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## Socio-economic Profiling at the Local Level: An Update

### Key Findings

- Service delivery within local government is the most important link for SA regional development.
- Financial sustainability is an important consideration and a precondition for service delivery.
- There are still come challenges facing local government and some of those are structural.
- Internal capacity in relation to staff appears to be healthy at a district level. However, the staffing situation within individual municipalities is less satisfactory, which is linked to problems in basic service delivery.
- There are municipalities in the Western Cape which serve as best practice cases within the province and nationally.
- There is multi-faceted deprivation (infra-structure, education, employment & environment) across the Province.
- Service delivery can be improved by implementing a model that is efficient and cost effective.
- The City is planning to tap the markets in 2007 to fund infrastructure.

- Integration of information systems through harmonising the co-ordination between different spheres of government and streamlining interventions.
- Resource allocation and distribution can be targeted to reflect both the potential and the developmental needs of regions targeted, using correct interventions to address the problem areas.

## 1. Introduction

Despite SA's successful record of macroeconomic stability as a result of prudent fiscal and monetary policies<sup>1</sup> the record of basic service delivery by local government remains a key challenge.

SA has in 2007, for the first time since the democratic government was elected in 1994, reported a budget surplus. This record is in stark contrast with the financial performance seen in the sphere of local government.

The magnitude of challenges facing the local sphere of government puts the country's structural problems into perspective. When disaggregated by locality, the challenges are more acute than seen through the national picture, and reveal the realities of poverty and inequality.

This scenario suggests that funding is not a problem for government, but it is rather the manifestation of inefficiencies and imbalances in planning, co-ordination and implementation. In particular, the inefficiencies limit the capacity of local government to spend capital budgets in order to facilitate the fast tracking of capital projects.

These problems are a reflection of missed opportunities to take advantage of the favourable environment at the macro level as well as the degree to which inefficiencies compromises service delivery.

In an attempt to unlock the reasons for non-delivery, this chapter explores some of the factors influencing the local sphere of government's ability to deliver. The Western Cape's first comprehensive Socio-Economic Profiles (SEP-LG) 2006 of the metropole, category B and category C<sup>2</sup> municipalities in the Province were aimed at adopting an evidence-based approach to service delivery.

The profiles juxtapose the uneven foundation of development, as shown by the Provincial Index of Multiple Deprivation, development indices and the utilisation of social and economic infrastructure. These indicators confirm the existence of multifaceted deprivation within the Province.

The developmental disparities are to some degree influenced by unfavourable indicators of socio-economic status within households, access to infrastructure, markets, internal staffing and systems, political and financial stability.

On a positive note, the profiles have begun to yield good results as they set a platform for debate around findings related to sector departments & service delivery plan within municipalities. The Department of Education has notably been pro-active and has engaged stakeholders on the findings to formulate appropriate responses to challenges, in concert with the Province's *iKapa Elihlumayo* lead strategies.

<sup>1</sup> Fiscal and monetary policies are determined at the national level of government.

<sup>2</sup> In SA municipalities are categorised as A, B and C. A Category A municipality is a metropole and a Category B municipality is a district municipality. A Category B is defined as a municipality that shares executive and legislative authority with a category C municipality within whose area they fall.

Going forward, efficiency-related issues should be targeted in a way that addresses service-delivery in areas that provide quicker payoff. At the same time it should be acknowledged that some challenges will take longer to address.

This chapter revisits some of SEP-LG 2006's high-level findings, and the evidence that financial sustainability is an important consideration and a pre-condition for service delivery and access to capital, where necessary.

Case studies are presented to illustrate the intra-district dynamics influencing various municipalities and some municipalities that have won national recognition as models for best practice in the Western Cape. These factors when combined influence quality of service delivery and ability to access alternative sources of funding.

## **2. The inter-relation of socio-economic findings**

This section highlights findings by district with a greater emphasis on indicators that influence quality of life and potential pressures on service delivery. The indicators of socio-economic well-being are inter-related and must therefore be contextualised and should not be read in isolation.

This approach assists in identifying the type of required interventions and the target areas for such interventions. For example, drug-related crimes might be linked to poverty and an ineffective education system, with major implications for the mental health system, social capital and investment.

Meanwhile, unfavourable education indicators suggest that the education programmes are ineffective, with adverse effects for social capital, skills, literacy and health in general.

Therefore, the indicators should be read mindful of the issues around the extent to which government programmes address issues of access, affordability and relevance of the education system to the needs of the economy and the community.

**Table 1: Social indicators by district, 2005**

Indicator	Cape Town	Cape Winelands	Central Karoo	Eden	Overberg	West Coast
<b>Health</b>						
Patient nurse ratio	54	32***	31	42	29	40
TB prevalence/100 000 people	N/A	1 113	1 014	1 133	1 142	1 214
TB cure rate	71%	66%	71%	78%	74%	73%
Births under 2,5 kg (%)	2,40%	18%	26%	26%	16%	16%
Under 1 with 1 <sup>st</sup> measles immunisation	83%	82%	80%	85%	75%	88%
HIV deaths (2010)	41 306	1 163	106		3 108	807
HIV prevalence rate (2010)	6,90%	4,70%	3,30%	4,60%	4,90%	4,30%
<b>Education</b>						
Educator learner ratio	39	38	36	40	37,00	37
People over 14 illiterate	15%	28%	37%	26%	27%	29%
Enrolment rate	96%	99%	87%***	98%	94%***	97%
Unemployment rate	29,2%					
	23,4% (2004)	18%	36%	27%	19%	14%

Source: SEP-LG, 2006

\*\*\* Although the healthcare workload is within acceptable benchmark in Cape Winelands, the outcomes as reflected in other health indicators suggests that the interventions are not yielding positive results. For education related issues, high illiteracy and unemployment rates are a problem. Low enrolment rates in schools suggests the need to intensify interventions in Central Karoo and Overberg.

