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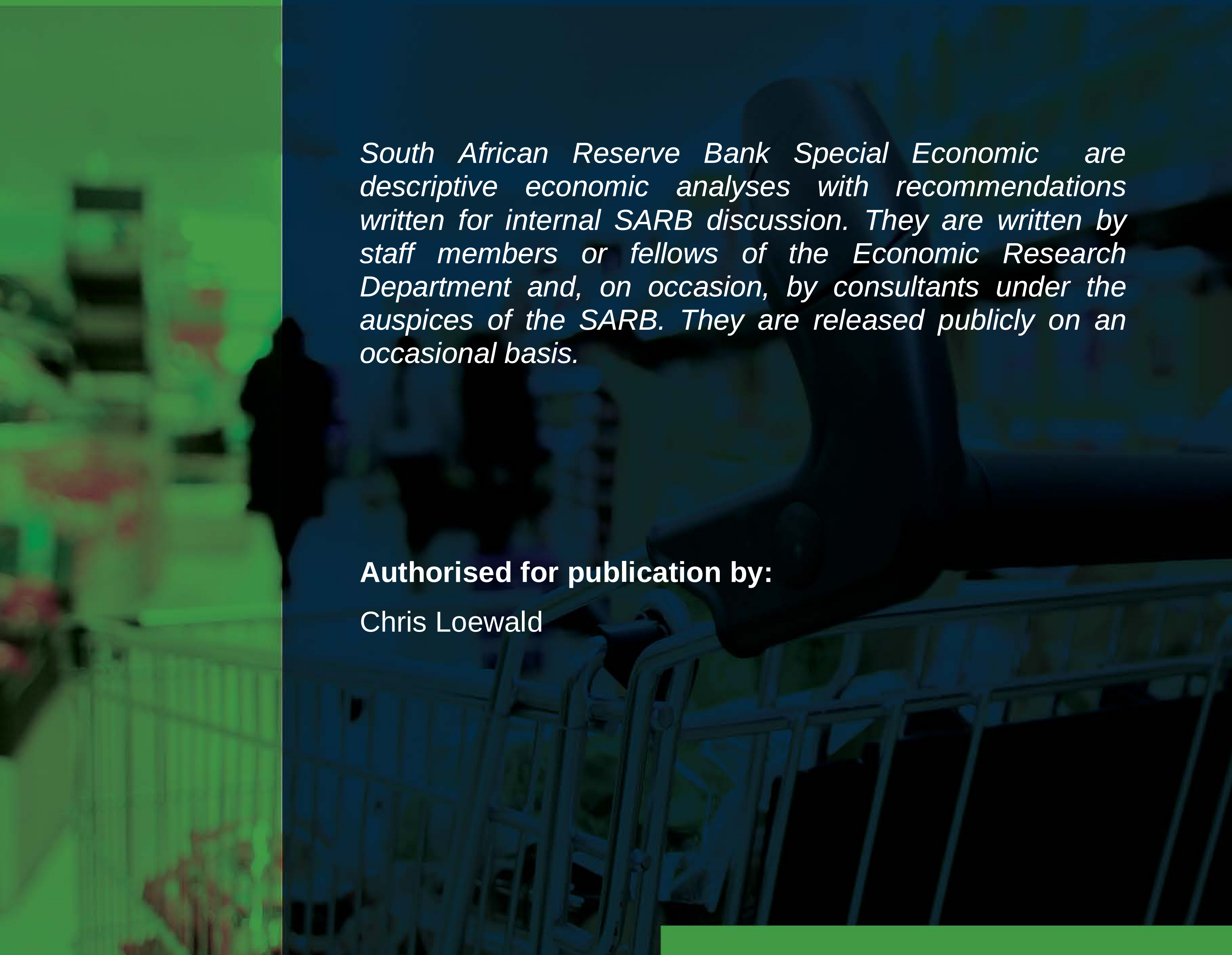

South African Reserve Bank Special Economic are descriptive economic analyses with recommendations written for internal SARB discussion. They are written by staff members or fellows of the Economic Research Department and, on occasion, by consultants under the auspices of the SARB. They are released publicly on an occasional basis.

Authorised for publication by:

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Review of administered prices in South Africa: Municipal rates and taxes

Kim Walsh

Abstract

Growth in property rates revenues was well above inflation between 2016 and 2021. This seems to have been driven by growth in the market value of properties captured in municipal General Valuation Rolls and not by the cent in the rand property rate, which has increased by close to or below inflation. Cent in the rand property rates are seldom set based on analysis of the change in the cost of providing the services that they are intended to fund. Rather, rates are set within an overall budget process that considers what revenue increases are required from the budget and what rates increases are affordable to customers or politically acceptable to councils. This is an inherently political process. Factors that have driven increases in the costs of the publicly accessed services that are funded by property rates include slower growth in infrastructure grants; un(der)funded mandates and the expansion in standards for rates-funded services; declining electricity surpluses reducing the space for cross-subsidisation; high growth in employee-related costs; and high growth in debt impairment. Recommendations include (1) continuing to address issues of unfunded, underfunded or expanding municipal mandates through appropriate intergovernmental processes; (2) municipalities exercising caution in expanding service delivery standards or mandates in a constrained economic environment with significant affordability pressures on residents and businesses; (3) continuing to prioritise work on alternative revenue sources for municipalities; (4) providing urgent support to municipalities to contain employee-related costs; and (5) municipalities reintroducing debt collection and credit control measures, accompanied by careful indigent management.

