138,376	1,697,091	1,657,716
Conditional grants and receipts		242,784	187,563	176,500
Provisions	163,922			
Consumer deposits	213,604	216,220	240,485	236,092
Current portion of long-term liabilities	248,047	140,397	180,259	59,410
VAT		120,260	95,513	166,782
Short-term loans				
Bank overdraft	35,851	88,508	38,962	29,715
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**5,855,930**	**8,989,979**	**10,366,834**	**10,969,446**
NON-CURRENT ASSETS	3,240,341	6,157,873	7,080,115	8,092,899
Property, plant and equipment	2,500,853	5,614,524	6,415,334	7,458,749
Intangible assets				
Non-current receivables	164,721	144,909	209,136	151,607
Investments	574,767	398,440	451,545	482,543
Investments in Mun Entities/associates			4,100	
Other				
Deferred taxation				
CURRENT ASSETS	2,615,589	2,832,106	3,286,719	2,876,547
Cash and cash equivalents	182	222	9,178	18,812
Current portion of non-current loans	66,810	89,148	29,898	16,321
Short-term investments	431,078	645,484	649,366	375,569
Consumer debtors	1,744,924	1,692,950	2,007,402	2,128,996
Housing rental debtors				
RSC levy debtors				
Other debtors	273,515	251,711	435,107	220,827
Inventory	99,080	152,591	155,768	116,022
Other				
TOTAL ASSETS	**5,855,930**	**8,989,979**	**10,366,834**	**10,969,446**

ETHEKWINI (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	2,046,756	2,367,293	2,939,573	3,071,229	16	24	4
Service charges	3,627,287	3,849,265	4,319,028	4,510,763	6	12	4
Electricity	2,531,371	2,757,471	2,942,349	3,021,130	9	7	3
Water	952,654	1,065,112	1,153,066	1,241,251	12	8	8
Sewerage			62,872	63,960			2
Cleansing			89,772	104,834			17
Other	143,262	26,682	70,969	79,588	-81	166	12
Interest earned	777,066	494,128	287,292	281,306	-36	-42	-2
Investments	777,066	494,128	234,702	212,527	-36	-53	-9
Outstanding debtors			52,590	68,779			31
Government grants and subsidies	310,527	373,703	738,329	1,045,242	20	98	42
Fines			113,422	112,820			-1
Public contributions			10,337	6,877			-33
RSC levies			500,851	570,029			14
Other	511,361	922,921	698,266	701,812	80	-24	1
TOTAL	**7,272,997**	**8,007,310**	**9,607,098**	**10,300,078**	**10**	**20**	**7**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	2,348,881	2,476,470	2,690,754	2,465,289	5	9	-8
Remuneration of Councillors	36,444	39,791	40,354	46,391	9	1	15
Bad debts			474,693	388,045			-18
Depreciation	1,048,717	1,197,563	525,851	823,120	14	-56	57
Repairs and maintenance	800,971	787,631	797,737	830,240	-2	1	4
Interest	469,009	503,287	527,717	560,317	7	5	6
Bulk purchases			2,349,834	2,443,253			4
Other	2,370,503	2,767,792	1,876,495	1,686,669	17	-32	-10
TOTAL	**7,074,525**	**7,772,534**	**9,283,435**	**9,243,324**	**10**	**19**	**-0**

SURPLUS	2003	2004	2005	2006
Revenue	7,272,997	8,007,310	9,607,098	10,300,078
Expenses	7,074,525	7,772,534	9,283,435	9,243,324
Surplus	198,472	234,776	323,663	1,056,754
Less: Other adjustments			27,067	1,432
Less: Unknown difference				
TOTAL	**198,472**	**234,776**	**350,730**	**1,058,186**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	4,525,501	4,627,141	8,168,404	9,226,590
Capital Reserves	3,669,859	3822261	1,999,439	2,313,091
Revaluation Reserves				
Housing Development Fund	855,642	804880	778,241	709,881
COID reserves			29,144	31,802
Accumulated (deficit)/surplus			5,361,580	6,171,816
NON-CURRENT LIABILITIES	3,415,193	3,435,223	3,933,110	4,479,154
Long-term liabilities	3,128,350	3,183,420	3,018,132	3,737,918
Non-current liabilities			50,000	50,000
Other liabilities	286,843	251,803	864,978	691,236
Deferred taxation				
CURRENT LIABILITIES	2,595,152	3,035,301	4,959,567	6,377,301
Creditors	1,445,910	1,680,185	2,575,157	2,703,600
Conditional grants and receipts			90,810	100,681
Provisions	482,103	502,826		6,889
Consumer deposits	304,248	354,327	421,413	466,135
Current portion of long-term liabilities	158,031	237,184	547,640	480,215
VAT				
Short-term loans				
Bank overdraft	204,860	260,779	1,324,547	2,619,781
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**10,535,846**	**11,097,665**	**17,061,081**	**20,083,045**
NON-CURRENT ASSETS	7,630,014	8,441,524	13,045,029	13,807,088
Property, plant and equipment	4,403,891	5,098,890	9,740,416	10,998,946
Intangible assets			42,924	43,121
Non-current receivables	103,843	95,916	307400	311,989
Investments	3,067,278	3,231,443	2,895,088	2,402,399
Investments in Mun Entities/associates			2	2
Other	55,002	15,275	59199	50631
Deferred taxation				
CURRENT ASSETS	2,905,832	2,656,141	4,016,052	6,275,957
Cash and cash equivalents	25,575	52,555	1,125,835	2,593,682
Current portion of non-current loans			19,072	12,774
Short-term investments			170,533	667,117
Consumer debtors	1,392,226	1,387,407	1,335,235	1,630,014
Housing rental debtors			34,290	10,609
RSC levy debtors			121,195	91,178
Other debtors	1,407,138	1,125,031	1,069,052	1,118,742
Inventory	80,893	91,148	127,143	119,504
Other			13,697	32,337
TOTAL ASSETS	**10,535,846**	**11,097,665**	**17,061,081**	**20,083,045**

MANGAUNG (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	181,623	209,793	197,618	218,345	16	-6	10
Service charges	536,330	597,052	728,244	754,321	11	22	4
Electricity	365,071	407,524	451,563	463,463	12	11	3
Water	171,259	189,528	203,438	209,229	11	7	3
Sewerage			70,554	78,482			11
Cleansing			2,689	3,147			17
Other							
Interest earned	54,549	43,645	49,313	45,800	-20	13	-7
Investments	54,549	43,645	32,448	25,698	-20	-26	-21
Outstanding debtors	0		16,865	20,102			19
Government grants and subsidies	190,578	201,703	308,801	286,207	6	53	-7
Fines			7,311	13,186			80
Public contributions			9,670	10,827			12
RSC levies							
Other	127,483	161,283	68,151	55,916	27	-58	-18
TOTAL	**1,090,563**	**1,213,476**	**1,369,108**	**1,384,602**	**11**	**13**	**1**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	312,983	350,405	411,756	444,460	12	18	8
Remuneration of Councillors	8,829	10,440	10,455	14,064	18	0	35
Bad debts			65,134	108,951			67
Depreciation	103,532	116,540		115,524	13	-100	
Repairs and maintenance	86,140	78,866	89,026	80,090	-8	13	-10
Interest	426	2,354	3,616	3,635	453	54	1
Bulk purchases	320,701	335,736	371,532	411,298	5	11	11
Other	210,732	259,216	191,051	203,878	23	-26	7
TOTAL	**1,043,343**	**1,153,557**	**1,142,570**	**1,381,900**	**11**	**-1**	**21**