Table 1 above shows health and education indicators by district. When read together, these indicators reflect the extent of development or under development by district using education and health-related indicators as proxy (see footnote). It is worth noting that these are not the latest indicators and might have changed since publication.

In Cape Winelands the workload of nurses is relatively low (32 patients to 1 nurse) compared to other.

## 2.1 Health indicators and access to health services

In 2005, the general trend of health indicators trend across the Western Cape was disappointing. Table 1 shows that tuberculosis (TB) cure rates for the City and the five districts were reported at levels well below the national target of 85 per cent.

Eden district had the most favourable TB cure rate at 78 per cent, while the City had the worst cure rate at 71 per cent. The TB cure rate in Overberg has since improved to 85 per cent (2006).

The provincial average for percentage of new-born babies (under 1 year old) with first measles immunisation is marginally below the national target of 90 per cent but the Overberg district has a figure of 75 per cent.

The workload in the health care system is generally high within the City, Eden and the West Coast districts. The high workload can be attributed to the burden of disease and the accessibility of facilities.

The City, Eden and the West Coast districts reported high patient nurse ratios of 54:1, 42.1, and 40:1, respectively. These compare unfavourably with the national target of 34:1.

Although the statistics are useful in highlighting where the pressures are, they conceal issues such as the efficiency of nurses, compliance of patients with the treatment programmes and accessibility of healthcare facilities.

## **2.2 Access to education and the employment link**

Education is a primary influence in shaping the size and quality of skills available to support economic activity in an area. In addition, policy-(political and economic) related influences such as accessibility, relevance of the curriculum and affordability determine the availability of skills.

Table 1 also shows that illiteracy rates reported in the districts are relatively high when compared to that of 15 per cent reported for the City. Comparisons can be made between the shortage of schools, illiteracy rates and the eventual unemployment rates for the specific districts.

In particular, a strong correlation exists between the illiteracy levels and the unemployment rate. High levels of illiteracy are found in predominantly rural areas. The illiteracy levels are particularly high for the Central Karoo (37%), Cape Winelands (28%), Eden (26%), Overberg (27%) and West Coast (29%).

Central Karoo has the highest need for the Department of Education to deepen interventions that encourage a culture of learning to address problems related to unemployment and illiteracy. It had the most unfavourable indicators with regard to unemployment, illiteracy and school enrolment rates. According to Census 2001 the unemployment rate was the highest (36%), the illiteracy rate, with 37 per cent of the population over 14 illiterate, was the highest and enrolment rate (87%) was the lowest.

The recent engagements with the Western Cape Department of Education and stakeholders (local government, Further Education and Training (FET) institutions and adult basic education and training (ABET) providers) revealed that the ABET centres were not used as effectively as possible.

At the same time the FET representatives expressed concerns about the co-ordination and communication of FET programmes in order to ensure that the FET curriculum is relevant for different regions and needs of district economies.

There is a strong link between education and skills development. It is therefore important that employment creation initiatives take into consideration the fundamental importance of education in unlocking the socio-economic potential of local economies. There is a strong need to strengthen ties with the private sector and the sector education training authorities (SETAs) on board.

### 3. Economic infrastructure

Economic infrastructure is a key factor in economic growth performance, whether at the national, regional or local level.

At a regional level, the rate of economic growth is generally premised on:

- Regional economic infrastructure;
- Inward investment;
- Labour intensity and productivity amongst regional industries;
- Income earning potential of residents;
- Possession of tangible assets, the ability of the region to retain and/or circulate the income earned within the region; and
- The ability to retain, increase and attract the skills base.

All these factors, amongst others, when combined determine the speed of growth and development. Within the growth framework, the role of government is to create an enabling environment to support the efforts of other economic agents.

At the local level, investment in transport, housing, water and electricity-reticulation infrastructure, sanitation and refuse-removal facilities, as well as municipal roads, pavements, bridges and storm-water drains are critical to advancing economic development.

Municipalities generally face a problem of ageing economic infrastructure coupled with bulk infrastructure backlogs. Chronic shortages were notably reported in the City. This is of great concern as the City accounts for 72 per cent of the Province's municipal budgets and the fact that, in 2004, approximately 76,5 per cent of Western Cape's economic activity was within the City. Furthermore, 65 per cent of the Western Cape population resides in the City. If left unattended, the infrastructure-related problems have the potential to hold growth plans hostage.

### **Strategic Focus Area: Sustainable Urban Infrastructure and Services, City of Cape Town**

The City of Cape Town has, in light of the widespread infrastructure backlogs, unveiled an Integrated Development Plan (IDP) that addresses these concerns, focusing on universal access to basic services, conservation of natural resources and effective management of the City's infrastructure and resources.

#### **Universal access to basic services**

- Reduce backlogs in line with national objectives for basic services.
- Large or bulk infrastructure programmes that are essential must receive priority.