1. Introduction

Municipal rates and taxes in South Africa refer exclusively to so-called property rates,[1] a cent in the rand rate levied on the market value of properties.[2] Property rates are taxes on wealth

[1] Property rates are a key element of local taxation in most developed and industrialised countries but are typically underutilised in developing and transition countries (Franzsen and McCluskey 2017). There is little data or literature available on property rates price increases in emerging markets, with most of the literature focusing on increasing the use of property taxes as an income source (see, for example, Ali et al. 2017; Granger 2019; and Moore and Monkam 2015).

[2] Clause 229(1)(a) of the Constitution of South Africa allows municipalities to impose rates on property. This is supported by clause 4(1) of the Municipal Systems Act 32 of 2000, which indicates that a municipality may finance its affairs out of a combination of fees on services and surcharges on these fees, rates on properties and "to the extent authorised by national legislation, other taxes, levies and duties". The Constitution states that these powers may not be exercised in a way that materially and unreasonably prejudices national economic policies, economic activities across municipal boundaries, or the national mobility of goods, services, capital or labour.

and are generally regarded as progressive but can make up a significant portion of monthly bills for low-income households (Tshangana 2021). According to the South African Property Owners Association (SAPOA), rates and taxes made up 25% of operating costs for commercial properties in South Africa in June 2019 (SAPOA 2019). Increases in property rates can thus have a significant impact on the commercial property market.

This economic note will discuss current mechanisms for setting property rates in South Africa, consider key drivers of inflation in property rates and make recommendations for setting property rates in future. However, before doing that, the paper will comment on the complexity of determining what 'price' of property rates to compare and how property rates have changed over time in South Africa.[3]

1.1 What 'price' to compare?

Property rates are set annually by each of the country's eight metropolitan and 226 local municipalities. New property rates come into force on 1 July each year. The municipality sets a 'cent in the rand' rate, which is multiplied by the market value of immovable property to calculate a property rates bill. Cent in the rand rates differ for different categories of property. In the case of residential properties, an initial value is zero-rated and therefore deducted from the market value before applying the cent in the rand rate. Municipalities also offer additional exemptions, rebates and reductions to property rates to protect certain categories of property owners, including indigent owners and those dependent on pensions or social grants.

As a result, the property rates bill that a property owner receives may change from year to year due to:

- changes in the cent in the rand rate for the relevant property category;
- changes in the zero-rated property value for residential property owners or in other rebates or exemptions offered; or
- changes in the market value of property assumed as the basis for the property rates bill.

Values for similar properties may differ significantly from municipality to municipality, and property values increase differently in different municipalities.

The property values used to calculate property rate bills are held in a General Valuation Roll (GV). According to the Municipal Property Rates Act 6 of 2004, as amended, metropolitan municipalities must update their GVs every four years and local municipalities every five years.[4] Some municipalities choose to update their GVs more regularly.[5] The changes in property value shown in the previous paragraph will therefore be captured only periodically in

[3] Palmer Development Group has written a paper on water prices for this series. Sections of that paper are duplicated in this one as many of the processes for setting property rates align with those for setting water tariffs, and several of the inflation drivers are the same.

[4] Municipalities also produce Supplementary Valuation Rolls annually. These contain properties that were not included on the most recent GV or that have changed (this includes changes such as subdivision, consolidation or changes in category, as well as changes in market value due to a previous error or significant shifts in the market).

[5] The City of Cape Town updated its roll every three years between 2006 and 2018 "to minimise the impact of changes in property values between valuation cycles" (City of Cape Town 2022).

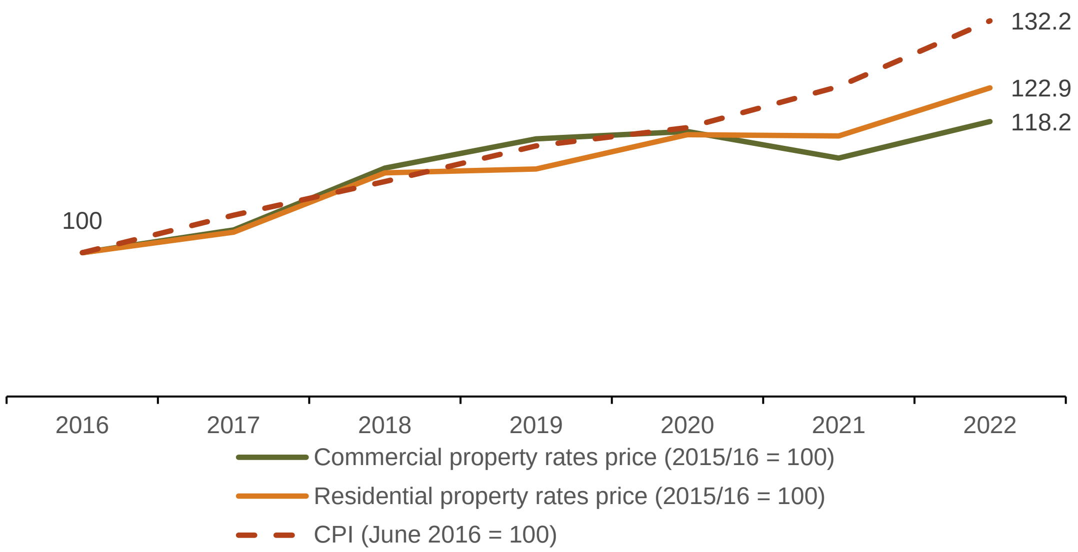
the GV. Property values typically change significantly upon introducing a new GV. Municipalities often 'buffer' the impact of a change in property values on the property rates bill by introducing lower increases in the cent in the rand rate in the year in which a new GV is introduced.

