Ratings Afrika

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GOVERNMENT'S R51 BILLION MUNICIPAL CASH PROBLEM

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1. Introduction

Ratings Afrika has published its annual Municipal Financial Sustainability Index (MFSI™) for the financial results of the 105 largest local municipalities plus the 8 metros in South Africa. The analyses are based on the fiscal year ending in June 2020.

The MFSI™ is a scoring model that evaluates six financial components, namely the operating performance, liquidity management, debt governance, budget practices, affordability and infrastructure development of a municipality; and scores these components out of 100.

The MFSI™ is furthermore a numerical expression of Ratings Afrika's definition of financial sustainability stated as: "The financial ability of a municipality to deliver services, develop and maintain the infrastructure required by its residents without unplanned increases in rates and tariffs or a reduction in the level of services. Additionally, the municipality should have the capacity to absorb financial shocks caused by natural, economic, political and other adversities without external financial assistance."

2. Financial results

The results of the latest MFSI™ once again confirms the disastrous trend Ratings Afrika has warned about since 2011. The South African municipal sector is in a financial mess, and it is time for the Government to acknowledge it and start taking the necessary steps to save the country from disaster. Residents and businesses are suffering from poor service delivery and economic growth is jeopardised by the inability to maintain and develop infrastructure. Government needs to realise in more practical terms that well-run, efficient municipalities that provide high quality services to its residents and support local businesses, are the underpin to economic growth and prosperity of the country.

Since Ratings Afrika published its first MFSI™ in 2011, the financial sustainability of the South African municipal sector has deteriorated dramatically. The only exception is most of the municipalities in the Western Cape.

The two key forces that drive a municipality's financial sustainability are the generation of operating surpluses and positive working capital (liquidity or cash) balances. However through gross financial mismanagement and lack of corporate governance the majority of the South African municipalities are still operating at deficits. For fiscal 2020, the aggregate operating deficits for the 113 municipalities included in our index amount to R26,8 billion. These losses have over time culminated in huge working capital (liquidity) shortfalls for most of them. As reflected in Table 1 the aggregate cash or liquidity shortfall is now a staggering **R50,7 billion** - up from R32,9 billion in 2019. It is no wonder that services are breaking down in most municipalities and that infrastructure is crumbling at a pace unheard of. South Africa faces a calamity of major proportions if this lack of sustainability is not dealt with effectively and as a matter of urgency. The following table shows a summary of the operating performance and working capital or cash positions of the indexed municipalities:

Financial results 2020					
	Operating surpluses	**Operating deficits**	**Working capital surpluses**	**Working capital shortfalls**	**Collection rate (ave.)**
Local municipalities	**Rm**	**Rm**	**Rm**	**Rm**	**%**
Eastern Cape	27	1 093	386	2 002	85,3
Free State	-	2 920	-	10 313	70,0
Gauteng	265	2 023	297	6 027	79,0
KwaZulu-Natal	127	1 519	1 555	956	87,6
Limpopo	142	806	255	1 609	71,3
Mpumalanga	-	4 052	631	12 657	76,1
Northern Cape	-	167	-	771	92,2
North West	-	2 221	67	4 483	65,5
Western Cape	384	349	4 034	411	93,2
Total - local municipalities	**945**	**15 150**	**7 225**	**39 229**	**82,1**
Total - metro municipalities	**3 614**	**11 615**	**16 055**	**11 479**	**85,4**
Total 113 municipalities	**4 559**	**26 765**	**28 280**	**50 708**	**82,3**

Table 1

The practical reality of the liquidity shortfalls is that these municipalities do not have the working capital or funds available to deliver services or pay their service providers such as ESKOM, the water utilities and other creditors within 30 days as required by the Municipal Finance Management Act (MFMA). Without working capital it becomes almost impossible for these municipalities to provide an acceptable level of services. This might lead to a total breakdown in service delivery with catastrophic consequences for residents and businesses; which in turn could continue to encourage political unrest.