#### **Conservation of natural resources**

- Develop demand management programmes for water, electricity, waste and transport and reduce attendant pollutants.
- Conserve biodiversity and improve quality living environments through greening, education and access.
- Reduce impact of flooding on community livelihoods and regional economies.

#### **Effective management of the City's infrastructure and resources**

- Develop an 'integrated programme' approach to infrastructure and service planning and budgeting.
- Safeguard human health, protect natural aquatic environments, and improve and maintain recreational water quality.

*Source: City of Cape Town IDP 2007 – 2008, draft 2.3 to Council*

## **3.1 Transport infrastructure**

Transport infrastructure – road networks, airports, harbours, etc. – play an important role in facilitating economic growth. The road networks in the Western Cape are continuously upgraded and there is a comprehensive network of primary (tarred) and secondary (gravel) roads.

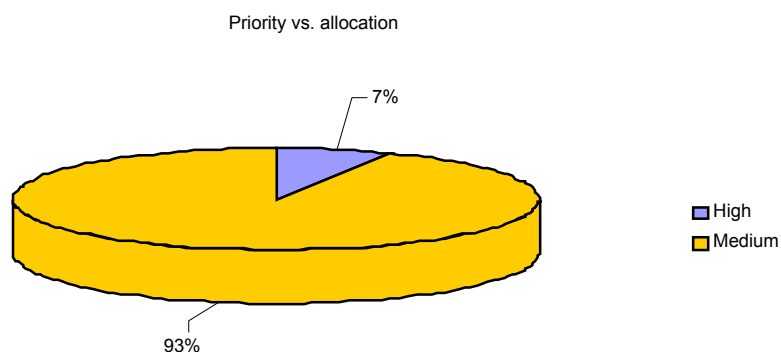
More frequent maintenance is required on the gravel roads in order to improve the connectivity of the region's economic network. In addition, SEP-LG 2006 highlighted that rural areas are under serviced and that there are areas that need interventions to improve market access and reduce the cost of doing business for farmers. The expanded public works program (EPWP) in roads maintenance play an important role not only for poverty reduction program, but also for long term viability to maintain roads in rural areas.

The Strategic Infrastructure Plan (SIP) estimates that between 2006 and 2009, the Province will invest R17,6 billion of capital expenditure on road infrastructure. However, the allocation of funds and timing does not reflect the priority given to the projects and risk consideration.

Approximately 92 per cent of the total allocation is allocated to a single project (which the department of transport and public works classified as a medium priority project) over a period of one year which makes the project prone to concentration risk.



**Figure 1: Provincial roads projects: 2006 – 2009**



*Source: Western Cape Provincial Treasury, adapted from the Western Cape Strategic Infrastructure Plan*

The lack of efficient public transport services in the region is a major problem, particularly given the extremely dispersed settlement pattern. An efficient public transport system ensures that the amount of time people spend travelling is minimised. At a strategic level, the safety of the public transport system needs monitoring given its impacts on other department's service delivery obligations.

### **City's public transport plan**

Improve public transport system and services

- Improve public transport services and secure new investment in infrastructure.
- Promote use of public transport. Creation of a unified road-based public transport system utilising the optimum mode for a particular route/corridor. Promote use of public transport to access all facilities and services and reduce the need to use private cars.
- Reduce demand for travel and create conditions for all day public transport services.
- Integration of land use and transport.
- Ensure that freight moves efficiently and safely within the City.
- Develop and implement a transport asset management plan for the City.

*Source: City of Cape Town IDP 2007 – 2008, draft 2.3 to Council*

The infrastructure-led growth in provinces is mainly driven by activities in the built environment. The transport sector has received a major boost as a result of the preparations for the 2010 FIFA World Cup.

In a context of a growing economy, those provinces with large transport network (road, rail, air and ports) need to work closer with the state owned enterprises to influence the planning and executing infrastructure delivery.

## 3.2 Water

Water availability is a contentious issue within the Western Cape region especially in major towns. The availability of water is also linked to the bulk infrastructure issues.

A strong emphasis is placed on water infrastructure development in the major towns. Water network upgrading is in progress in some areas with the construction of reservoirs and upgrading of water pipes.

In the area of bulk infrastructure, sanitation and pipe blockages are a persistent problem. Many households in the Western Cape do not have access to water-borne sanitation. The City has stopped approving new plans in certain areas as a result of bulk infrastructure backlogs.

## 3.3 Energy

Recently, the energy crisis in the region has hindered economic activity and created problems in households as well as in leisure and daily living activities. It also added to the challenges of doing business in the Western Cape. Alternative sources of energy such as solar panels are being considered.

The greatest need for electricity exists with farm worker houses and a policy decision is required on whether farmers, Eskom or the district municipalities are responsible for providing electricity to farm workers.

### RED 1: Recent developments

In 1997, the national Cabinet approved the restructuring of the electricity distribution industry to a model of Regional Distributors (REDs). The REDs are aimed at fast tracking access to electricity to all of SA's households, while providing low-cost, reliable and quality electricity with equitable tariffs to all.

The Regional Distribution One (RED1) is one of six REDs, which form part of Government's restructuring of the Electricity Distribution Industry (EDI).

The Cape Town based RED1 was launched in July 2005 and includes 40 municipalities, sixteen district councils and the metropolitan area of Cape Town. However, some players contested the establishment of the REDs.

Municipalities feel that the REDs will have a negative effect on their revenues as they generate most of their income from electricity distribution. In the operating revenue estimate for 2007/08 for the City of Cape Town, electricity accounts for 19,1 per cent of the revenue.