Therefore, when comparing the 'price' of property rates over time, it is ideal to assess the property rates bill for a specific property over time to capture the impact of changes in all three parameters identified in the bulleted list above. Looking at changes in the cent in the rand rate only presents part of the picture. However, this would require data on changes in the values of properties captured in the GVs of municipalities. Such data are not readily accessible and comprehensive analysis on changes in property rates bills over time is thus difficult.

1.2 What has the level of inflation in property rates been?

Statistics South Africa (Stats SA) includes 'assessment rates' in the basket of administered goods used to determine the consumer price index (CPI), but data on inflation in assessment rates as a specific item are unavailable (personal communication with Marietjie Bennet, Price Statistics Compilation, Stats SA). Figure 1 shows an index of the average cent in the rand residential and commercial property rate for seven of the eight metros[6] compared to CPI between 2016 and 2022.[7]

Figure 1: Growth in the average cent in the rand residential and commercial property rates for seven metros compared to CPI between 2016 and 2022



Source: Author's analysis of data from city tariff books and CPI reported by Stats SA.

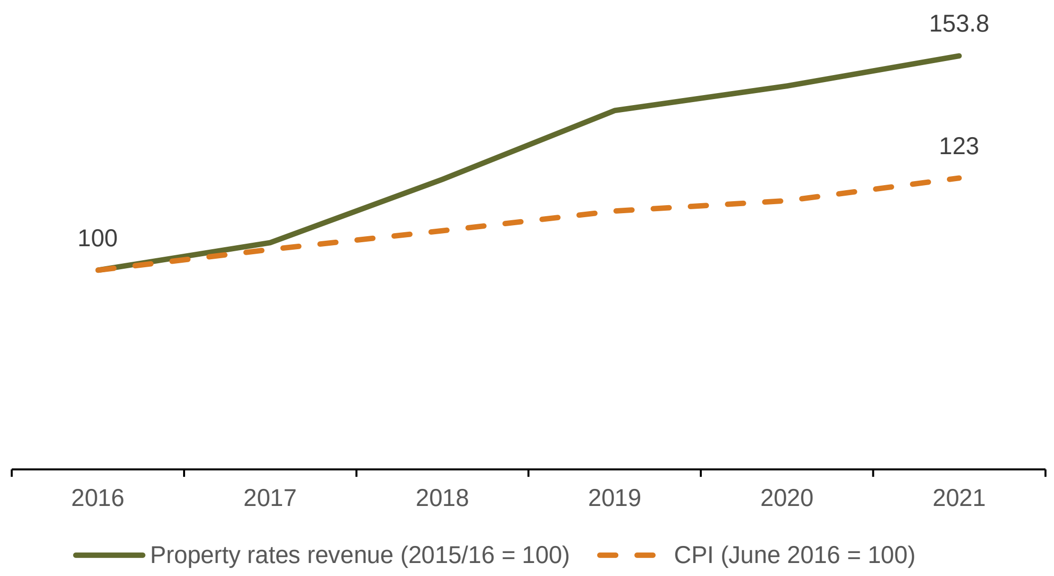
Figure 1 shows that the price increase in the cent in the rand property rate has been close to CPI over the period and dropped below CPI in 2021 and 2022. In contrast, Figure 2 shows

6 Nelson Mandela Bay was excluded due to unavailability of data in some years. Note that this is a simple average.

7 This is a simple average. The cent in the rand rates were averaged across the seven metros and this average was used to calculate the indices shown.

property rates revenues generated by the seven metros grew substantially ahead of inflation over the same period.

Figure 2: Growth in the property rates revenues in the seven metros compared to CPI between 2016 and 2021



Source: Author's analysis of National Treasury Local Government Database and CPI reported by Stats SA.

A portion of this growth may be due to increases in the number of properties in the metros, but most of the growth has been driven by increases in the market value of properties used to determine property rates bills. These market values, not the cent in the rand rate, drive any above-inflation growth in property rates bills and are typically the focus of complaints and objections to property rates appearing in the media.

While growth in property rates revenues has outstripped CPI, Ntiyiso Consulting (2017) reported that the growth in residential property values was 7.1% per annum on average between 2012 and 2017, higher than the 6.1% average annual growth in property rates revenues. In other words, municipalities are not capturing the full value of residential property growth through their rates.

Concerning commercial properties specifically, SAPOA produced a report in 2019 that indicated that rates and taxes for commercial properties had grown 8.6% per annum from 2000 to 2019. They indicate that the growth rate was CPI+3.6% from 2000 to 2005, CPI+4.8% from 2005 to 2014 and CPI+5.2% from 2014 to 2019 (SAPOA 2019). The report does not indicate the data source for this analysis, but one can assume it is based on actual rates bills by SAPOA members. In other words, the trend captures changes in both the cent in the rand rate and the market value of commercial properties in the GV. Given the data shown in Figure 1, which shows that cent in the rand rates on commercial properties grew at close to inflation in this period, the increase in rates bills reported by SAPOA must be due largely to increases in the assumed market value of commercial properties. The SAPOA report notes that this makes property rates an increasing portion of commercial property incomes but does not comment on increases in rates and taxes relative to the value of commercial properties.

