

SOUTH AFRICA 2012

LOCAL GOVERNEMENTS— LOANS GRANTED BY THE DEVELOPMENT BANK OF SOUTH AFRICA

LONG TERM
EXTERNAL
RESOURCES

Local governments

In 2006, the 283 municipalities are distributed between :

- 6 metropolitan municipalities (Johannesburg, eThekweni (ex Durban), Cape Town, Ekurhuleni (ex East Rand), Nelson Mandela (Port Elizabeth), Tshwane (Pretoria)
- 46 district municipalities
- & 231 local municipalities

Development bank of South Africa, DBSA

- DBSA, Public development bank, created in 1983,

LOANS TERMS

- Loans intended for capital expenditure only
- Loan term limited to the lifetime of funded infrastructures
- DBSA is able to provide long term loans

INSTITUTIONAL AND REGULATORY FRAMEWORK

- The last territorial reorganizations led to the re-centralization of decentralized institutions, and a series of governmental reforms and project seem to lean towards increasing centralization
- Between 1995 and 2000, the number of local governments have been divided fourfold
- 2000 : elimination by the state of municipalities , replaced by *district municipalities*, divided in *local municipalities*, and in *metropolitan municipalities* for the country's largest cities ; in metropolitan municipalities, a metropolitan council, implemented by the *Local Government Municipal Systems Act*, is elected through direct election and headed by a mayor
- In 2006, the 283 municipalities are distributed in 6 *metropolitan municipalities* (Johannesburg, eThekweni (ex Durban), Cape Town, Ekurhuleni (ex East Rand), Nelson Mandela (Port Elizabeth), Tshwane (Pretoria), 46 *district municipalities* and 231 *local municipalities*
- Created in 1983 in order to improve former townships and black homelands' infrastructure equipments, the Development Bank of South Africa (DBSA) reached out to local municipalities in the 90s.
- State-owned
- Classic development bank which, benefiting from its public status, can refinance itself on financial markets and by borrowing from lenders on concessional terms.

INSTITUTIONAL AND REGULATORY FRAMEWORK

- The nine Provinces, represent the largest territorial unit
- The *White Paper on Local Government* in 1998 puts municipalities at the center of local development, by granting them autonomy and placing social services and basic infrastructures such as water and electricity distribution, waste collection sewage systems, care centers and local railway lines under their jurisdiction
- On the other hand, the allocation of responsibilities between the three territorial levels (State, provinces and municipalities) is not determined by the legislation.

Loan

- Tradition of municipal borrowings in South Africa since the Apartheid: white municipalities borrowed from commercial banks, and for some of them, issued with implicit state guarantee; and as a consequence, limited regulatory and risk analysis mechanisms.
- New Constitution : no state guarantee on local governments' loans
- 2004 : entry into force of the *Municipal Financial Management Act* (MFMA)
 - Regulatory framework intended to respond to concerns due to municipal reforms and to reassure investors: the new administrative definition of municipalities, the end of state guarantee on non-sovereign loans and of the legal vacuum on local governments' financing terms had indeed created a climate of uncertainty; the increasing risks and transaction costs had led to the withdrawal of private investors
 - Clear rules providing strong incentives
 - Control of financing terms for local governments while providing incentives for them to improve financial management, transparency and skills
- According to MFMA's terms, loans are only granted for capital expenditures and the loan term is limited to the financed infrastructures' lifespan.

USES

- Borrowings are most often used to finance water supply system, electricity and road networks
- It gives autonomy and responsibility to local governments regarding basic infrastructures and social services (water and electricity distribution, waste collection, sewage systems, care facilities, local railway lines)
- The duties of municipalities can be broken down into three main categories
- Managing urban planning activities and the urban sprawl generated by a continuing vigorous growth
- Catching up with the infrastructure deficit built up during the Apartheid regime and the following period of low investment
- Supplying low-cost or free housing and services for the most disadvantaged populations. This obligation is enshrined in the Constitution.
- By the end of the 2000s, DBSA owned almost 50% of outstanding loans to local governments
- DBSA has gradually developed a financing activity dedicated to overseas infrastructure (approximately 25 % of its liabilities)

