

ANNEXURE 3: Financial Framework

Review of the national financial context

The global economic slowdown in 2001 and 2002, coupled with the dampening effect of the strong rand on the foreign trade performance has held back faster growth in the 2003 financial year. Initially, it was anticipated that the South African economy would grow by 3,3% during the 2003 year. This has had to be revised due to the constraints referred to above, and the growth is now estimated at 2,2 % rising to 3,3 % in 2004 and continuing this upward trend to potentially reach 4% in 2006. In order to meet the national objectives of employment creation, poverty reduction and broadening participation in economic activities, a sustained higher rate of economic growth remains a central requirement.

Lower inflation, lower interest rates (reduction by 5 percentage points since June 2003) and a relatively stable currency have contributed to a marked improvement in business confidence in the second half of 2003. National initiatives implemented to sustain business confidence include:

- the introduction of accelerated depreciation allowances for designated urban development zones;
- tax relief to support business investment, research and development and start-up expenses; and
- the rationalisation of the principles governing VAT on subsidies to businesses.

The local financial context

External factors

As a major contributor to the Gross Domestic Product for the country, the City operates within the same challenging arena as National Government. Some of the pertinent external issues affecting the financial viability of the City include:

- rising levels of unemployment;
- migration to urban areas;
- the need for improvements in living conditions;
- changes in health care coverage;
- HIV and other communicable diseases infection rates;
- crime and crime prevention measures; and
- limited opportunities for job creation initiatives.

These challenges obviously have to be addressed through targeted programmes to ensure they do not further negatively influence the finances of the City. However, the cost/benefit ratio has to be carefully determined to ensure that the City reaps the greatest return on social investments.



Further challenges are created by the introduction of financial reforms in the local government sphere. National Government will be reviewing the fiscal framework for local government with a view to finalising various reforms. These reforms will take into account the fiscal powers and functions of municipalities in light of the pending Local Government Property Rates Bill, the review of the Regional Services Council levies and the shifting of electricity distribution functions away from municipalities to the Regional Electricity Distributors.

Internal factors

While external factors certainly influence the finances of the City, these are not the only constraints under which local government has to work. Continual assessment of the needs of the communities must determine the developmental priorities within the short to medium term and the proportion of budget allocated to these priorities. National Government is providing targeted funding for infrastructure development and basic service delivery to poor households, but these initiatives are limited considering the scope of community needs and developmental pressures. The vast majority of programmes have to be initiated and funded by the City. These have to be done within the internal financial constraints facing the City, which include:

- rising personnel costs;
- increases in outstanding service payments due to the City;
- decreasing efficiency of service delivery processes;
- ageing infrastructure; and
- reduction in usable life of assets caused by low maintenance levels.

Initiatives to maintain affordability and sustainability

Various initiatives have been implemented during the 2003/04 financial year to ensure that affordability levels are maintained and financial sustainability is preserved over the medium to long term. These were outlined clearly in the Restructuring Grant application of the City.

Restructuring Grant application

The possibility of serious financial distress in the City in the short term initiated the City's application to National Treasury for an allocation from the Restructuring Grant. This grant assists cities to implement various internal restructuring processes in order to align with the requirements of developmental local government as outlined in the Constitution and further expanded within local government legislation. It was clear that the City could not wait for National Government to assess and approve the proposed restructuring processes contained in the application and thus various interventions were immediately proposed for implementation.

As financial sustainability has to be maintained within the context of an ever-changing City, the interventions implemented address both internal and external factors. The City has implemented interventions in the following key areas:

- Cutting levels of expenditure within the operating budget by implementing operational efficiencies.
- Rephasing of various capital projects over a period of longer than 12 months to reduce the level of borrowing required.
- Sale of non-strategic Council-owned property.
- Increasing income collection.
- Increasing funding received or reducing expenditure of services provided on behalf of other spheres of government.

The potential impact of these initiatives, as well as other financial reforms being brought into the local government sphere, have been modelled and the overall positive cash flow effect will assist the City to achieve a far more financially sustainable future. The effectiveness of these initiatives are being monitored and, at this stage, appear to be benefiting the City. It must be emphasised that the effects of these interventions will not only be felt in the short term. Some of the financial benefits may, in fact, only be realised in the medium term.

Transparency on the use of public funds and accountability for the funds entrusted to the City are the driving forces behind the financial reforms. The implementation of these reforms has ensured that the City now clearly shows income and expenditure items separately without offsetting costs, adequately discloses the grants and subsidies received from external sources within the income of the City, matches assets with the funding sources and identifies the extent of income foregone through the provision of subsidies and rebates.

Long-term financial plan

Restructuring the local government sphere

Local government has undergone three major restructuring phases since 1993. Each phase has had a significant impact on Cape Town and has utilised scarce resources without adding significant value or generating further funding. This has been at the expense of expanding existing service provision to all communities thus addressing some of apartheid-induced service backlogs.