The Municipal Property Rates Act requires that property rates for non-residential property categories are set to a ratio for residential categories. If this ratio is kept fixed, then cent in the rand property rates will increase at equivalent rates for all property categories. If the ratio changes, then the rates for some property categories may increase more or less rapidly than others. Table 1 shows the ratios for commercial properties compared to residential for seven of the eight metros between 2016 and 2022.

Table 1: Ratio of the cent in the rand rate levied on commercial properties relative to residential properties in seven metros between 2016 and 2022

	2016	2017	2018	2019	2020	2021	2022
Johannesburg	2.80	2.60	2.60	2.60	2.60	2.50	2.50
Cape Town	2.00	2.00	2.00	2.00	2.00	2.00	2.00
eThekwini	2.27	2.27	2.27	2.27	2.27	2.27	2.27
Ekurhuleni	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Tshwane	3.02	3.02	3.02	2.94	2.94	2.50	2.50
Buffalo City	2.50	2.50	2.50	2.50	2.50	2.50	2.50
Mangaung	4.08	4.12	4.12	5.03	4.11	4.11	3.87

Source: Author’s analysis of municipal property rates policies or budget documentation.

Four of the seven metros kept the ratios fixed. Johannesburg and Tshwane have brought their ratios down steadily since 2016, which would result in lower increases in the commercial cent in the rand rate compared to residential. Mangaung increased the ratio from 2016 to 2019 but brought it down again in recent years. Regarding rebates and exemptions, it is notable that several metropolitans increased the value of properties that are zero-rated over the past five years, in some cases by a significant margin.

Table 2: Rand value of residential properties on which no rates are levied in each metro in 2016/17 and 2020/21

	2016/17	2020/21
Johannesburg	200 000	350 000
Cape Town	200 000	300 000
eThekwini	120 000	120 000
Ekurhuleni	150 000	150 000
Tshwane	75 000	150 000
Nelson Mandela Bay	15 000	15 000
Buffalo City	15 000	15 000
Mangaung	70 000	80 000

Source: Author’s analysis of municipal property rates policies or budget documentation.

The Municipal Property Rates Act requires that at least R15 000 be zero-rated. Most metros zero rate a significantly larger portion of the property value. Johannesburg, Cape Town and

Tshwane increased their zero-rated portion significantly between 2016/17 and 2020/21. Increases in the zero-rated portion reduce the rate of growth in the property rates bill for residential customers and offset increases in property values to some extent.

In sum, the level of inflation in property rates bills is uncertain, but the growth in property rates revenues suggests that it has been well above inflation. Above-inflation growth has been driven by the market value of properties captured in municipal GVs, not by the cent in the rand rate, which has increased by close to or below inflation. For many metros, expansion of the zero-rated property value has placed downward pressure on property rates bills.

2. The current price-setting mechanism

As noted in Section 1.1, three separate factors determine the increase in the property rates bill: the cent in the rand rate, the rebates or exemptions offered (including the zero-rated residential property value), and the market value of property assumed in the GV. The cent in the rand rate and zero-rated property values are set through the budget process, while the market value of properties is determined through the periodic valuations process. These will be discussed separately below.

2.1 Setting the cent in the rand rate, rebates and exemptions

The setting of the cent in the rand rate and determination of the size of rebates and exemptions is part of the overall annual municipal budget process. Rates are set to achieve revenue targets required to ensure an overall funded budget for all municipal functions combined.

In research conducted by National Treasury on tariff-setting processes in the North West and Gauteng provinces, it was found that no municipality used a tool or model to set tariffs (National Treasury 2019). A relatively small number of municipalities undertook analysis to inform tariff setting, looking at growth in anticipated cost drivers or benchmarking with other municipalities. Most municipalities, however, simply adjusted tariffs by inflation only. While this research did not cover property rates specifically, similar findings likely hold for setting property rates in these municipalities.

The key point is that setting the cent in the rand property rate is seldom based on analysis of the change in the cost of providing the services it is intended to fund. Rather, rates are set within an overall budget process that considers what revenue increases are required from the budget and what rates increases are affordable to customers or politically acceptable to councils. This is an inherently political process.

The second key point is that annual increases have little or no regulation. Section 19 of the Municipal Property Rates Act allows the Minister of Cooperative Governance and Traditional Affairs (CoGTA) to set upper limits for the ratio between the rates levied on residential and non-residential property categories. Section 20 allows them to set an upper limit on the percentage increase in the rate or property rates revenues. Draft regulations on both were published in 2007. Regulations related to the ratios were gazetted in 2009, referring only to the agricultural and public service infrastructure property categories. Regulations related to upper limits on the percentage increases were not gazetted.[8] There is no process for reviewing or commenting on the property rates increases that each of the eight metros and 226 local municipalities proposes for each year.

2.2 Determining the market value of properties

The value of properties to be used in calculating property rates bills is held in a municipality's GV. These values are determined through a valuations process that must be undertaken by a municipal valuer internal to the municipality or by an external service provider.[9]

The key concern related to the valuation process is its periodic nature (four to five years), meaning that property values can change dramatically upon introducing a new valuation roll.[10] As noted in Section 1.1, municipalities often 'buffer' the impact of a change in property values on the property rates bill by introducing lower increases in the cent in the rand rate in the year in which a new GV is introduced. Municipal officials, however, note that lead times in preparing valuation rolls can be very long and that it is therefore difficult to prepare a GV more regularly (National Treasury 2018). Municipalities could, however, use supplementary valuations as indicators of changes in property values between GVs, and try to set the cent in the rand rates in a way that smooths the impact of a new GV on rates bills.