SURPLUS	2003	2004	2005	2006
Revenue	1,090,563	1,213,476	1,369,108	1,384,602
Expenses	1,043,343	1,153,557	1,142,570	1,381,900
Surplus	47,220	59,919	226,538	2,702
Less: Other adjustments	-7,905	10,382		
Less: Unknown difference				
TOTAL	**39,315**	**70,301**	**226,538**	**2,702**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	1,224,703	1,318,333	2,504,609	2,436,048
Capital Reserves	1,123,881	1210561	1,362,688	1,036,507
Revaluation Reserves			697,736	698,673
Housing Development Fund	76,704	71390	63,966	54,262
COID reserves			15,614	14,007
Accumulated (deficit)/surplus	24,118	36,382	364,605	632,599
NON-CURENT LIABILITIES	21,752	20,440	20,742	19,237
Long-term liabilities	21,752	20,440	19,032	17,479
Non-current liabilities			1,710	1,758
Other liabilities				
Deferred taxation				
CURRENT LIABILITIES	273,146	276,310	320,438	429,294
Creditors	223,862	223,686	188,683	257,664
Conditional grants and receipts			48,951	65,611
Provisions	14,477	14,967	10,247	10,761
Consumer deposits	32,720	36,341	39,388	44,194
Current portion of long-term liabilities	2,087	1,316	1,407	1,553
VAT			31,762	49,511
Short-term loans				
Bank overdraft				
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**1,519,601**	**1,615,083**	**2,845,789**	**2,884,579**
NON-CURRENT ASSETS	684,961	784,401	2,015,366	2,141,870
Property, plant and equipment	636,190	728,568	1,965,396	2,102,373
Intangible assets				
Non-current receivables	48,766	55,825	49962	39,489
Investments	5	8	8	8
Investments in Mun Entities/associates				
Other				
Deferred taxation				
CURRENT ASSETS	834,640	830,682	830,423	742,709
Cash and cash equivalents	74,662	63,643	315,783	114,198
Current portion of non-current loans	18,810	22,241	22,621	24,514
Short-term investments	315,281	317,025	85,150	213,300
Consumer debtors	402,006	399,060	338,089	286,973
Housing rental debtors			8,645	9,867
RSC levy debtors				
Other debtors			42,784	72,829
Inventory	23,881	28,713	17,351	21,028
Other				
TOTAL ASSETS	**1,519,601**	**1,615,083**	**2,845,789**	**2,884,579**

CAPE TOWN (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates		2,092,541	2,056,817	2,227,794		-2	8
Service charges		4,197,118	4,163,407	4,297,032		-1	3
Electricity		2,358,366	2,497,632	2,653,863		6	6
Water		771,411	896,976	1,059,056		16	18
Sewerage		525,084	537,250	570,445		2	6
Cleansing		380,612	408,340	440,272		7	8
Other		161,645	-176,791	-426,604		-209	141
Interest earned		349,162	342,008	423,476		-2	24
Investments		167,062	212,911	241,837		27	14
Outstanding debtors		182,100	129,097	181,639		-29	41
Government grants and subsidies		562,423	631,906	1,018,808		12	61
Fines		93,756	121,098	174,977		29	44
Public contributions		31,356	40,872	39,774		30	-3
RSC levies		780,028	893,838	1,027,420		15	15
Other		603,729	578,516	427,404		-4	-26
TOTAL		**8,710,113**	**8,828,462**	**9,636,685**		**1**	**9**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs		2,870,534	2,674,246	2,740,000		-7	2
Remuneration of Councillors		45,827	49,952	51,801		9	4
Bad debts		637,307	76,519	93,340		-88	22
Depreciation		708,227	629,561	675,396		-11	7
Repairs and maintenance		560,864	679,956	803,972		21	18
Interest		347,402	346,827	349,325			1
Bulk purchases		1,574,028	1,703,049	1,780,755		8	5
Other		1,856,881	2,169,045	3,140,123		17	45
TOTAL		8,601,070	8,329,155	9,634,712		-3	16

SURPLUS	2003	2004	2005	2006
Revenue		8,710,113	8,828,462	9,636,685
Expenses		8,601,070	8,329,155	9,634,712
Surplus		109,043	499,307	1,973
Less: Other adjustments				
Less: Unknown difference				
TOTAL		**109,043**	**499,307**	**1,973**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	6,020,008	6,129,051	6,628,056	6,630,029
Capital Reserves	5,342,706	5,169,671	4,946,802	5,309,146
Revaluation Reserves				
Housing Development Fund	614,770	631370	554,970	501,627
COID reserves				
Accumulated (deficit)/surplus	62,532	328,010	1,126,284	819,256
NON-CURRENT LIABILITIES	2,017,074	3,317,957	3,100,354	3,760,869
Long-term liabilities	2,017,074	2,467,059	2,132,016	2,217,222
Non-current liabilities		850,898		
Other liabilities			968,338	1,543,647
Deferred taxation				
CURRENT LIABILITIES	2,816,784	2,613,988	2,998,858	3,241,624
Creditors	1,581,383	1,777,177	1,557,388	1,848,865
Conditional grants and receipts	176,560	260,288	370,752	438,763
Provisions	877,747	143,155	371,310	431,385
Consumer deposits	75,205	135,292	161,686	176,982
Current portion of long-term liabilities	105,889	162,055	366,014	137,477
VAT		136,021	171,708	208,152
Short-term loans				
Bank overdraft				
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**10,853,866**	**12,060,996**	**12,727,268**	**13,632,522**
NON-CURRENT ASSETS	8,368,124	8,532,393	8,606,927	9,455,170
Property, plant and equipment	7,260,653	7,439,590	7,631,288	8,704,123
Intangible assets				
Non-current receivables	473,032	429,430	322370	294,287
Investments	634,439	663,373	308,691	373,857
Investments in Mun Entities/associates			284,000	39,297
Other			60,578	43,606
Deferred taxation				
CURRENT ASSETS	2,485,742	3,528,603	4,120,341	4,177,352
Cash and cash equivalents	532,073	1,239,780	1,711,792	2,054,467
Current portion of non-current loans	13,657	30,711	33,401	22,287
Short-term investments				
Consumer debtors	1,691,549	1,442,899	1,554,347	1,360,936
Housing rental debtors		162,558	183,740	191,223
RSC levy debtors		51,627	50,498	39,735
Other debtors	100,969	467,267	468,868	387,533
Inventory	147,494	133,761	117,695	121,171
Other				
TOTAL ASSETS	**10,853,866**	**12,060,996**	**12,727,268**	**13,632,522**