RESOURCES

- High degree of financial independence, based on their own resources, supplemented with state transfers and access to loans: South African Metropolitan municipalities are far less dependent on transfers than other counterparts on the African continent.
- Refinancing on the market and from funders with good financial terms
- Internal resources : the share of internal resources on total income is decreasing, primarily due to the institutional reforms of the Central State
 - Large cities benefit from income generated by economic activities : land taxes (for *metropolitan* and *local municipalities*), fluid sales (electricity mainly) and until recently, the Regional Service Council (RSC), a professional tax levied on the turnover and total payroll; the budget of metropolitan municipalities was relying for 90% on this income; for medium-sized or smaller municipalities, this ratio is far lower
 - The Constitutional Council has abolished the RSC in 2006. It generated 17% of the nine largest cities' total income while state transfers only generated 10%. Since transfers have not increased to compensate the income shortfall, the legislation not only led to the municipalities' loss of financial autonomy but also to a reduction in overall resources.
 - Other measures seem to indicate a decline in the responsibilities exercised by municipalities: electricity distribution, which generated significant financial surplus, particularly for large metropolitan municipalities, is transferred to regional distributors; the government is considering pooling investment amounts – from municipalities which have fell behind schedule in upgrading their infrastructure network – into a central fund.
- Transfers : The State has implemented two types of transfers to foster investment
 - Equitable Share (ES)* is an equalization mechanism by which 50% of global transfers are facilitated
 - The Municipal Infrastructure Grant (MIG)* is used to finance basic infrastructure particularly for the poorest municipalities and represents 35% of national transfers
 - There are three simultaneous restructuring and capacity building funds (*Municipal Systems Improvement Grant, Financial Management Grant, Local Government Restructuration Grant*), that represent only a small fraction of transfers
 - The government spends a increasing share of the State budget on transfers (3.3 % in 2002, 5.9 % in 2006 and 6.5 % in 2009), that sends a strong signal to municipalities and enables greater visibility for them to plan their investments
- Local governments also receive money from provinces : large municipalities are complaining about the unpredictability of transfers' amounts and of the disbursement schedule, as well as the lack of transparency in the process of fund allocation

MANAGEMENT

- Johannesburg, eThekweni, Cape Town, Buffalo City, Mangaung and Msunduzi have joined together to form the *South Africa City Network*, an initiative of the *Minister for Provincial and Local Government*, in partnership with the *South African Local Government Association (SALGA)*
- DBSA's purpose is also to support local governments : its operating surpluses are used to finance a fund dedicated to capacity building, and called the *DBSA Development Fund*

DISADVANTAGES, ISSUES RAISED

- The legal framework is conducive to the use of debt, but in practice borrowing and absorption capacities of small and medium-sized municipalities remain low and hinder market development
- Local governments also receive money from provinces : it leads to jurisdictional conflicts in sensitive areas such as housing, basic health services and public transportation
- *Local municipalities* remained very dependent upon transfers, and besides have experienced difficulties in implementing those transfers.
- Private companies have criticized DBSA for practicing unfair competition while benefiting from privileged resources due to its public status
- Governments also criticized DBSA for failing to fulfill its duty as an intermediary promoting public policies
- Since the middle of the 1990s, the role of DBSA, as a public institution, should have consisted in proving to the private sector that financing municipal infrastructures was sustainable and profitable, promoting the emergence of new players, then letting the private sector take care of solvent borrowers while devoting itself to supporting less-solvent ones. Nevertheless, although new private actors have emerged, DBSA remained the main player in the municipal debt market and continued to finance even the most solvent cities, 65% of their outstanding credit being dedicated to metros
- In practice, DBSA is not provided with the necessary means to perform its money-losing public service mission since it has to secure its financial sustainability.

- **The debt market has not yet reach its development potential**
- **The financing of local governments is focused on large cities , the six *metros***
- **In spite of repeated efforts from successive governments, middle-sized and smaller cities have little benefited from loans for investments. On average, they did not improve their solvency position, and their investment efforts have been constrained by the lack of tailored financial products.**