The key delivery challenge facing all municipalities is the developmental nature of local government. Cape Town has determined a system of prioritisation, which assists to carefully balance developmental obligations with the expansion of capacity required in certain areas to provide adequate services with the limited resources and gradual decline in investment funding available. The stabilisation and consolidation of the City into a cohesive whole, providing efficient and

effective service delivery, is essential to ensure maximum leverage is obtained from available funds. The implementation of the ERP system, as well as the modernisation of service delivery initiatives has resulted in more transparent budgeting and efficient financial management systems. These changes are all essential to counteract the rising bad debts situation and the greater subsidisation required not only for the provision of nationally determined free basic services but also the social responsibility of caring for the indigent.

To ensure full accountability to the communities paying for services rendered by the municipality, it is clear that every cent received by the Council must add value. While steps are being taken in the right direction with new systems and processes being put in place, it is clear this will have to be aggressively pursued and non-value adding systems and non-core services scaled down to limit their impact on the tariffs charged by the City. The restructuring process that the City is currently following will harness the benefits of the amalgamation of seven previously distinct administrations and the economies of scale achieved will ensure future affordability of the administrative structure.

The most cost-effective service delivery strategy will guide this structure. In terms of pending local government legislation, income and expenditure streams related to individual services will be clearly identifiable, objectives for each service stipulated and the legitimacy of providing affordable and sustainable in-house delivery of services will be clearly motivated. Tariffs should be reflective of the cost of service provision, with the cross-subsidisation of services being shown in a transparent manner.

Economic opportunities and the ability to pay

The City is only as financially viable as the communities that it serves. If the communities are not provided with social and employment opportunities, the very fabric of life is at stake, putting the finances of the City in jeopardy. While National Government is providing the necessary incentives to ensure future economic growth takes place, the City will take a developmental approach to ensure that the communities have future economic opportunities at their disposal.

As the communities fund future development in the City through the active payment for services, all proposals with regard to tariffs charged for services rendered have to be considered taking a number of factors into consideration. The growth rate in the City is above the national norm, however, employment opportunities are not being created at the same rate. The growth factors predicted at National Government level will have to be achieved or succeeded in the Western Cape as a whole to provide sufficient opportunities for the economically active population.

The City thus takes cognisance of the current migration statistics, employment and poverty levels and general economy to determine the payment threshold that the communities can bear. The limited resources available to the City have to be effectively spread, and value must be added to communities through the efficient application of public funds. Prioritisation is thus given to projects where there is visible usage of public funds to encourage future active participation of the community in Council-organised meetings and increased levels of payment for services.

Determining the total municipal account

Financial modelling on the current “basket of services” provided to the average Cape Town city dweller is taking place, in order to ensure that the cost of services provided in various different communities is balanced and equitable.

While there have been disputes regarding certain tariffs implemented by the City, overall the total municipal account of residents is evaluated to determine the “bottom line” impact of current and proposed tariff structures. Further investigation is also taking place to adequately assess the financial impact of providing support to families in dire need brought about through social effects such as communicable diseases and lack of employment opportunities.

The sustainability of the City depends on the balancing of the extension of service provision with the creation of opportunities for growth, which will provide better social conditions and ultimately improve revenue collection.

National Government support dictates priorities

The strong national emphasis on social development is guiding National Government to shift more funding to social services. National Government is committed to investing in low-income neighbourhoods and under-serviced communities, in part through the free basic services programme which provides a minimum package of municipal services including electricity, water, refuse removal and sanitation. National Government is also targeting the removal of backlogs in water, sanitation and electricity through the provision of a consolidated Municipal Infrastructure Grant. Local government is set to receive the largest percentage increase in funding due to its vital role in delivering basic services to poor communities. This funding sets some of the priorities for local government and will assist the City to meet some of the social obligations of developmental local government.

Significant emphasis is being placed on the utilisation of labour-intensive methods in the delivery of infrastructure. This will provide further employment opportunities that would not have been available with conventional mechanical processes.

Medium Term Income and Expenditure Framework (MTIEF) for the City

All these issues are taken into consideration when determining the Medium Term Income and Expenditure Framework (MTIEF) within which the City can operate while retaining sustainable service delivery at an affordable rate to the community.

At this time, the level of affordability has been modelled taking into account rates increases in line with current inflation trends over the next three years, while maintaining and expanding service delivery through an internally funded Capital Budget of R685 million in 2004/05, increasing to R835 million in the following two financial years.

Cash flow projections show that this affordability level will produce a balanced budget for the City and, with careful planning, sustainable service delivery can be maintained and improved upon, while the expansion of services keeps taking place. Through accessing further funds from sources external to the City, infrastructure development can be accelerated in order to address the backlogs experienced by the City, and, depending on the level of funding received, keep pace with the predicted economic growth rate.

If Council can balance the political directives with the economic realities and be relevant to the communities, the future of the City can only be brighter.