In the latest developments, the National Energy Regulator of South Africa (NERSA) declined the application from RED1 for the extension of its license period that terminated on 31 December 2006. The previous RED1 license was issued subject to conditions, which currently have not been satisfied. These conditions comprise the following:

- All electricity customers, assets and staff belonging to the City of Cape Town are transferred to RED1.
- All non-contestable electricity customers, assets and staff belonging to the Eskom distribution business in the RED1 end-state-area are transferred to RED1.

- All electricity customers, assets and staff belonging to the majority of the remaining municipalities in the RED1 end-state-area to be transferred to RED or Service Delivery Agreement (SDA) be concluded with RED1.

Consequently the board of RED1 has placed the entity under voluntary liquidation. NERSA issued to the City of Cape Town the electricity distribution and supply license for a term of six months commencing from 1 January 2007. One of the reasons for the decision by NERSA was that the City of Cape Town indicated unequivocally that it would not renew any new agreements. The reason for this is that Cabinet amended the original conditions on 25 October 2006 to state that REDs would be a public entity and not a municipal entity. As a result, the City of Cape Town will have to reapply to NERSA to extend its license at the end of June 2007.

Concurrently, the national Government has commenced the development of the enabling legislation to smooth the process of implementation of six REDs as public entities as recognised by Cabinet on 25 October 2006. According to EDI Holdings, the country is losing between R2,6 billion and R8 billion a year because of inefficiencies in the current fragmented electricity distribution.

### 3.4 Housing

Housing is one of the problem areas for the Western Cape. Housing backlogs are widespread throughout the Province. Most of the backlogs are in the City with a shortfall of housing unit of about 300 thousand, followed by the Cape Winelands and Eden Districts.

Affordability and location are the major problems facing the black middle class that has been driving SA's economy. Buying a house in the Western Cape, especially Cape Town is expensive compared to elsewhere in the country. A large proportion of black people remain inadequately housed with consequent negative impact on the burden of diseases, crime and social capital.

**Table 2: Estimated housing backlogs, 2007**

Metropole/district	Housing units
City of Cape Town	300 100
Cape Winelands	38 522
Eden	35 380
West Coast	15 876
Overberg	17 427
Central Karoo	2 522
<b>Total</b>	<b>409 827</b>

*Source: Western Cape Department of Local Government and Housing, 2007*

On the supply side, the most cited problems are lack of land for development of housing projects and lack of skills. This leads to a slower pace in providing bulk infrastructure for new developments. The greatest supply side problem in the construction sector is actually capacity constraints. In other words, there is a shortage of formally recognised skills and huge demand in the industry along with anomalously large inflation cost of building materials. The situation, in turn, exacerbates the budgetary constraints for government.

The Western Cape compares unfavourably with the rest of SA in the delivery of low cost housing. The rate of delivery of the subsidised low cost housing in 2005/06 was far below the national average of 15 295 units, making the Province an outlier on the national scale.

**Table 3: Subsidised low-cost dwelling-houses completed by Province: 2005/06**

Province	Number <sup>1</sup>	Square metres <sup>2</sup>	Value (R'000) <sup>2</sup>
Western Cape	2 040	61 200	52 877
Eastern Cape	16 874	506 220	437 374
Northern Cape	5 293	158 790	137 195
Free State	17 635	529 050	457 099
KwaZulu-Natal	21 601	648 030	559 898
North West	14 445	433 350	374 414
Gauteng	23 409	702 270	606 761
Mpumalanga	14 389	431 670	372 963
Limpopo	21 973	659 190	569 540
<b>SA</b>	<b>137 659</b>	<b>4 129 770</b>	<b>3 568 121</b>

Source: Statistics SA

Notes: <sup>1</sup> Units completed during the financial year, 1 April 2005 to 31 March 2006

<sup>2</sup> Estimates by the National Department of Housing

## 4. Economic performance

The City of Cape Town forms the Province's main economic growth engine contributing 76,5 per cent of the Western Cape's GDP in 2004. Two economic growth nodes flank the City: the Saldanha-Vredenburg node to the west and the South Cape to the east.

Table 4 below presents the City and district contribution to Provincial GDP in 2004, illustrating key economic contributions from the City (76,5%), Cape Winelands (10,5%) and Eden (6,2%) districts. In contrast, municipalities with a more rural and agricultural bias struggled to grow.

**Table 4: City and district GDP contribution, 2004**

Region	Share of WC (%)	Share of SA (%)
Central Karoo	0,50	0,07
Overberg	2,37	0,35
West Coast	4,00	0,58
Eden	6,5	0,90
Cape Winelands	10,49	1,54
City of Cape Town	76,49	11,19
<b>Western Cape</b>	<b>100,00</b>	<b>14,63</b>

Source: Western Cape Provincial Treasury calculations based on Quantec Research, 2007

Furthermore, in addition to economic resources, to become a top performing municipality sound leadership is a required.

In the period 1995 to 2004, the Western Cape economy grew at an average rate of 3,5 per cent a year, marginally higher than the average for SA over the same period (see Table 5 below). The Western Cape's growth rate has increased, and is expected to remain steady.