Contributing to the cash shortfall is the very low average revenue collection rate of only 82,3%. The Western Cape municipalities' collection rate at 93,2% is the only provincial average that is close to the benchmark of 95%. The metros are not much better with an average collection rate of 85,4%. Cape Town is the exception with a collection rate of 93,6%. These very low average collection rates show a lack of commitment from the management and political leaders to collect what is due for services delivered and property rates payable.

The cash shortfalls are expected to get worse every year since the majority of the municipalities will continue to realise losses, and revenue collection is expected to remain subdued because of the slow economic growth caused by the COVID-19 lockdown and government's inability to implement free market economic policies that would stimulate economic activity in the private sector. To prevent a total collapse of these municipalities, the only solution is for the Government to bail them out to the amount of R51 billion. This will only bring the municipalities onto a level footing to pay their creditors as stipulated by the MFMA. Unfortunately this R51 billion burden will have to be carried by the already overstressed taxpayers.

Another very concerning aspect highlighted by the financial analysis is the very low level of spending on repairs and maintenance. Given the huge maintenance backlogs built up over the years, the spending should be between 6% and 8% of the carrying value of the fixed assets.

Currently the average maintenance spending by the local municipalities is only 1,5%. It is hopelessly inadequate to keep the infrastructure in good operating condition. The deterioration of the infrastructure, such as crumbling roads, sewer spillage, and water or electricity disruptions is visible everywhere as a consequence. Increasing the maintenance spending dramatically is imperative to prevent a total breakdown in services in many municipalities.

3. Provincial and Metro MFSI™ performance

The following table depicts the average scores achieved by the metros and the provinces of the municipalities included in the MFSI™.

Average MFSI™ scores - 2016 to 2020					
Province	**2016**	**2017**	**2018**	**2019**	**2020**
Eastern Cape	32	29	26	26	25
Free State	23	21	19	19	17
Gauteng	32	30	31	31	32
KwaZulu-Natal	47	46	44	41	39
Limpopo	39	38	28	32	35
Mpumalanga	29	29	30	29	27
Northern Cape	45	39	34	33	33
North West	27	22	25	22	21
Western Cape	52	55	54	55	53
Average local municipalities	**39**	**38**	**36**	**36**	**35**
Average metro municipalities	**50**	**47**	**49**	**47**	**43**

Table 2

The weakest provinces are Free State and North West, with average scores in 2020 of 17 and 21 respectively. It is very clear that the majority of the municipalities in these provinces are in serious financial trouble and are probably facing collapse. The leaders of these provinces should be held accountable for this dismal performance.

Western Cape, with an average of 53, is the highest-scoring province. It is the only province with an average of more than 50 and also the only province whose municipalities are considered to be largely sustainable financially.

The provinces' average local municipality score for 2020 has deteriorated to a very low 35 out of 100. This very low average indicates very poor financial management practices and discipline. Furthermore the majority, namely 63 local municipalities out of the top 105, achieved a score of less than 35, rendering them seriously unsustainable and perhaps even dysfunctional in terms of normal service delivery.

The average score for the metros is showing a steeper decline over the last five years than the local municipalities, being a 7-point decline from 50 in 2016 to 43 in 2020. This is a very concerning trend since the metros are considered to be the backbone of the South African economy. Service delivery failure by the metros will cause immeasurable damage to the economy of the country.

It is clear that the majority of the municipal councils have failed miserably in their governance responsibilities by allowing them to sink into this desperate, unsustainable financial situation. Furthermore, it seems that the oversight role by the respective provincial administrations, except the Western Cape, has so far been totally ineffective to improve the financial sustainability at municipal level, as the situation has been continuing unchecked for more than five years.