BUFFALO CITY (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	207,184	229,708	255,438	271,366	11	11	6
Service charges	427,088	643,920	721,508	756,405	51	12	5
Electricity	319,501	351,472	387,004	409,763	10	10	6
Water	107,587	120,024	146,391	144,346	12	22	-1
Sewerage		94,357	102,424	111,809		9	9
Cleansing		78,067	83,739	88,080		7	5
Other			1,950	2,407			23
Interest earned	1,707	56,842	57,552	64,403	3,230	1	12
Investments	1,707	21,271	27,425	43,232	1,146	29	58
Outstanding debtors		35,571	30,127	21,171		-15	-30
Government grants and subsidies	125,792	216,130	395,751	397,241	72	83	
Fines		6,447	9,559	9,184		48	-4
Public contributions			21,403	8,093			-62
RSC levies							
Other	262,572	71,312	85,115	98,370	-73	19	16
TOTAL	**1,024,343**	**1,224,359**	**1,546,326**	**1,605,062**	**20**	**26**	**4**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	360,717	409,091	437,749	462,044	13	7	6
Remuneration of Councillors	10,234	11,368	11,882	13,390	11	5	13
Bad debts		40,380	80,619	52,405		100	-35
Depreciation	147,054	78,059	59,376	70,834	-47	-24	19
Repairs and maintenance	38,528	50,969	72,001	71,474	32	41	-1
Interest	1,134	58,532	57,430	56,227	5,062	-2	-2
Bulk purchases	244,998	265,089	278,789	289,518	8	5	4
Other	219,145	291,805	368,648	385,368	33	26	5
Total	**1,021,810**	**1,205,293**	**1,366,494**	**1,401,260**	**18**	**13**	**3**

SURPLUS	2003	2004	2005	2006
Revenue	1,024,343	1,224,359	1,546,326	1,605,062
Expenses	1,021,810	1,205,293	1,366,494	1,401,260
Surplus	2,533	19,066	179,832	203,802
Less: Other adjustments			3,754	1,418
Less: Unknown difference				
TOTAL	**2,533**	**19,066**	**183,586**	**205,220**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	420,800	601,874	787,404	1,064,433
Capital Reserves	412,361	492,712	400,264	529,612
Revaluation Reserves			192,064	238,767
Housing Development Fund				
COID reserves		6,030	5,979	6,851
Accumulated (deficit)/surplus	8,439	103,132	189,097	289,203
NON-CURRENT LIABILITIES	341,440	378,398	399,804	402,431
Long-term liabilities	341,440	373,188	399,804	402,431
Non-current liabilities		5,210		
Other liabilities				
Deferred taxation				
CURRENT LIABILITIES	248,122	299,141	364,712	410,067
Creditors	131,871	99,414	166,121	177,187
Conditional grants and receipts		129,107	151,667	193,131
Provisions	14,330	21,645	1,524	566
Consumer deposits	18,853	21,128	20,259	22,254
Current portion of long-term liabilities	12,980	27,847	25,141	16,929
VAT				
Short-term loans				
Bank overdraft	70,088			
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**1,010,362**	**1,279,413**	**1,551,920**	**1,876,931**
NON-CURRENT ASSETS	615,814	840,490	988,639	1,061,853
Property, plant and equipment	530,744	741,824	872,459	1,044,898
Intangible assets				
Non-current receivables	8,530	5,628	2542	1,090
Investments	75,937	93,038	109,884	10,693
Investments in Mun Entities/associates			3,754	5,172
Other	603			
Deferred taxation				
CURRENT ASSETS	394,548	438,923	563,281	815,078
Cash and cash equivalents	1,403	8,657	45,095	52,691
Current portion of non-current loans	2,966	2,320	1,560	945
Short-term investments	50,418	106,642	179,892	436,361
Consumer debtors	326,361	192,561	226,189	247,007
Housing rental debtors		21,796		
RSC levy debtors				
Other debtors		82,069	77,144	38,932
Inventory	13,400	12,878	15,330	17,166
Other		12,000	18,071	21,976
TOTAL ASSETS	**1,010,362**	**1,279,413**	**1,551,920**	**1,876,931**

MSUNDUZI (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	225,115	244,969	363,973	396,485	9	49	9
Service charges	492,664	554,508	601,833	847,162	13	9	41
Electricity	369,798	404,282	397,285	570,818	9	-2	44
Water	122,866	150,226	124,929	170,811	22	-17	37
Sewerage			48,765	65,212			34
Cleansing			30,854	40,321			31
Other							
Interest earned	47,089	46,781	21,504	13,514	-1	-56	-34
Investments	47,089	46,781	5,351	10,169	-1	-89	90
Outstanding debtors			15,153	3,345			-78
Government grants and subsidies	49,879	71,000	106,129	250,183	42	50	136
Fines			7,575	10,634			40
Public contributions							
RSC levies							
Other	201,935	243,094	129,471	81,249	20	-47	-37
TOTAL	**1,016,682**	**1,160,352**	**1,229,485**	**1,599,227**	**14**	**6**	**30**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	304,131	337,182	360,630	383,602	11	7	6
Remuneration of Councillors	8,813	10,049	10,006	10,948	14		9
Bad debts	-4,098	36,712	67,000	15,413	-996	83	-77
Depreciation	130,535	128,176	67,289	78,450	-2	-48	17
Repairs and maintenance	43,867	47,952	42,427	49,458	9	-12	17
Interest	41,081	43,907	39,091	43,165	7	-11	10
Bulk purchases	318,005	362,719	427,974	456,652	14	18	7
Other	158,610	191,448	209,568	396,398	21	10	89
Total	**1,000,944**	**1,158,145**	**1,223,985**	**1,434,086**	**16**	**6**	**17**

SURPLUS	2003	2004	2005	2006
Revenue	1,016,682	1,160,352	1,229,485	1,599,227
Expenses	1,000,944	1,158,145	1,223,985	1,434,086
Surplus	15,738	2,207	5,500	165,141
Less: Other adjustments				
Less: Unknown difference	-1			2,504
TOTAL	**15,737**	**2,207**	**5,500**	**167,645**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	642,178	633,963	815,453	766,913
Capital Reserves	555,516	586,265	662,073	715,812
Revaluation Reserves				
Housing Development Fund	48,300	46625	47,915	50,215
COID reserves				
Accumulated (deficit)/surplus	38,362	1,073	105,465	886
NON-CURRENT LIABILITIES	254,105	281,238	269,743	380,033
Long-term liabilities	254,105	281,238	269,333	331,623
Non-current liabilities			410	48,410
Other liabilities				
Deferred taxation				
CURRENT LIABILITIES	224,272	293,989	440,252	432,454
Creditors	180,021	246,208	204,734	263,440
Conditional grants and receipts			152,526	100,945
Provisions			1,284	1,547
Consumer deposits	24,004	25,800	24,362	26,670
Current portion of long-term liabilities			27,530	26,043
VAT			29,816	13,809
Short-term loans	20,247	21,981		
Bank overdraft				
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**1,120,555**	**1,209,190**	**1,525,448**	**1,579,400**
NON-CURRENT ASSETS	758,511	679,136	990,208	1,103,111
Property, plant and equipment	659,223	665,453	982,271	1,091,226
Intangible assets				
Non-current receivables	18,641	11,775	6029	9,977
Investments	80,647	1,908	1,908	1,908
Investments in Mun Entities/associates				
Other				
Deferred taxation				
CURRENT ASSETS	362,044	530,054	535,240	476,289
Cash and cash equivalents	7,702	61,194	19,059	27,532
Current portion of non-current loans			3,959	3,589
Short-term investments		48,142	140,454	210,605
Consumer debtors	334,132	390,456	295,151	172,068
Housing rental debtors				
RSC levy debtors				
Other debtors	6,968	14,367	46,626	29,278
Inventory	11,280	14,163	29,991	33,217
Other	1,962	1,732		
TOTAL ASSETS	**1,120,555**	**1,209,190**	**1,525,448**	**1,579,400**