**Table 5: Selected regional growth rates, 1995 – 2004**

Region	Average annual growth rate, 1995 – 2004 (%)	Growth rate, 2003 – 2004 (%)
Central Karoo	4,23	5,26
Overberg	2,58	4,26
West Coast	2,38	4,33
Eden	3,34	5,38
Cape Winelands	2,87	5,06
City of Cape Town	3,73	5,38
<b>Western Cape</b>	<b>3,53</b>	<b>5,27</b>
<b>SA</b>	<b>3,13</b>	<b>4,43</b>

*Source: Western Cape Provincial Treasury calculations based on Quantec Research, 2007*

The fastest growing region within the Western Cape for the period 1995 to 2004 was the Central Karoo (albeit off a low base), followed by the City of Cape Town. The interpretation of the growth rates in the Central Karoo should be treated with caution given its relative size compared to other districts in the Province. Despite its faster growth rate, Central Karoo remains the poorest district.

In 2004, the main sectors driving robust provincial economic performance were construction (4,5%), financial & business services (5,3%), wholesale & retail trade (9,7%), and transport & communication (5,2%).

Table 6 disaggregates the sectoral contribution of the City and the districts to the Province's GDP. The City plays a dominant role in the Province's economic activity with all sectors accounting for more than 55 per cent, with the exception of agriculture (23%).

The Cape Winelands district is the largest contributor to the Province's agriculture forestry & fishing sector, accounting for 33,9 per cent of the agricultural output, followed by the City at 27,2 per cent. The contribution from the construction sector is significant in Eden, contributing 10,3 per cent to the Province.

**Table 6: City and district sectoral contributions to Western Cape GDP, 2004**

Sectors	Central Karoo %	Overberg %	West Coast %	Eden District %	Cape Winelands %	City of Cape Town %
Agriculture, forestry & fishing	1,2	11,0	17,1	9,6	33,9	27,2
Mining	0,2	0,7	18,5	13,5	10,4	56,8
Manufacturing	0,2	2,0	4,5	5,6	12,7	75,0
Electricity & water	0,4	2,5	4,1	11,5	3,4	78,1
Construction	0,7	3,5	4,4	10,3	9,3	71,8
Wholesale & retail trade; catering & accommodation	0,5	2,6	3,8	6,8	9,3	77,1
Transport & communication	1,0	1,6	3,4	4,8	7,7	81,5
Financial & business services	0,3	1,2	1,9	4,8	7,4	84,4
CSP services	0,5	2,7	4,5	6,3	9,3	76,6
General government services	0,6	2,3	3,7	7,2	12,1	74,2
<b>Overall contribution to Western Cape GDP</b>	<b>0,5</b>	<b>2,4</b>	<b>4,0</b>	<b>6,2</b>	<b>10,5</b>	<b>76,5</b>

Source: Western Cape Provincial Treasury calculations based on Quantec Research, 2007

## 5. Municipal sustainability

Changes in political governance disrupt the implementation of strategies and programmes as political parties further party specific strategies. This was evident in a number of municipalities across the Western Cape during the period although the major changes were in specific local municipalities where some parties lost ward seats to others. Thus the continuity of governance and policy-making processes were not compromised.

Internal capacity in relation to staff appears to be healthy when assessed at a district level. However, the staffing situation within individual municipalities is less satisfactory with a strong correlation existing between staff shortages and problem in basic service delivery.

The City is an example of this correlation with less than 90 per cent of its posts filled. Staffing problems within the City are concentrated in critical areas such as engineering, fire fighting and finance. The impact of a protracted restructuring and realignment process within the organisational structure of the City of Cape Town has also had a negative effect on human resources and service delivery.

In 2005, the Cape Winelands district had four local municipalities (Witzenberg, Breede Valley, Drakenstein and the Cape Winelands District Municipality) that had vacancy rates of less than 75 per cent. The Central Karoo had filled almost all of their vacancies.

## 6. Fiscal landscape and financial sustainability

Understanding the fiscal landscape and the limitations to financial sustainability is key to unlocking the resources of municipalities. In addition to the fiscal landscape, efficiency gains can be realised through internal controls, information management and innovative models of service delivery that encourage local responses directed at maximising the impact of service delivery.

The fiscal landscape and financial sustainability are some of the key considerations in determining the speed of service delivery in municipalities, assuming no skills constraint exists.

The size of the budget and the efficient execution of budget plans are important levers for accelerated development. Table 7 below compares the size and composition of SA's municipal budgets.

The Western Cape has the second largest municipal budget (R21,6 billion) after Gauteng (R41,2 billion). The average budget size for Western Cape municipalities is estimated at R699<sup>3</sup> million with the bulk (72%) of the budget concentrated within the City.

Category B and Category C municipalities account for 24 and 4 per cent respectively of the overall provincial municipal budget. In other words, the overall budget of the City amounted to R15,6 billion and the Category B and Category C municipalities received R5,2 billion and R866 million respectively.

Municipalities drive the developmental agenda of the country. The size of the budget should therefore be linked to its execution. More is needed to test the alignment of the municipal budgets and expenditure to national priorities.