It is important to note that these numbers are based on the results for fiscal year ended June 2020 that includes just over three months of COVID-19 lockdown, from late March 2020 to June 2020. It is generally expected that the results for the current fiscal year ending in June 2021 would be much worse as the effects of the lockdown for a full year will then be reflected in the financial results of the municipalities.

4. Performance of individual municipalities

In spite of the challenges there are still municipalities that are performing well, demonstrating that with commitment to sound financial management and dedication they can maintain a high level of financial sustainability. Five local municipalities achieved a score of 70 or more on the Index. Four of them, Mossel Bay, Saldanha Bay, Swartland (Malmesbury) and Overstrand (Hermanus) are in the Western Cape, with Midvaal in Gauteng the only one outside this province. These high-scoring municipalities demonstrate consistency over the five years mentioned. They normally have well-entrenched financial policies and their budgets are based on sound long-term financial strategies. They adhere to good budgetary practices, strict financial control and good revenue collection even through tough economic conditions. The sound levels of financial sustainability place these municipalities in a very strong position to invest in infrastructure and it gives them the capacity to absorb the financial shock caused by the COVID-19 lockdown.

Cape Town is the only metro that is still considered to be financially sustainable in 2020 with a score of 71, outperforming the rest of the metros by a large margin.

The best-performing municipalities by province in 2020 are shown in Table 3:

Best performing by province in 2020		
Province	**Municipality**	**Score**
Eastern Cape	Senqu (Lady Grey)	59
Free State	Metsimaholo (Sasolburg)	31
Gauteng	Midvaal (Meyerton)	70
KwaZulu-Natal	KwaDukuza (Stanger/Ballito)	65
Limpopo	Lepelle Nkumpi	62
Mpumalanga	Steve Tshwete (Middelburg)	58
Northern Cape	Sol Plaatje (Kimberley)	44
North West	JB Marks (Potchefstroom)	42
Western Cape	Mossel Bay	74

Table 3

Unfortunately there are also municipalities that reflect extremely low financial stability and they are a cause for grave concern, as service delivery is normally affected adversely by financial constraints. The results of the lowest-scoring municipalities in our index for 2020 by province are shown in Table 4:

Lowest scoring by province in 2020		
Province	**Municipality**	**Score**
Eastern Cape	Enoch Mgijima (Queenstown)	9
Free State	Matjhabeng (Welkom)	12

Gauteng	Emfuleni (Vereeniging)	12
KwaZulu-Natal	Newcastle	14
Limpopo	Modimolle (Nylstroom)	12
Mpumalanga	Lekwa (Standerton)	13
Northern Cape	Emthanjeni (De Aar)	20
North West	Naledi (Vryburg)	9
Western Cape	Beaufort West	18
Table 4		

A common feature of the municipalities with the lowest scores is that their liquidity positions are extremely weak. Their operating revenue and expenditures are not evenly matched, resulting in relatively large operating deficits, and the quality of their infrastructure is deteriorating, caused by low spending on repairs and maintenance which could threaten long-term service delivery and sustainability. The going-concern status of these municipalities is extremely doubtful.

Tshwane is the lowest scoring metro with a score of only 21 in 2020.

5. Conclusion

As depicted by the results of the latest MFSI, the financial sustainability of the municipalities and concomitantly their service delivery capacity, continues to deteriorate rapidly which has a disastrous effect on the quality of life for most of the South African population and the economic activity of the businesses located within their jurisdictions.

Unfortunately, the adverse effect of just over 3 months' effect of the COVID-19 lockdown on the finances of the municipalities has already worsened the situation dramatically.

COVID-19 will have a prolonged effect on the finances of the municipalities even after the lockdowns have been lifted. The full effect on the financial sustainability of the municipalities will only be visible in a year or two. At the moment it is only the Western Cape municipalities that have some capacity to absorb the devastating financial effects of the corona virus pandemic.

Municipalities, communities and other interested parties can purchase an individual MFSI™ report of a specific municipality from Ratings Afrika should they be interested to discern detail on its soundness.

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