NELSON MANDELA BAY (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	376,322	419,188	466,715	498,867	11	11	7
Service charges	1,197,356	1,375,840	1,486,221	1,529,552	15	8	3
Electricity	809,665	934,173	1,025,847	1,013,160	15	10	-1
Water	197,042	220,436	231,398	267,457	12	5	16
Sewerage	129,709	153,564	154,338	167,465	18	1	9
Cleansing	60,940	67,667	74,638	81,470	11	10	9
Other							
Interest earned			201,801	203,517			1
Investments			145,714	125,156			-14
Outstanding debtors			56,087	78,361			40
Government grants and subsidies	144,592	364,596	332,910	365,457	152	-9	10
Fines			9,257	13,227			43
Public contributions							
RSC levies	174,223	194,007	229,258	268,728	11	18	17
Other	534,604	413,958	204,942	208,171	-23	-51	2
TOTAL	**2,427,097**	**2,767,589**	**2,931,104**	**3,087,519**	**14**	**6**	**5**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	702,959	775,280	897,360	939,042	10	16	5
Remuneration of Councillors	21,200	22,464	25,291	29,325	6	13	16
Bad debts			17,450	7,926			-55
Depreciation	177,200	172,640	162,459	192,238	-3	-6	18
Repairs and maintenance	192,931	199,204	218,467	258,018	3	10	18
Interest	30,378	30,853	39,840	27,252	2	29	-32
Bulk purchases	472,810	534,969	589,992	601,177	13	10	2
Other	812,863	1,164,222	1,048,781	955,893	43	-10	-9
Total	**2,410,341**	**2,899,632**	**2,999,640**	**3,010,871**	**20**	**3**	**0**

SURPLUS	2003	2004	2005	2006
Revenue	2,427,097	2,767,589	2,931,104	3,087,519
Expenses	2,410,341	2,899,632	2,999,640	3,010,871
Surplus	16,756	-132,043	-68,536	76,648
Less: Other adjustments				
Less: Unknown difference	-1	11,283		
TOTAL	**16,755**	**-120,760**	**-68,536**	**76,648**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	3,071,437	3,388,898	3,682,915	4,191,677
Capital Reserves	2,963,267	3,298,925	3,519,421	4,036,603
Revaluation Reserves				
Housing Development Fund			80,329	90,321
COID reserves				
Accumulated (deficit)/surplus	108,170	89,973	83,165	64,753
NON-CURRENT LIABILITIES	613,737	669,758	722,625	731,112
Long-term liabilities	613,737	669,758	702,625	712,152
Non-current liabilities			20,000	18,960
Other liabilities				
Deferred taxation				
CURRENT LIABILITIES	472,621	577,816	618,328	681,588
Creditors	318,005	371,260	505,772	553,567
Conditional grants and receipts			22,575	20,869
Provisions	77,456	127,802	115	169
Consumer deposits	55,937	63,196	69,203	80,613
Current portion of long-term liabilities	21,223	15,558	17,757	26,370
VAT			2,906	
Short-term loans				
Bank overdraft				
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**4,157,795**	**4,636,472**	**5,023,868**	**5,604,377**
NON-CURRENT ASSETS	3,685,683	3,894,054	4,306,787	4,780,609
Property, plant and equipment	2,349,279	2,560,138	2,849,920	3,266,786
Intangible assets				
Non-current receivables	186,772	119,873	49724	45,647
Investments	1,149,632	1,214,043	1,407,138	1,468,176
Investments in Mun Entities/associates				
Other			5	
Deferred taxation				
CURRENT ASSETS	472,112	742,418	717,081	823,768
Cash and cash equivalents	53,052	204,687	61,017	53,344
Current portion of non-current loans	8,022	7,338	4,015	3,049
Short-term investments			75,881	60,372
Consumer debtors	344,183	453,581	450,125	536,397
Housing rental debtors			3,097	1,947
RSC levy debtors				
Other debtors	2,473	3,286	47,608	83,198
Inventory	64,382	73,526	75,338	82,581
Other				2,880
TOTAL ASSETS	**4,157,795**	**4,636,472**	**5,023,868**	**5,604,377**

EKURHULENI (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	1,302,397	1,503,776	1,681,077	1,753,716	16	12	4
Service charges	4,595,656	4,046,654	4,199,086	4,398,419	-12	4	5
Electricity	2,298,812	2,470,136	2,578,332	2,749,332	8	4	7
Water	847,843	947,903	931,067	1,001,548	12	-2	8
Sewerage		292,282	294,582	321,502		1	9
Cleansing		295,168	303,188	326,037		3	8
Other	1,449,001	41,165	91,917		-97	123	-100
Interest earned		328,374	337,341	363,115		3	8
Investments		194,327	244,847	241,412		26	-1
Outstanding debtors		134,047	92,494	121,703		-31	32
Government grants and subsidies	248,581	581,767	765,330	978,374	134	32	28
Fines		95,274	90,823	104,823		-5	15
Public contributions		110,116	3,423			-97	-100
RSC levies	541,400	551,588	842,318	691,290	2	53	-18
Other	6,138	231,457	290,344	360,394	3,671	25	24
TOTAL	**6,694,172**	**7,449,006**	**8,209,742**	**8,650,131**	**11**	**10**	**5**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	1,644,739	1,719,477	2,045,627	2,198,251	5	19	8
Remuneration of Councillors	33,190	37,321	41,143	44,085	12	10	7
Bad debts		988,201	1,283,225	677,317		30	-47
Depreciation	379,330	344,139	392,736	336,861	-9	14	-14
Repairs and maintenance	390,618	377,842	397,538	445,346	-3	5	12
Interest	163,953	157,670	190,442	187,680	-4	21	-2
Bulk purchases	2,097,759	2,402,052	2,545,042	2,689,320	15	6	6
Other	1,505,569	495,891	1,068,656	961,320	-67	116	-10
TOTAL	**6,215,158**	**6,522,593**	**7,964,409**	**7,540,180**	**5**	**22**	**-5**