Some municipalities express concerns that municipal supply chains cannot assess the professional merits of valuers and that appointed valuers, therefore, do not always have the necessary skill and experience. Some municipal officials lack adequate understanding of the Municipal Property Rates Act. Section 81 of the Act requires provinces to monitor compliance with its provisions. Provincial monitoring is often not undertaken (National Treasury 2018) and in some municipalities there is no auditing of the valuation roll.

3. Inflation drivers

A theoretically sound process for setting property rates would include the following steps:

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8 Note that property rates are an important general revenue source for municipalities, and it is considered appropriate that they have a high degree of discretion in setting these rates. The draft regulations published in 2007 were strongly criticised by local government as being irrational and unduly restrictive (Steytler 2008).

9 The Municipal Property Rates Act specifies that municipal valuers must be registered as professional valuers or professional associated valuers in terms of the Property Valuers Profession Act 47 of 2000. The South African Council sets standards for valuations for the Property Valuations Profession (SACPVP) in accordance with policy and guidance from the International Association of Assessing Officers. Valuations can be determined individually or via a mass evaluation method, with the latter referring to the use of a model based on the relationship between value and variables representing factors of supply and demand (SACPVP 2021). Valuations may be prepared on a sales, income or cost basis, with the latter two applied for non-residential properties. Physical assessments are undertaken at least periodically for a sample of properties; these are done via physical inspection or pictometry (aerial images taken from multiple angles). Mass valuations are necessary as, in most municipalities, it is impossible to value each property individually. However, they may result in some unjustified variances in the values of individual properties where the assumed supply and demand factors do not hold. Municipalities have processes that allow for objections to proposed market values in the GV, representing an important check and balance on the valuations process.

10 There are processes in place for objecting to the market property value in the valuation roll.

- determine the cost of supply of the services to be funded through property rates, including both direct and indirect costs;[11]
- allow for surpluses or deficits;[12]
- allocate subsidies and other revenues to determine the revenue required;[13] and
- apply tariff structures to generate the revenue required.

Under such a process, the drivers of inflation in property rates would be:

1. Increases in the key expenditures associated with the rates-funded services.
2. Changes in the quantum of grants and subsidies received.
3. The amount allocated to rates-funded services.

However, as noted in the previous section, the actual impact of these inflation drivers on property rates is sometimes delinked through the tariff-setting process, with increases ultimately coming down to perceptions of affordability. The next section will nonetheless discuss some trends in key inputs to a theoretical rate-setting process that may be driving the inflation of property rates in at least some municipalities, including metros.

3.1 State funding through grants

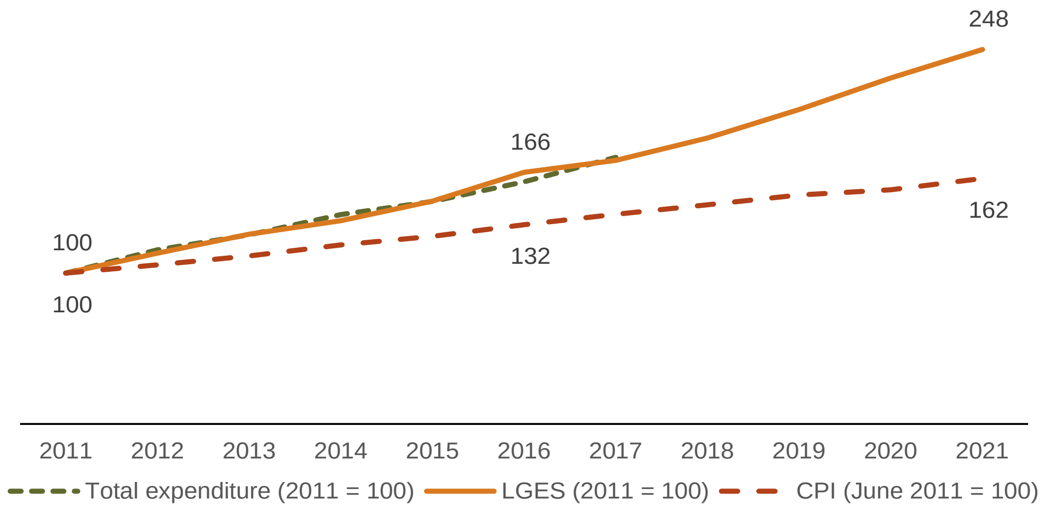
It may seem contradictory to think of trends in state funding through grants as an 'inflation driver' for property rates, but if the growth in state funding is lower than the growth in costs, then the quantum of revenue that must be generated through rates will be higher, driving greater increases in rates. Figure 3 shows that the Local Government Equitable Share (LGES) allocations to all municipalities have increased at a rate well above inflation over the past 10 years.

11 Property rates are the main funding source for services that are publicly accessed, which include community and social services, sports and recreation, public safety, municipal housing, municipal health, planning and development, roads and public transport, and environmental protection. 'Indirect costs' refers to a portion of municipal overheads (budget and finance department, human resources, information technology, etc.) allocated to these services. The supply cost should also include a provision for capital expenditure sufficient to allow for necessary expansions to infrastructure and the management of existing assets.

12 Current practice in municipalities includes a high degree of cross-subsidisation between services and customer groups. Historically, the electricity service has operated at a significant surplus in most municipalities, which has been used to cross-subsidise the provision of other services. In most municipalities, property rates revenues do not cover the cost of providing rates-funded services, and electricity surpluses have been significant in making up the deficit.