<sup>3</sup> The figure includes the budget of the Metro

**Table 7: Budget size by province and municipality category, 2005/06**

Province	Overall Budget R million	Average budget size per municipality R million	Category A %	Category B %	Category C %
Eastern Cape	10 780	234	34	46	20
Free State	5 480	219	0	94	6
Gauteng	41 230	2425	90	9	1
KwaZulu-Natal	20 433	330	59	30	11
Limpopo	5 828	194	0	67	33
Mpumalanga	5 395	257	0	83	17
Northern Cape	2 314	72	0	84	16
North West	6 513	261	0	86	14
Western Cape	21 670	699	72	24	4
<b>Total</b>	<b>119 642</b>	<b>521</b>	<b>57</b>	<b>34</b>	<b>9</b>

Source: National Treasury 2007

## 6.1 Municipal revenue sources

Municipalities source revenue mainly from:

- Intergovernmental transfers – local equitable share and conditional grants from national and provincial government;
- Own source of revenue (property taxes, water, electricity, sanitation, refuse removal and other sources);
- Donor funding – though not on a large scale; and
- Borrowing (excluding recurrent deficits).

### 6.1.1 Intergovernmental transfers

According to section 214 of the Public Finance Management Act (PFMA), the size of the equitable share to a sphere is based on expenditure (service delivery) responsibilities, and fiscal capacity and efficiency. In addition to intergovernmental transfers, municipalities are expected to raise revenues on their own and borrow on the strength of their balance sheets to supplement transfers.

#### The local government 'equitable share'

The local government equitable share (LES) was introduced in 1998. It is the lump sum transfer made to local government, among a system of transfers, by national government. Local government is also able to generate its own revenue, which is an additional revenue stream.

The Division of Revenue Act governs the Local Government Equitable Share, and allocations are made by national government in terms of a complex range of considerations.

Source: Institute for Security Studies, 2007



### 6.1.2 Own revenue

Findings from SEP-LG 2006 highlighted the degree to which various municipalities are able to raise revenue. The main determinants of the municipalities' ability to raise revenue are wealth and poverty patterns amongst the populations. Wealth and poverty amongst municipalities are assessed on the basis of geographic location, the level of economic activity, income levels and access to social and economic infrastructure.

Wealthier areas tend to be in good geographical locations that attract investment (e.g. infrastructure) and in turn influences economic activity which then informs the socio-economic status of households.

As far as the fiscal landscape is concerned, the SEP-LG 2006 found that municipalities continue to face an array of mounting challenges. Apart from poverty-induced revenue constraints, some challenges are largely associated with the combination of inefficient/ineffective debt collection, internal capacity (personnel and billing system), diminishing revenue due to legislative changes (abolition of the Regional Services Council (RSC) levy in 2005 and the proposed introduction of RED1) and limited use of external borrowing. It is not clear whether the equitable share sufficiently compensates municipalities for loss of revenue and whether the REDs would do so as well.

These factors collectively affect the fiscal landscape and have a strong influence on municipalities' fiscal sustainability and could undermine the distributional goals of service delivery.

Charges for electricity and water are also important sources of finance. Of the 30 municipalities of the Western Cape, 22 municipalities collect at least 35 per cent of their own revenue from electricity. Revenue generation and collection varies across districts and municipalities alike. The number of municipalities reflecting revenue receipts above the notional benchmark for February 2007 has also increased.

Of the 30 municipalities, 21 (70%) reflected year-to-date (YTD) figures above the 66,7 per cent benchmark (for the first eight months) as compared to January 2007, when 19 out of the 30 municipalities (63,3%) reflected YTD figures above the notional benchmark of 58,3 per cent (for the first seven months).

Only two municipalities have collected less than 50 per cent of their budgeted operating revenue namely: Kannaland (39%) and Drakenstein (49,3%).

### **Vuna Awards: Rewarding service excellence in municipalities**

In December 2006, Overstrand Municipality received a financial boost totalling R3 million from the national Vuna Awards, in recognition of their performance in areas of governance and financial management. It was the country's best category B municipality for the financial year ended 2004/05.

The Vuna Award is a national competition, which recognises and rewards excellent municipal performance. The following five key performance areas are used to assess municipalities:

- Infrastructure development and service delivery;
- Local economic development;
- Municipal transformation and institutional development;
- Financial viability; and
- Good governance.

The Vuna Award aims to cultivate a culture of performance and productivity in South African local government. The improvement in the performance of municipalities is measured and the top three in each province are short listed for the annual ministerial awards.

Overstrand municipality was nominated alongside Swartland and Breede River/Winelands municipalities to represent the Western Cape for the competition.

Overstrand also received a favourable assessment from the Provincial Treasury's SEP-LG 2006.

"Overstrand's financial health is commendable, with marked improvement in the recovery of bad debt. It is more reliant on own-revenue resources rather than government grants" *Socio Economic Profile: Overberg District page 61.*

*Source: National Department of Provincial and Local Government, Development Bank of Southern Africa*

### **6.1.3 Borrowing**

Borrowing is another source of funding for municipalities. Municipalities can borrow using various funding instruments, ranging from project finance, short-term or long-term loans using either marketable or non-marketable debt to fund infrastructure projects.

The choice of funding instruments amongst municipalities differs, some motivated by extent of required disclosure, costs, flexibility and relative complexity of sourcing funds.

Traditionally, the objectives of accessing the municipal bond market, amongst others, include:

- Improve credit worthiness
- Diversify funding instruments
- Build liquid benchmarks
- Reduce debt-service costs
- Increase investor base and encourage regional investment flows
- Benchmark opportunities amongst municipalities
- Build price tension in the municipal bond market.

SA's municipal debt market has been depressed — until the City of Johannesburg's first issuance in 2004 — and remains largely untapped, despite the deep and liquid capital market that is of world standard. For borrowers to access the bond market, a credit rating is a prerequisite.