SURPLUS	2003	2004	2005	2006
Revenue	6,694,172	7,449,006	8,209,742	8,650,131
Expenses	6,215,158	6,522,593	7,964,409	7,540,180
Surplus	479,014	926,413	245,333	1,109,951
Less: Other adjustments			8,894	12,657
Less: Unknown difference		-337,688	1	
TOTAL	**479,014**	**588,725**	**254,228**	**1,122,608**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	2,639,895	3,070,096	4,896,319	5,983,650
Capital Reserves	1,946,134	2,130,956	2,373,554	2,175,046
Revaluation Reserves			369,710	382,367
Housing Development Fund	142,708	153525	144,983	112,128
COID reserves				
Accumulated (deficit)/surplus	551,053	785,615	2,008,072	3,314,109
NON-CURRENT LIABILITIES	1,192,122	1,107,905	1,494,529	1,352,318
Long-term liabilities	1,192,122	1,107,905	1,441,481	1,295,540
Non-current liabilities			53,048	56,778
Other liabilities				
Deferred taxation				
CURRENT LIABILITIES	1,195,807	1,738,202	1,699,156	1,801,058
Creditors	837,751	1,317,112	1,153,254	1,272,954
Conditional grants and receipts			67,250	67,514
Provisions	110,707	112,820	146,388	145,494
Consumer deposits	192,765	221,973	240,079	262,288
Current portion of long-term liabilities	54,584	86,297	92,185	52,808
VAT				
Short-term loans				
Bank overdraft				
Taxation				
TOTAL NET ASSETS AND LIABILITIES	**5,027,824**	**5,916,203**	**8,090,004**	**9,137,026**
NON-CURRENT ASSETS	3,377,700	4,230,345	4,555,380	5,076,792
Property, plant and equipment	1,863,614	2,085,700	3,592,175	4,021,131
Intangible assets				
Non-current receivables	679,156	964,986	300743	356,103
Investments	834,930	1,179,659	292,752	309,851
Investments in Mun Entities/associates			369,710	389,707
Other				
Deferred taxation				
CURRENT ASSETS	1,650,124	1,685,858	3,534,624	4,060,234
Cash and cash equivalents	716,376	890,335	2,243,511	2,652,399
Current portion of non-current loans	15,155	84,209	24,050	20,593
Short-term investments			132,382	85,541
Consumer debtors	866,459	657,754	840,866	877,170
Housing rental debtors				
RSC levy debtors			71,470	
Other debtors			114,678	298,609
Inventory	52,134	53,560	58,536	61,905
Other			49,131	64,017
TOTAL ASSETS	**5,027,824**	**5,916,203**	**8,090,004**	**9,137,026**

TOTALS: 9 CITIES (R'000)

REVENUE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Property rates	7,793,764	10,847,506	12,113,867	12,980,510	39	12	7
Service charges	18,753,797	24,242,443	26,203,605	27,634,649	29	8	6
Electricity	11,189,470	14,702,360	15,993,619	16,776,677	31	9	5
Water	4,367,640	5,696,581	6,240,459	6,826,042	30	10	9
Sewerage	904,409	2,073,639	2,362,882	2,610,217	129	14	11
Cleansing	533,261	1,428,343	1,535,775	1,660,246	168	8	8
Other	1,759,017	341,520	70,870	-238,533	-81	-79	-437
Interest earned	1,153,525	1,811,737	1,867,767	2,014,186	57	3	8
Investments	1,023,106	1,157,033	1,298,433	1,341,981	13	12	3
Outstanding debtors	130,419	654,704	569,334	672,205	402	-13	18
Government grants and subsidies	1,457,464	3,171,870	5,030,754	6,497,635	118	59	29
Fines	90,885	405,940	564,318	654,777	347	39	16
Public contributions		142,597	261,444	345,486		83	32
RSC levies	2,423,928	3,341,493	4,645,497	5,107,571	38	39	10
Other	2,752,380	3,781,139	3,753,717	3,407,189	37	-1	-9
TOTAL	**34,425,743**	**47,744,725**	**54,440,969**	**58,642,003**	**39**	**14**	**8**

EXPENDITURE	2003	2004	2005	2006	Percentage Changes 2004	2005	2006
Employee related costs	9,967,140	13,908,365	14,645,747	15,260,680	40	5	4
Remuneration of Councillors	186,701	251,747	267,518	294,855	35	6	10
Bad debts	858,362	2,522,288	3,360,221	2,520,983	194	33	-25
Depreciation	2,877,396	4,156,017	3,174,772	3,710,899	44	-24	17
Repairs and maintenance	2,433,995	3,117,030	3,365,927	3,874,958	28	8	15
Interest	1,594,324	1,922,687	2,108,737	2,269,575	21	10	8
Bulk purchases	7,412,880	10,099,144	13,137,223	14,015,302	36	30	7
Other	8,422,961	10,277,784	10,915,469	12,633,780	22	6	16
TOTAL	**33,753,759**	**46,255,062**	**50,975,614**	**54,581,032**	**37**	**10**	**7**

SURPLUS	2003	2004	2005	2006
Revenue	34,425,743	47,744,725	54,440,969	58,642,003
Expenses	33,753,759	46,255,062	50,975,614	54,581,032
Surplus	671,984	1,489,663	3,465,355	4,060,971
Less: Other adjustments	183,703	101,465	-81,990	-236,826
Less: Unknown difference		-326,406	-212,720	2,502
TOTAL	**855,687**	**1,264,722**	**3,170,645**	**3,826,647**

BALANCE SHEET	2003	2004	2005	2006
NET ASSETS	21,467,846	27,274,227	41,750,973	47,587,850
Capital Reserves	22,744,845	24,263,585	22,737,084	24,316,127
Revaluation Reserves	0	1,198	1,259,736	1,323,791
Housing Development Fund	2,055,703	1,924,488	1,786,174	1,668,898
COID reserves	12,991	82,884	145,652	161,307
Accumulated (deficit)/surplus	-3,345,693	1,002,072	15,822,327	20,117,727
NON-CURRENT LIABILITIES	15,561,051	17,607,054	18,100,690	20,907,884
Long-term liabilities	12,780,606	14,328,939	14,317,225	16,623,572
Non-current liabilities	1,595,205	2,533,182	1,950,149	1,975,012
Other liabilities	792,677	251,803	1,833,316	2,237,752
Deferred taxation	392,563	493,130	0	71,548
CURRENT LIABILITIES	13,602,195	15,145,399	18,785,060	20,528,739
Creditors	8,927,140	10,344,639	11,649,284	12,276,171
Conditional grants and receipts	400,220	935,979	1,378,438	1,526,536
Provisions	1,773,084	976,356	589,514	1,061,147
Consumer deposits	1,186,714	1,326,076	1,527,360	1,642,350
Current portion of long-term liabilities	973,818	915,371	1,930,676	914,394
VAT	0	271,376	331,705	450,361
Short-term loans	20,247	21,981	0	0
Bank overdraft	310,799	349,287	1,363,509	2,649,496
Taxation	10,173	4,334	14,574	8,284
TOTAL NET ASSETS AND LIABILITIES	**50,631,092**	**60,026,680**	**78,636,723**	**89,024,473**
NON-CURRENT ASSETS	36,234,495	42,438,747	55,743,343	63,622,147
Property, plant and equipment	26,475,600	31,948,789	47,323,760	55,601,367
Intangible assets	382,375	363,204	125,238	138,925
Non-current receivables	1,834,832	1,964,442	1,400,903	1,348,626
Investments	7,240,594	7,818,244	6,029,842	6,004,814
Investments in Mun Entities/associates	0	0	661,566	434,178
Other	55,605	28,832	119,782	94,237
Deferred taxation	245,489	315,236	82,252	0
CURRENT ASSETS	14,396,597	17,587,933	22,893,380	25,402,326
Cash and cash equivalents	2,156,432	2,655,619	5,589,057	7,627,906
Current portion of non-current loans	125,420	235,967	138,576	104,072
Short-term investments	903,127	2,266,923	3,856,693	4,342,343
Consumer debtors	8,345,754	7,978,565	8,729,120	9,178,468
Housing rental debtors	0	529,751	261,052	240,406
RSC levy debtors	0	200,416	397,773	338,292
Other debtors	2,274,162	3,040,128	3,150,383	2,792,893
Inventory	574,990	633,959	682,771	656,736
Other	16,712	46,605	87,955	121,210
TOTAL ASSETS	**50,631,092**	**60,026,680**	**78,636,723**	**89,024,473**