13 The Local Government Equitable Share (LGES) is a substantial, unconditional grant provided to municipalities annually through the Division of Revenue Act. While unconditional, it is intended to subsidise the provision of basic services to the poor. Because it is unconditional, municipalities can allocate it between functions as they see fit. The quantum of LGES received by the municipality and the quantum that they choose to allocate to rates-funded services significantly influence the amount of revenue that must be generated through rates. However, allocating more LGES to rates-funded services means allocating less to other services, which places upward pressure on the tariffs for these other services. Municipalities also receive a range of conditional grants, largely for capital expenditure.

Figure 3: Growth in LGES allocations to all municipalities combined compared to growth in CPI and growth in total municipal operating expenditure between 2011 and 2021[14]



Source: Author's analysis of municipal expenditure data from National Treasury's Municipal Budget Reporting Reform A2 tables for all municipalities combined for 2015, 2018 and 2021 Medium Term Revenue and Expenditure Frameworks; LGES data from the Division of Revenue Acts for the relevant years; CPI year-on-year for June each year as reported by Stats SA.

It is also notable that growth in total operating expenditure by municipalities has tracked LGES growth almost exactly. The close tracking of expenditure with LGES allocations indicates that the portion of expenditures covered by the subsidy has remained largely fixed over the period, and declining LGES allocations have, therefore, not been an inflation driver for rates and tariffs over the past 10 years.

Municipalities often indicate that the number of poor households to whom they must provide subsidised services has grown and that subsidy allocations are increasingly inadequate to cover the costs. There is, however, no data to determine the accuracy of this assertion.[15] While growth in the number of households subsidised is uncertain, there has been upward pressure on the level of subsidy required through the zero-rated portion of the residential property value, as noted in Section 1.2.

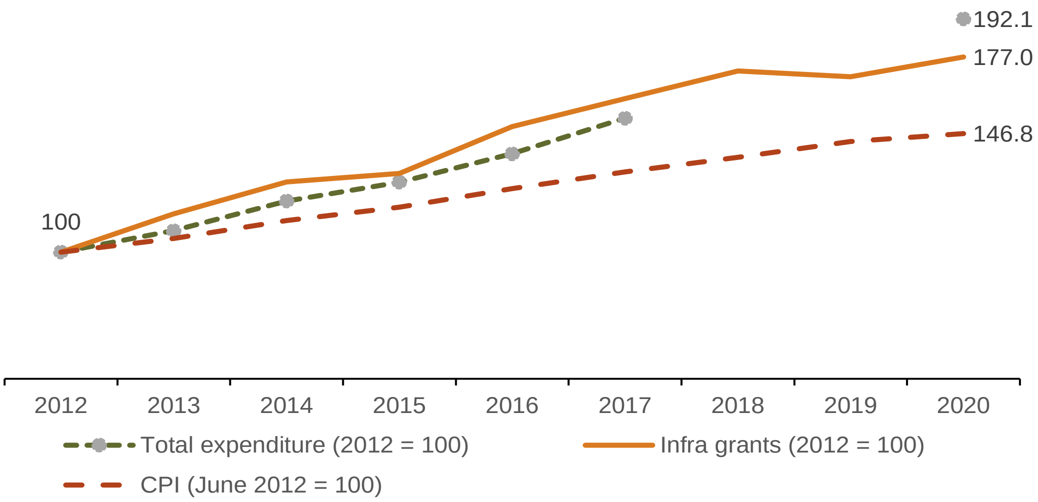
A similar analysis for infrastructure grants shows that these also grew well ahead of inflation until 2018, although less rapidly than the LGES. Growth in infrastructure grants has slowed

14 There were changes to the way in which municipalities reported to National Treasury in 2018, with the introduction of the Municipal Standard Chart of Accounts. As a result, there were inaccuracies in reporting for 2018 and 2019 and data for these years have been omitted from all expenditure trends presented in this report.

15 LGES allocations are calculated based on an estimated number of poor households in each municipality, which has remained fixed since the last census in 2011. The extent to which the number of indigent households has grown will not be known until the results of Census2022 become available. Data on the number of registered indigents in municipalities, as reported in Stats SA's annual Non-Financial Census of Municipalities, indicate that the number of indigents registered in all municipalities has remained largely static since 2011. This is likely to say more about processes of indigent registration in municipalities than actual numbers of indigent households.

somewhat since 2018 but dropped below growth in expenditures. Declining growth in infrastructure grants may therefore be placing upward pressure on rates as municipalities need to increase rates and tariffs to fund capital expenditure.

Figure 4: Growth in infrastructure grant allocations to all municipalities combined compared to growth in CPI and growth in total municipal operating expenditure between 2012 and 2020



Source: Author's analysis of municipal expenditure data from National Treasury's Municipal Budget Reporting Reform A2 tables for all municipalities combined for 2015, 2018 and 2021 Medium Term Revenue and Expenditure Frameworks; infrastructure grant data from the Division of Revenue Acts for the relevant years; CPI year-on-year for June each year as reported by Stats SA.

