Municipal debts are rising

Key points

- Most municipalities have exceeded their budget estimates.
- Levels of uncollected municipal debt are rising and total municipal debt is R32bn.
- The equitable share is not always being used for the purpose for which it is meant.

In a recent report to Parliament, the Auditor-General, Shauket Fakie, questioned the ability of South African municipalities to continue operating as going concerns. He commented that municipalities' mounting level of uncollected debt relative to their income was a cause for concern. The total municipal debt countrywide is more than R32bn and it is getting worse each year because of non-payment.

In a report tabled in Parliament on 10 September 2004, Fakie said municipalities were in danger of defaulting on the delivery of expected services if provincial and central government did not intervene. The report analysed the top 50 municipalities and found that the big municipalities are experiencing problems. Between 2002 and 2003, total municipal debt rose by 12%, or R5.1bn, and the provision for bad debt rose by an "alarming" 28%, or R1.3bn.

Salga report

A similar trend was reported by Salga in its analysis of 31 municipal budgets for the 2004/2005 financial year in August 2004. This article outlines the major findings of the Salga report.

General growth in municipal budgets

The National Treasury provides annual parameters to municipalities on the growth allowed for municipal budgets. These parameters are guidelines only and can be exceeded if motivated. Growth rates in the Guideline Growth

Table 1: Growth rates

Budget year	Growth rate
2003–2004	9%
2004–2005	7%
2005–2006	6.5%
2006–2007	6%

Parameters contained in the National Treasury Budget circular 1 for the 2004/2005 financial year are set out in Table 1.

As discovered by Salga, the actual general

Table 2: Growth in income

Municipal group	Growth rate 2002/03 to 2003/04	Growth rate 2003/04 to 2004/05
Group one municipalities (budgeted income > R500m)	14%	12%
Group two municipalities (budgeted income R60m–R500m)	18%	11%
Group three municipalities (budgeted income < R60m)	16%	23%
Metropolitan municipalities	15%	9%

growth in income from 2002/03 to 2004/05 was clearly higher than the established parameters, as shown in Table 2.

The general growth in expenditure from 2002/03 to 2004/05 is set out in Table 3.

According to Salga, the excessive growth in income (measured against the guideline growth parameters) can primarily be attributed to the significant increases in the equitable share allocations for all municipalities in both years, which in turn will stabilise the cash-flow position. This will be particularly so for the smaller municipalities.

The same can be said for expenditure, where equitable share allocations were used for the provision of free basic services as well as the expenditure portion of all grants.

Operating expenditure

Apart from bulk purchases, salary costs are the second biggest cost factor in the provision of services such as electricity and water.

In general, tariffs have again been increased below the salary increase rate. The result is that other expenditures, such as general expenses or repairs and maintenance, must be decreased to maintain surplus margins.

The norm for salaries, wages and allowances is approximately 30% of the total expenditure budget. However, for smaller municipalities, salary costs represent the biggest single expenditure and it is unlikely that they will be able to restrict salary costs to less than 35% in the immediate future.

General expenses, excluding the cost of bulk services, have again increased below the inflation rate. At the same time capital costs, especially in the smaller municipalities, are still decreasing as municipalities are becoming more reliant on grants and donations to fund capital programmes. This is partly as a result of poor payment levels. Smaller municipalities also find it increasingly difficult to raise external loans as their cash-flow position makes servicing debts a problem.

Smaller municipalities are, to a large extent, becoming more dependent on district municipalities and provincial and national government to address infrastructure backlog.

Infrastructure development also brings the burden of future maintenance obligations.

The guidelines from the National Treasury require that municipalities provide for bad debt/working capital in line with their current payment levels but some municipalities are not sufficiently providing for this.

Some smaller municipalities use a significant portion of their equitable share contribution to provide for bad debt/working capital instead of using these funds for free services or subsidisation of tariffs.

Operating income

Electricity remains the largest source of income for the majority of municipalities and represents approximately 28% to 33% of total operating income. The introduction of prepayment systems allows for a very stable income base for this service. As electricity is normally operated at a surplus of 12% to 15%, the outcome of the envisaged restructuring of the electricity distribution industry could have a major financial impact on all municipalities.

Table 3: Growth in iexpenditure

Municipal group	Growth rate 2002/03 to 2003/04	Growth rate 2003/04 to 2004/05
Group one municipalities (budgeted income > R500m)	14%	12%
Group two municipalities (budgeted income R60m–R500m)	20%	11%
Group three municipalities (budgeted income < R60m)	22%	18%
Metropolitan municipalities	14%	9%

Income from property rates is the second largest source of income and budgeted income varies from 18% to 21% as a percentage of the total income budget. The implementation of the Property Rates Act will allow a significant increase in the income base of all municipalities.

Many municipalities have already used the opportunities created by the 'wall-to-wall' boundaries to broaden their income base by including rural areas not previously valuated for the payment of rates and taxes.

Sundry income remains constant. The only significant increase was in the form of grants and subsidies in metropolitan municipalities, where there was an increase from 5% to 7% as a percentage of the total income budget.

Sources of funding for capital projects

Municipalities are largely becoming more reliant on external funding to pay for capital projects. Smaller municipalities are more reliant than bigger municipalities on external funding in the form of grants.

Smaller municipalities find it increasingly difficult to raise external loans as their cash-flow position makes servicing debts a problem.

Loss of electricity and water

Of concern is that municipalities in general are faced with challenges regarding water and electricity distribution losses as a result of theft, meter tampering or infrastructure that is not properly maintained. As a result municipalities lose much-needed income from these services.

Electricity distribution losses of 10–25% are common. Water distribution losses are even more disturbing: 10–40% is not unusual. If funding is made available to curb the problem, the cost could be recovered within a reasonable time from the savings generated.

Indigents' support

It is essential that municipalities are aware of the status of individual consumers in respect of their policy on indigents if they are to implement effective credit control measures.

It is concerning to note how many municipalities have not yet completed or regularly updated their register of indigents.

Provision for bad debt

It is not unusual for some municipalities to enjoy average payment levels of 90% and more. Smaller municipalities, however, that do not have major industries or businesses, are normally reliant on household consumers for 50% or more of their income. The payment levels in these municipalities average 70–85%.

It is concerning that municipalities whose budgeted income is less than R60 million do not adequately provide for bad debt but instead rely on the equitable share allocation to support their cash flow position.

Influence of equitable share allocations

There is an increase in equitable share allocations to help municipalities provide free basic services. In small municipalities the equitable share allocation can be as much as 50% of the total income budget.

However, measures must be in place to ensure that this grant is used in accordance with the Division of Revenue Act and is not used to provide for working capital or reserves for bad debt.

Cristin Peel, Abdul-hakim Issa
Local Government Project
Community Law Centre, UWC