DIVISION OF REVENUE ACT GRANTS 2003 to 2006 (R'000)

	R '000				% change from previous year		
	2003	2004	2005	2006	2004	2005	2006
Equitable Share							
Cape Town	105,111	151,353	196,243	267,461	44	30	36
Nelson Mandela Bay	96,108	141,799	150,846	199,333	48	6	32
Buffalo City	126,890	175,938	179,480	184,233	39	2	3
Mangaung	134,036	188,012	190,135	167,319	40	1	-12
Ethekwini	249,465	348,738	366,181	520,958	40	5	42
Msunduzi	49,302	71,000	69,469	101,800	44	-2	47
Ekurhuleni	123,706	182,871	296,535	460,058	48	62	55
Johannesburg	150,928	227,551	380,545	524,760	51	67	38
Tshwane	100,592	149,731	191,810	261,870	49	28	37
TOTAL	**1,136,138**	**1,636,993**	**2,021,244**	**2,687,792**	**44**	**24**	**33**
Infrastructure							
Cape Town	99,739	132,573	154,098	203,433	33	16	32
Nelson Mandela Bay	59,034	65,322	79,041	88,645	11	21	12
Buffalo City	37,888	50,115	82,962	107,261	32	66	29
Mangaung	31,417	45,211	66,827	89,252	44	48	34
Ethekwini	143,652	151,431	243,564	310,164	5	61	27
Msunduzi	11,977	19,991	41,614	51,451	67	108	24
Ekurhuleni	66,309	88,840	199,300	259,990	34	124	31
Johannesburg	101,845	127,644	223,992	300,688	25	76	34
Tshwane	55,590	78,269	160,076	205,703	41	105	29
TOTAL	**607,451**	**759,396**	**1,251,474**	**1,616,587**	**25**	**65**	**29**
Recurrent							
Cape Town	3,000	3,500	4,000	71,000	17	14	1675
Nelson Mandela Bay	8,800	3,500	3,500	57,500	-60	0	1543
Buffalo City	5,600	3,000	22,500	45,471	-46	650	102
Mangaung	44,825	47,000	27,000	14,992	5	-43	-45
Ethekwini	3,000	4,000	3,500	71,545	33	-13	1944
Msunduzi	3,825	43,000	52,500	2,500	1024	22	-95
Ekurhuleni	10,678	3,500	3,000	5,000	-67	-14	67
Johannesburg	179,000	3,500	68,000	32,000	-98	1843	-53
Tshwane	4,000	3,000	3,000	72,645	-25	0	2322
TOTAL	**262,728**	**114,000**	**187,000**	**372,653**	**-57**	**64**	**99**
Eradication of Buckets							
Cape Town							
Nelson Mandela Bay							
Buffalo City				2,300			
Mangaung				4,950			
Ethekwini							
Msunduzi							
Ekurhuleni							
Johannesburg							
Tshwane							
TOTAL				**7,250**			
Total: DORA grants							
Cape Town	207,850	287,426	354,341	541,894	38	23	53
Nelson Mandela Bay	163,942	210,621	233,387	345,478	29	11	48
Buffalo City	170,378	229,053	284,942	339,265	34	24	19
Mangaung	210,278	280,223	283,962	276,513	33	1	-3
Ethekwini	396,117	504,169	613,245	902,667	27	22	47
Msunduzi	65,104	133,991	163,583	155,751	106	22	-5
Ekurhuleni	200,693	275,211	498,835	725,048	37	81	45
Johannesburg	431,773	358,695	672,537	857,448	-17	88	28
Tshwane	160,182	231,000	354,886	540,218	44	54	52
TOTAL	**2,006,317**	**2,510,389**	**3,459,718**	**4,684,282**	**25**	**38**	**35**

ANALYSIS OF GOVERNMENT GRANTS 2005 & 2006 (R'000)

		Equitable share	Provincial Health Subsidies	Provincial Capital Grants	Other Provincial	MIG	FMG	Restructuring Grant	Ambulance Subsidy	Housing	Operating Grants	MSIG	DWAF	Transport	unknown difference	Other	Donors	TOTAL
Johannesburg	2006	524,761	43,787	92,615		312,613	2,803	84,567	58,746	91,540	719	960				157,754		1,370,865
	2005	380,545	40,893	164,085		104,961	1,589	34,944	44,615	69,314						209,043		1,049,989
Tshwane	2006	261,870	10,912	152,628		193,062	2,956	42,550	30,641				18,147	51,325		21,167		785,258
	2005	192,482	10,495	261,225		155,342	4,351	7,044	27,109					43,148		413		701,609
eThekwini	2006	521,080	31,804			286,172		72,584						18,351		51,252	63,999	1,045,242
	2005	347,773	26,501			210,410		82,416								49,439	21,790	738,329
Manguang	2006	155,607	14,486			82,817	5,802	14,065			11,713	19	471		-1	1,228		286,207
	2005	164,327	12,309	167		77,866	1,648	21,745			25,808		1,617		-1	3,315		308,801
Cape Town	2006	254,216	105,759			227,428								69,356		362,049		1,018,808
	2005	180,893	100,921			147,959								28,793		173,340		631,906
Buffalo City	2006	182,621	367		4,872	94,670	2,433	21,743		27,234		768	2,883		-8,093	67,743		397,241
	2005	177,528	142		2,193	78,752	1,697	18,839		48,030		544	5,993		-21,403	83,436		395,751
Msunduzi	2006	101,800	99		10,496	80,198					16,424					41,166		250,183
	2005	69,469	49		8,599	7,357		15,122			5,516					17		106,129
Nelson Mandela Bay	2006	151,131	63,399		2,166	690	521	5,481		113,334	208	2,895		4,654	-1	19,447	1,532	365,457
	2005	136,932	60,036				873			123,916				5,482	-1	5,537	135	332,910
Ekurhuleni	2006	460,058	62,694			226,445	3,749	8,365	75,689	105,936		2,290	735	812	-278	31,631	248	978,374
	2005	296,535	58,391			179,594	1,107	14,591	83,853	171,265		2,500			-61,627	19,121		765,330
Total: 9 cities	**2006**	**2,613,144**	**333,307**	**245,243**	**17,534**	**1,504,095**	**18,264**	**249,355**	**165,076**	**338,044**	**29,064**	**6,932**	**22,236**	**144,498**	**-8,373**	**753,437**	**65,779**	**6,497,635**
	2005	**1,946,484**	**309,737**	**425,477**	**10,792**	**962,241**	**11,265**	**194,701**	**155,577**	**412,525**	**31324**	**3,044**	**7,610**	**77,423**	**-83,032**	**543,661**	**21,925**	**5,030,754**