3.2 Un(der)funded mandates and the expansion in standards for rates-funded services

The issue of unfunded mandates has been controversial, and its impact on property rates inflation is difficult to determine. In the metros, at least, it is potentially significant. Strictly speaking, unfunded mandates occur when a municipality carries out a function not allocated to them in the Constitution or legislation. There are several largely undisputed examples of unfunded mandates being carried out by municipalities, including libraries, museums and primary health care. There are also areas of concurrent function between municipalities and other spheres of government where the role of municipalities, particularly metros, has increased over time, often without additional revenue sources (Kumar and Reddy 2019). These mandates may be considered 'underfunded' and include housing provision, public transport and policing. The roll-out of bus rapid transit systems in many metros, for example, is likely to have placed upward pressure on property rates as fees and grants for these systems are seldom sufficient to cover their costs.

As noted by the South African Cities Network (SACN) (2016), other considerations related to the service standards placed upward pressure on expenditures and, therefore, the revenues required from property rates. Such considerations include national or provincial governments setting minimum standards for service delivery that result in significant and/or unintended costs at the local level; and (often more significantly) political choices that drive the provision of services beyond what is mandated. For example, the latter can be observed in growth in the provision of metro policing or the roll-out of paved roads in rural areas.

3.3 Declining electricity surpluses reducing space for cross-subsidisation

Municipal electricity services have been undergoing substantial shifts in recent years, particularly in metropolitan areas. Rapidly rising electricity tariffs (due largely to rapidly rising electricity bulk prices from Eskom) have driven reductions in electricity sales volumes as well as the rise of small-scale embedded generation (SACN 2018).

Municipalities have historically provided electricity at a substantial surplus and used this surplus to cross-subsidise the provision of other services, including rates-funded services. Electricity surpluses are, however, coming under increasing pressure, declining from 9% of electricity revenues in 2015/16 to 5% in 2019/20.[16] This decline has reduced the opportunity for cross-subsidisation and increased the need to raise property rates.

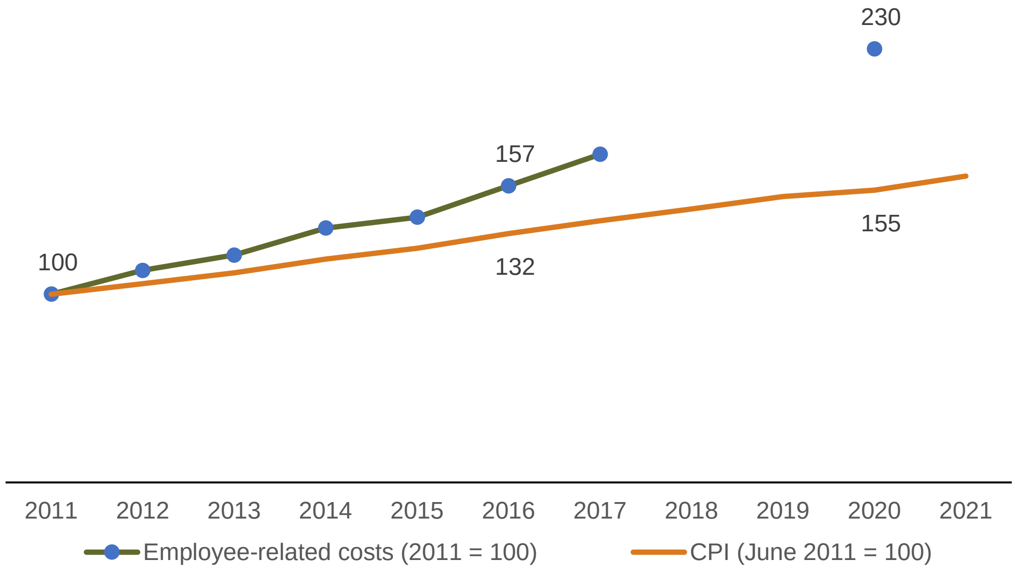
3.4 Employee-related costs[17]

Employee-related costs have increased at a rate significantly ahead of inflation over the past 10 years, as shown in Figure 5. Employee-related costs constitute about 28% of total municipal operating expenditures, and so are a significant driver of increases in the cost of providing municipal services.

16 Author's calculations based on audited financial data reported by municipalities to National Treasury in the Municipal Budget Reporting Reform tables for 2017 and 2021.

17 Note that, unless specifically indicated, all data reported in this sub-section on employee-related costs are for municipalities as a whole and not the rates-funded services in particular. This is because financial reporting for individual services is not ring-fenced and reporting on expenditures incurred in providing specific services is poor.

Figure 5: Growth in employee-related costs by all municipalities combined compared to growth in CPI between 2011 and 2021