In the Western Cape there seems to be a weak appetite for long-term municipal debt, especially listed securities. Although municipalities are assessed from time to time, only three municipalities – the City, George and Breede Valley local municipalities – are assigned ratings by CA Ratings<sup>4</sup>.

The City is planning to tap the markets in 2007 to fund infrastructure. In the context of the growing need to accelerate economic growth and infrastructure backlogs, having all municipalities rated can be a valuable exercise to gauge their credit worthiness and investor sentiment.

### Case study: The SA Municipal Bond Market — City of Johannesburg leads the way

The City of Johannesburg has emerged as one of the pioneers in reviving SA's listed municipal bond market to become the benchmark issuer in this tier of securities. The City of Johannesburg has built liquid benchmarks and they have four bonds listed on the Bond Exchange.

Their investment story began in 2002 when the Egoli 2002 team pioneered a financial sustainability benchmarking exercise by approaching international credit rating agencies. The evolution of the City of Johannesburg investment story is reflected in its ratings. Since their first rating in 2002 the ratings reflect a significant turnaround in credit worthiness and ability to service debt. In 2002, Fitch Ratings assigned the City of Johannesburg an investment grade rating of BBB+ in the long-term, which was upgraded to A- in 2003, and that rating was affirmed in 2004.

#### City of Johannesburg ratings history: 2002 – 2004

Year	Rating		Agency
	Short-term	Long-term	
2002	F2+	BBB+	Fitch Ratings
2003	F2+	A-	Fitch Ratings
2004	F2+	A-	Fitch Ratings
2004	ZaA2	ZaA	CA-Ratings

The benefits of the improved credit story are evident in the spreads at which the Municipality borrowed and the gradual reduction in its coupon rate. Another way of gauging the success of the issuance is the over subscription and the secondary market performance. There is evidence of growing appetite for the City of Johannesburg's paper.

#### City of Johannesburg bonds: 2004 – 2006

Stock Code	Issue Date	Amount	Coupon	Maturity	Issue Spread	Spread (22/05/2007)
COJ01	13 April 2004	R1bn	11.95%	13 April 2010	230 bps	90 bps
COJ02	30 June 2004	R1bn	11.9%	15 September 2016	164 bps	120 bps
COJ03	26 April 2005	R700m	9.7%	26 April 2013	154 bps	100 bps
COJ04	05 June 2006	R1.2 bn	9%	5 June 2018	120 bps	103 bps

The first bond issued (COJ 01) was 1,5 times over-subscribed and the second bond was 2,3 times over-subscribed. The spreads also continued to tighten, signalling the market conditions and to some extent the improved credit quality. The City of Johannesburg's 01 bond was issued at a spread of 230 basis points above the Government R153 bond. As at 22 May 2007 the spread was quoted at 90 basis points (bps). A spread is the difference between the underlying instruments and the benchmark bond of similar maturity. A tighter spread implies the narrowing gap between the COJ bond and the government bond while the wider spread is the opposite.

<sup>4</sup> CA Ratings (where 'CA' is drawn from the 'Chartered Accountant' profession) has been acquired by Moody's Investor Service. CA Ratings for municipalities are currently being converted to Moody's Ratings.

## 6.2 Financial sustainability

Financial sustainability is an important consideration in assessing municipalities' ability to access capital and service delivery. Financial stability refers to the extent to which the municipalities enjoy healthy long-term financial performance in such a way that long-term service delivery, new infrastructure and maintenance plans are financed comfortably without resorting to drastic hikes in rates and deterioration of service delivery.

In other words, for the municipality to be on a sustainable path, current economic and consumption patterns should not reduce opportunities for future generations by impairing or depleting existing resources (financial and environmental).

The municipalities' financial sustainability is measured by a matrix of indicators focused on financial issues (both revenue and expenditure), operating, and debt indicators. All these indicators have a series of subsets, which, when analysed together with the economic consideration of municipalities, inform the municipalities' ability to deliver and source funding from external loans.

### 6.2.1 Municipal assessments

Independent assessments on municipalities' financial standing are also important sources of financial disclosure used to assist prospective investors and lenders in making decisions. Such reports also complement the Provincial Treasury's oversight role. These include audit reports and rating reports from credit rating agencies.

The recent audit report of 27<sup>5</sup> out of 30 municipalities in the Province, found that the majority (55%) of the municipalities' annual financial statements for 2005/06 were qualified, 33 per cent unqualified with emphasis of matter, 8 per cent with adverse opinion and 4 per cent with disclaimer of opinion.

Most of the municipalities with unqualified annual financial statements with 'emphasis of matter' are medium to low capacity municipalities and only one high capacity municipality fell in this category.

In line with the SEP LG 2006 the 2005/06 audit report also emphasised weak debtors control as one of the areas that requires urgent corrective action. Other areas mentioned were non-compliance with the laws and regulation, supply chain management related issues, internal control weaknesses, asset management and financial statement items.

In the Western Cape, most Project Consolidate municipalities have a large rural component. The ability of some of these municipalities to fast track service delivery is undermined by exposure to external loans, thus diverting funds away from service delivery towards servicing debt. Cederberg, Witzenberg, Matzikama and Kannaland municipalities have the largest rural component.

<sup>5</sup> The District Management Areas report to the district municipalities and are not considered.

Since 2004 Witzenberg and Kannaland were two municipalities with severe cash flow problems. Kannaland's revenue growth is compromised by high interest payments (18,5% a year) for external loans with the Development Bank of Southern Africa (DBSA).