OPERATING BUDGETS FOR 2005/6 (R'000)

Expenditure	Salaries Wages Allowance	Electricity Bulk Purchases	Water Bulk Purchases	Sewer Payments	Other	Repairs and Maintenance	Interest & Redemption	Contributions to Special Funds	Provisions for Working Capital	Gross Budgeted Expenditure	Less Amounts Rellocated	Total
Nelson Mandela Bay	945,164	616,471	-	-	1,199,202	246,639	319	428,502	110,517	3,546,815	584,577	2,962,238
Buffalo City	501,556	239,701	64,056	-	456,656	81,684	58,367	-	32,692	1,434,712	-	1,434,712
Mangaung	471,329	277,183	144,261	-	335,282	97,262	130,776	2,382	6,834	1,465,308	32,105	1,433,203
Ekurhuleni	2,389,202	1,865,553	814,004	165,162	3,122,454	847,846	211,707	16,037	612,753	10,044,719	2,106,424	7,938,295
Johannesburg	3,541,051	2,337,484	1,349,019	-	4,452,734	210,690	1,406,113	-	904,686	14,201,777	-	14,201,777
Tshwane	2,383,044	1,250,000	569,880	195,330	2,422,458	910,168	1,034,562	-	-	8,765,442	1,486,578	7,278,863
eThekwini	2,928,004	1,694,863	727,179	0	3,572,677	1,024,384	582,335	-	104,384	10,633,825	1,307,057	9,326,769
Msunduzi	385,698	271,968	120,396	35,000	463,499	52,648	145,137	106,140	-	1,580,486	313,904	1,266,582
Cape Town	3,004,417	1,661,000	222,901		4,325,350	980,172	1,455,498		370,687	12,020,026	472,772	11,547,254
Totals	**16,549,465**	**10,214,223**	**4,011,696**	**395,492**	**20,350,312**	**4,451,493**	**5,024,814**	**553,061**	**2,142,553**	**63,693,110**	**6,303,417**	**57,389,693**

Revenue	Regional Levies	Property Rates	Electricity	Water	Sanitation	Refuse Removal	Subsidies and Grants	Other Income	Total
Nelson Mandela Bay	237,683	506,790	1,069,669	247,063	163,915	77,504	272,410	387,414	2,962,448
Buffalo City	-	273,898	413,571	149,453	100,802	89,412	253,778	153,917	1,434,831
Mangaung		214,719	479,081	201,183	78,979	-	182,233	285,596	1,441,791
Ekurhuleni	571,529	1,448,440	3,075,542	1,090,991	344,469	334,369	643,486	552,303	8,061,129
Johannesburg	1,574,508	2,960,376	3,514,633	2,878,902	-	382,389	1,046,077	3,865,345	16,222,230
Tshwane	580,000	1,553,500	2,477,000	925,000	229,520	241,000	650,449	622,395	7,278,863
eThekwini	530,000	2,877,527	3,103,524	1,272,848	58,784	96,067	310,406	1,077,613	9,326,769
Msunduzi	-	288,722	451,024	148,210	55,862	35,207	110,879	181,659	1,271,564
Cape Town	928,000	2,407,000	2,519,731	871,149	568,009	456,305	663,032	3,134,028	11,547,254
Totals	**4,421,720**	**12,530,972**	**17,103,775**	**7,784,799**	**1,600,340**	**1,712,253**	**4,132,750**	**10,260,270**	**59,546,879**

LIABILITIES 2003 to 2006 (R'000)

	2003	2004	2005	2006	Percentage Changes 2004	Percentage Changes 2005	Percentage Changes 2006	Debt to Revenue 2003	Debt to Revenue 2004	Debt to Revenue 2005	Debt to Revenue 2006
Johannesburg	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	3,686,529	4,729,701	4,594,119	5,770,475							
Current portion	370,977	244,717	672,743	113,589							
Total	**4,057,506**	**4,974,418**	**5,266,862**	**5,884,064**	**23**	**6**	**12**	**44**	**44**	**39**	**41**
Tshwane	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	1,525,497	1,496,230	1,740,683	2,138,732							
Current portion	248,047	140,397	180,259	59,410							
Total	**1,773,544**	**1,636,627**	**1,920,942**	**2,198,142**	**-8**	**17**	**14**	**32**	**28**	**27**	**28**
eThekwini	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	3,128,350	3,183,420	3,018,132	3,737,918							
Current portion	158,031	237,184	547,640	480,215							
Total	**3,286,381**	**3,420,604**	**3,565,772**	**4,218,133**	**4**	**4**	**18**	**45**	**43**	**37**	**41**
Mangaung	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	21,752	20,440	19,032	17,479							
Current portion	2,087	1,316	1,407	1,553							
Total	**23,839**	**21,756**	**20,439**	**19,032**	**-9**	**-6**	**-7**	**2**	**2**	**2**	**1**
Cape Town	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	2,017,074	2,467,059	2,132,016	2,217,222							
Current portion	105,889	162,055	366,014	137,477							
Total	**2,122,963**	**2,629,114**	**2,498,030**	**2,354,699**	**24**	**-5**	**-6**		**30**	**28**	**24**
Buffalo City	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	341,440	373,188	399,804	402,431							
Current portion	12,980	27,847	25,141	16,929							
Total	**354,420**	**401,035**	**424,945**	**419,360**	**13**	**6**	**-1**	**35**	**33**	**28**	**26**
Msunduzi	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	254,105	281,238	269,333	331,623							
Current portion	0	0	27,530	26,043							
Total	**254,105**	**281,238**	**296,863**	**357,666**	**11**	**6**	**21**	**25**	**24**	**24**	**22**
Nelson Mandela Bay	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	613,737	669,758	702,625	712,152							
Current portion	21,223	15,558	17,757	26,370							
Total	**634,960**	**685,316**	**720,382**	**738,522**	**8**	**5**	**3**	**26**	**25**	**25**	**24**
Ekurhuleni	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	1,192,122	1,107,905	1,441,481	1,295,540							
Current portion	54,584	86,297	92,185	52,808							
Total	**1,246,706**	**1,194,202**	**1,533,666**	**1,348,348**	**-4**	**28**	**-12**	**19**	**16**	**19**	**16**
TOTAL	**2003**	**2004**	**2005**	**2006**	**2004**	**2005**	**2006**	**2003**	**2004**	**2005**	**2006**
Long-term liabilities	12,780,606	14,328,939	14,317,225	16,623,572							
Current portion	973,818	915,371	1,930,676	914,394							
Total	**13,754,424**	**15,244,310**	**16,247,901**	**17,537,966**	**11**	**7**	**8**	**40**	**32**	**30**	**30**

LOAN PROFILES 2007 TO 2016 & THEREAFTER (R'000)

