Municipal debt comes first

The recent judgment in the Transvaal Provincial Division case of *Summer Symphony Properties 13 CC and BOE Bank v the City of Tshwane Metropolitan Municipality and Others* has attracted much attention in the press. This is the second recent judgment to deal with section 118 of the Municipal Systems Act, the first having been handed down in the Natal Provincial Division (see page 13).

What does the Summer Symphony judgment mean for municipalities? In the case, a Gauteng property was sold in execution for R725 000. In accordance with section 118(1) of the Municipal Systems Act, the Tshwane Municipality certified that an amount of R287 900.29 was owing in relation to the property in respect of municipal service fees, surcharges on fees, property rates and other municipal taxes, levies and duties ('municipal debts'), which had become due in the previous two years. The buyer of the property paid that amount to the municipality and the property was then transferred into the buyer's name.

A dispute then arose as to how the proceeds of the sale in execution were to be distributed. On one hand, an amount of R655 273.83 was still owing to Tshwane Municipality for municipal debts which had became due *prior* to the two-year period in respect of which the section 118(1) certificate had been given. On the other hand, BOE Bank held a first mortgage bond over the property.

The outcome of the case was that, in terms of section 118(3) of the Systems Act, *all* amounts due in respect of municipal debts constitute a charge on the property that ranks ahead of any mortgage bond registered against that property. The 'old' – i.e. older than two years – municipal debts owing to Tshwane Municipality were therefore paid out of the proceeds of the sale in execution before the bank was paid anything.

Will this judgment impact on the willingness of banks to grant bonds in the future? In theory it shouldn't. When a bank receives a bond application, it will be able to establish from the relevant municipality the total amount owing in respect of municipal debts and will be able to take a decision on whether or not to grant a bond on the basis of that information. There is, however, a weakness in the legislation. In terms of section 118(1A) of the Systems Act, a prescribed certificate issued by a municipality in terms of section 118(1) is valid for 120 days after the date of issue: the banks and prospective buyers of property can therefore safely rely on information given to them by municipalities in regard to municipal debts which became due in the previous two years. But there is no similar provision in respect of earlier debts, which constitute a charge on property in terms of section 118(3). What if a municipality gives a bank incorrect information about earlier debts and the bank makes its security arrangements based on that incorrect information? The bank may well be contend that the municipality should be held liable for any financial loss suffered in such a scenario.

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We anticipate an intensive round of lobbying from financial institutions on these issues. The banks may argue for a time limit on municipal debts which constitute a charge on properties – for example, banks may argue that section 118(3) should only apply to the two-year debts reflected in the section 118(1) certificate. The banks may also push for an extension of the principle reflected in section 118(1A) to earlier municipal debts. Until section 118 is amended, however, municipalities enjoy a preferent status greater than that which they enjoyed prior to the introduction of that section.

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