Kannaland spends about R2 million on debt service costs<sup>6</sup>. In Witzenburg, external loans constitute 16,7 per cent of capital funding, reflecting an increase of 48,3 per cent from 2006/07 to 2007/08.

**Table 8: Western Cape project consolidate municipalities, 2007<sup>7</sup>**

Municipality	Urban: rural split (%)
<b>Cape Town (Khayelitsha &amp; Mitchells Plain)</b>	N/A
<b>West Coast District Municipality (DMA area)</b>	<b>69,9 : 30,1</b>
Matzikama	60,7:39,3
Cederberg	48,8:51,2
<b>Cape Winelands District</b>	70,3:29,7
Witzenberg	58,5:41,6
<b>Overberg District</b>	75,7:24,2
Theewaterskloof	64,2:35,8
<b>Eden District</b>	79,8:20,2
Kannaland	38,9:61,1
<b>Central Karoo District (DMA: Murraysburg)</b>	<b>75,0:25,0</b>
Laingsburg	6,3,0:37,0
Beaufort West	82,0:18,0
Prince Albert	65,0:35,0

*Source: Western Cape Department of Local Government and Housing, Demarcation Board*

<sup>6</sup> Kannaland's financial statements were qualified due to the misallocation of R1,7 million worth of interest payment. The municipality included the amount to the trust fund instead of interest.

<sup>7</sup> Project Consolidate Municipalities are those identified to be in greater need of hands on support. The project is aimed at strengthening the performance of municipalities through support systems focusing on capacity building, economic development to support service delivery in the targeted municipalities. Only the district municipalities are not Project Consolidate municipalities.

## 7. Responding to socio-economic challenges

It is evident from the SEP-LG 2006 analysis that an urgent response to socio-economic challenges is critical. Failure to do so will undermine Government's socio-economic policies and strategic objectives, such as the Western Cape's *iKapa Elihlumayo*.

The skills and human resources issues in municipalities are the most fundamental issues that need urgent attention. With such skills in place, it will be easier to implement policy priorities that are evidence-based to ensure that the distribution of resources is equitable.

Whilst not decrying the benefits of promoting areas with greatest potential, strategies that are silent about the plight of the marginalised or under developed areas are harmful. This is as a result of overlooking issues that are potential causes of conflict (e.g. migration) that are constantly cited as sources of pressure for service delivery.

## 8. Information management

The benefits of good information gathering and dissemination are enormous for policy makers. However, it is not only the availability of information that is beneficial, but also understanding the implications of the data and formulating policy responses.

In the absence of harmonised information management systems, SEP-LG 2006 bridges the information gap by consolidating disparate information from different management systems, such as the Education Management Information System (EMIS) and Health Management Information System (HMIS) to reduce the extent of isolated policy responses.

SEP-LG 2006 revealed that there are regional imbalances in the developmental trajectory within the Province, suggesting the need to devise local solutions given the unique and complex nature of problems facing various municipalities.

## 9. Resource allocation

Municipalities provide several of the most crucial services to households and businesses – water, sanitation, storm water drainage, roads and electricity. Resource allocation (financial and non-financial) therefore needs to intentionally influence the quality of service delivery and the access of basic services to the under serviced areas to maximise the impact of service delivery.

The findings of the SEP-LG 2006 support the need for a targeted allocation of resources given the inequitable allocation of resources. Resource allocation and distribution can be targeted to reflect both the potential and the developmental needs of regions targeted, using correct interventions to address the problem areas (e.g. literacy, accessibility and relevance of curriculum to influence the skills need).

In addition to strategies, empirical evidence suggests that the ownership and customised interventions tend to be sustainable. The model of a successful approach to service delivery is underpinned by strategies that are based on a methodology that addresses issues of gender, age, location and social standing.

## 10. Conclusion

The rate of service delivery within the local sphere of government is the most important link for SA's regional development. The outcome of the 2006 national Budget suggests that financial resources are not a major problem in the improvement of service delivery at the local sphere of government.

The problems encountered are a reflection of lack of efficiency, innovation and capacity (staffing, systems and other exogenous issues) to enhance service delivery.

Financial sustainability, however, remains one of the significant influences on municipal performance. The path to the "ideal" route to development has been marred by structural challenges that manifest in "missed" opportunities for economic development and growth. These deficiencies also make it a mammoth task for policy makers to craft effective strategies timeously.

Although the fiscal landscape has changed, interventions do not necessarily imply that financial injection is always a solution. Instead, identifying opportunities and efficiency gains through local solutions can result in positive spin offs.

This can be achieved through building business/'government' intelligence from the wide range of available data. Despite the data availability and concerted efforts to deepen compliance, monitoring and evaluation tools currently in place have not improved outcomes.

One of the main challenges in accelerating an effective model of service delivery is the lack of harmonised co-ordination between the different spheres of government and streamlining of interventions. In the Western Cape, information management systems are stand-alone tools within departments and have not been utilised in a way that assists clusters within government.

The disintegrated fashion of service delivery from time to time lends itself to bottlenecks and unnecessary inefficiencies. Empirical evidence suggests that debt collection is an area of weakness among municipalities. This area of weakness means that municipalities forego revenue that could have otherwise been used for service delivery.

There is also room to access under utilised sources of funding (borrowing and donor finance). Relatively poor municipalities are limited by their capacity to access these sources of funding.