Amounts redeemable per year	TOTAL	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Thereafter	Unclassified
Msunduzi	357,665	12,766	12,403			101,903		7,919				221,588	1,087
Ekurhuleni	1,348,348	4,069	7,732	16,104	50,018	290,138	104,459	128,971	671,472	137			75,249
eThekwini	4,218,133	331,764	750	14,448		23,000		920			625,700	3,221,551	
Tshwane	2,755,667	500	155,000	40,000		309,046	200,000	18,826	107,571			1,367,195	557,529
Cape Town	2,354,699	5,408	305,805		212,380	159,271	34,138	105,963	6,800	233,799		1,291,135	
Mangaung	19,032	122	94	157			986				17,673		
Nelson Mandela Bay	284,993		2,000	8,000	8,000	8,000							258,993
Buffalo City	419,361	11,721	29	6,058	8,160	10,000						383,393	
Johannesburg	5,884,063	369	1,139	107,444	861,847	42,351	293,287	1,606,979	226,520	249,269	981,448	1,510,903	2,507
TOTAL	**17,641,961**	**366,719**	**484,953**	**192,211**	**1,140,405**	**943,709**	**632,870**	**1,869,578**	**1,012,363**	**483,205**	**1,624,821**	**7,995,765**	**895,364**

GROSS AND NET DEBTORS 2003 to 2006 (R'000)

Johannesburg	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	6,812,668	8,392,032	8,422,569	8,677,808	23	0	3	103	94	91			
Less bad debt provision	-5,568,754	-7,030,135	-6,740,853	-6,738,901	26	-4	-0						
Net debtors	1,243,914	1,361,897	1,681,716	1,938,907	10	24	15				17	19	20

Tshwane	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	2,384,306	2,174,887	2,711,188	2,959,669	-9	25	9	47	52	54			
Less bad debt provision	-639,382	-481,937	-703,786	-830,673	-25	46	18						
Net debtors	1,744,924	1,692,950	2,007,402	2,128,996	-3	19	6				37	39	39

eThekwini	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	1,708,910	2,328,678	2,530,603	3,002,168	36	9	19	38	35	40			
Less bad debt provision	-316,684	-941,271	-1,195,368	-1,372,154	197	27	15						
Net debtors	1,392,226	1,387,407	1,335,235	1,630,014	-0	-4	22				22	18	22

Mangaung	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	519,699	568,902	466,517	585,285	10	-18	26	71	50	60			
Less bad debt provision	-117,693	-169,842	-128,428	-298,312	44	-24	132						
Net debtors	402,006	399,060	338,089	286,973	-1	-15	-15				50	37	30

Cape Town	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	3,023,885	2,884,256	3,433,580	3,932,631	-5	19	15	46	55	60			
Less bad debt provision	-1,332,336	-1,441,357	-1,879,233	-2,571,695	8	30	37						
Net debtors	1,691,549	1,442,899	1,554,347	1,360,936	-15	8	-12				23	25	21

Buffalo City	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	443,871	367,671	360,475	394,724	-17	-2	10	42	37	38			
Less bad debt provision	-117,510	-175,110	-134,286	-147,717	49	-23	10						
Net debtors	326,361	192,561	226,189	247,007	-41	18	9				22	23	24

Msunduzi	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	401,534	494,570	465,151	356,326	23	-6	-23	62	48	29			
Less bad debt provision	-67,402	-104,114	-170,000	-184,258	55	63	8						
Net debtors	334,132	390,456	295,151	172,068	17	-24	-42				49	31	14

Nelson Mandela Bay	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	1,136,932	880,593	956,937	1,157,671	-23	9	21	49	49	57			
Less bad debt provision	-792,749	-427,012	-506,812	-621,274	-46	19	23						
Net debtors	344,183	453,581	450,125	536,397	32	-1	19				25	23	26

Ekurhuleni	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	4,843,780	5,221,868	4,381,014	4,499,796	8	-16	3	94	75	73			
Less bad debt provision	-3,977,321	-4,564,114	-3,540,148	-3,622,626	15	-22	2						
Net debtors	866,459	657,754	840,866	877,170	-24	28	4				12	14	14

TOTAL	2003	2004	2005	2006	Percentage Changes (%)			Gross Debtors/ Revenue (%)			Net Debtors/ Revenue (%)		
					2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross debtors	21,275,585	23,313,457	23,728,034	25,566,078	10	2	8	66	62	63			
Less bad debt provision	-12,929,831	-15,334,892	-14,998,914	-16,387,610	19	-2	9						
Net debtors	8,345,754	7,978,565	8,729,120	9,178,468	-4	9	5				23	23	23

ANALYSIS OF NET ASSETS 2005 & 2006 (R'000)

		Capital Replacement Reserve	Capitalisation Reserve	Government Grants Reserve	Donations and Public Contributions Reserve	Self insurance	Self insurance FDR	Sub-total	COID	Revaluation Reserve	Housing Development Fund	Accumulated Surplus	Unknown transactions	TOTAL
Johannesburg	2005	94,358	497,781	789,318	379,676			1,761,133	29,935	226	-	6,290,241		8,081,535
	2006	98,783	439,360	1,182,802	466,708			2,187,653	38,596	3,984		8,556,647		10,786,880
Tshwane	2005	294,730	2,096,887	3,135,576		184,097	420	5,711,710	64,980		115,770	293,818		6,186,278
	2006	357,858	2,177,575	3,348,292		128,555	377	6,012,657	70,051		150,464	268,458		6,501,630
eThekwini	2005	61,899	34,991	180,295	1,315,860	406,394		1,999,439	29,144		778,241	5,361,580		8,168,404
	2006	93,275	29,439	468,019	1,265,539	456,819		2,313,091	31,802		709,881	6,171,816		9,226,590
Mangaung	2005	202,005	801,793	214,241	71,484	73,164		1,362,687	15,613	697,736	63,966	364,605		2,504,607
	2006	185,684	498,614	272,838	7,244	72,127		1,036,507	14,007	698,673	54,262	632,599		2,436,048
Cape Town	2005	371,376	2,787,869	1,357,584	83,214	346,759		4,946,802			554,970	1,126,284		6,628,056
	2006	530,846	2,532,606	1,739,709	114,111	391,874		5,309,146			501,627	819,256		6,630,029
Buffalo City	2005	9	69,071	233,944	79,456	17,783		400,263	5,980	192,064		189,097		787,404
	2006	15,710	61,508	350,380	80,744	21,270		529,612	6,851	238,767		289,203		1,064,433
Msunduzi	2005		232,199	365,627	54,059	10,188		662,073			47,915	105,465		815,453
	2006		207,120	436,303	56,738	15,651		715,812			50,215	886		766,913
Nelson Mandela Bay	2005	228,987	2,824,232	378,977	27,414	59,810		3,519,420			80,330	99,887	-16,722	3,682,915
	2006	239,393	3,217,211	472,758	31,678	75,563		4,036,603			90,321	64,753		4,191,677
Ekurhuleni	2005	224,693	1,049,291	912,314	15,287	171,969		2,373,554		369,710	144,983	2,008,072		4,896,319
	2006	189,135	948,768	1,026,907	10,236			2,175,046		382,367	112,128	3,314,109		5,983,650
TOTAL	2005	1,478,057	10,394,114	7,567,876	2,026,450	1,270,164	420	22,737,081	145,652	1,259,736	1,786,175	15,839,049	-16,722	41,750,971
	2006	1,710,684	10,112,201	9,298,008	2,032,998	1,161,859	377	24,316,127	161,307	1,323,791	1,668,898	20,117,727	-	47,587,850