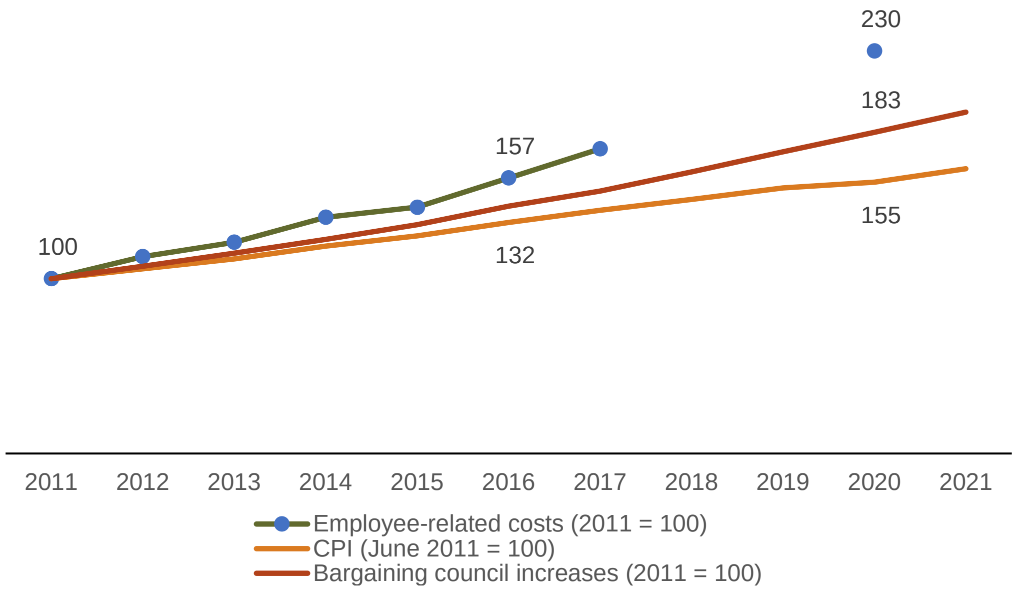


Source: Author's analysis of municipal expenditure data from National Treasury's Municipal Budget Reporting Reform AA tables for all municipalities combined for 2015, 2018 and 2021 Medium Term Revenue and Expenditure Frameworks; CPI year-on-year for June each year as reported by Stats SA.

Employee-related costs are set through two salary processes. Upper limits on salaries for municipal managers and managers who report directly to municipal managers are set by the Minister of CoGTA each year. The minister sets a range for these senior management salaries, and so salaries can be moved within the range, but the upper limits for senior management salaries have not been increased since 2019.

Salaries for other municipal staff are set through a collective bargaining process in which the South African Local Government Association bargains on behalf of local government. These increases are typically ahead of inflation and have been a long-term driver of high growth in employee-related costs. However, as shown in Figure 6, employee-related costs have grown even more rapidly than wages negotiated through the bargaining council.

Figure 6: Growth in employee-related costs by all municipalities combined compared to growth in CPI and salary increases negotiated in the bargaining council between 2011 and 2021



Source: Author's analysis of municipal expenditure data from National Treasury's Municipal Budget Reporting Reform AA tables for all municipalities combined for 2015, 2018 and 2021 Medium Term Revenue and Expenditure Frameworks; CPI year-on-year for June each year as reported by Stats SA, personal communication on bargaining council increases.

Stats SA has suggested that increased staff numbers to improve service delivery has been a further driver of high increases in employee-related costs (Stats SA 2015). However, analyses in the State of City Finances reports published by the SACN every two years suggest that costs per employee have been rising rapidly and that growth in the numbers of employees – at least in the metros – has not been significant (SACN 2020 and 2022).

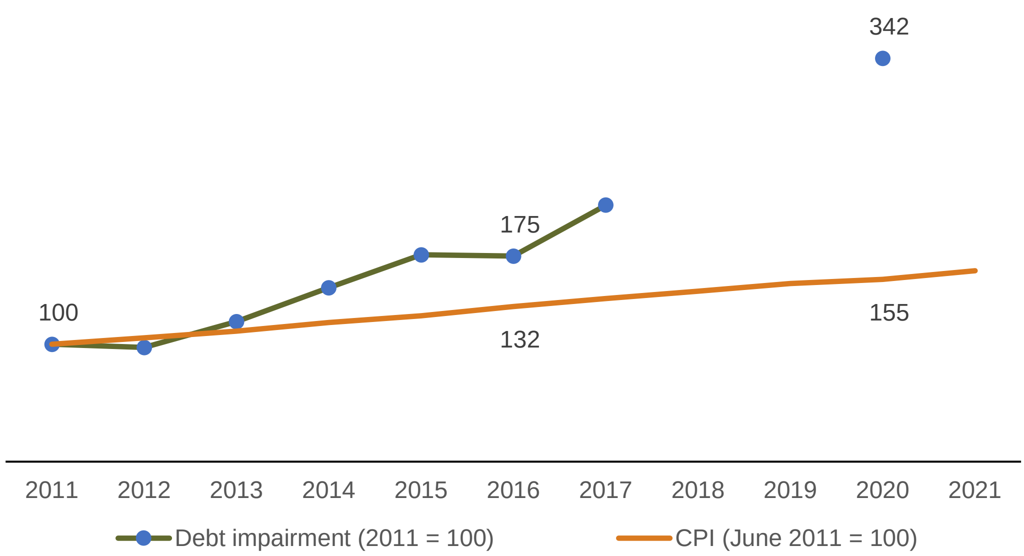
Employee-related costs include staff benefits and bonuses, as well as the costs of overtime. While good data on these expenditures are not available, interviews with metros reported in the State of City Finances reports indicate that high levels of overtime are a key driver of high employee-related costs. Furthermore, allowances for items such as cars and housing are often high and sometimes provided incorrectly (SACN 2022). Once provided, however, these allowances are very difficult to withdraw.

In general, the rapid growth in employee-related costs has been due to the significant power of labour in bargaining council negotiations and in resisting the control of items such as overtime, bonuses and allowances. There have been signs recently that this is shifting, with the Minister of CoGTA not increasing upper limits of salaries for senior management since 2019. The Constitutional Court ruling in February 2022 that the state can renege on collective wage-bargaining agreements if they are not affordable is also significant in this regard, as is strong messaging from the Minister of Finance on the unaffordability of the public sector wage bill.

3.5 Debt impairment

Municipalities report on an accrual basis and therefore report revenues when they are billed, not paid. Debt impairment is a non-cash expenditure item used to make provision that some of the billed revenue will not be paid and will have to be written off. As shown in Figure 7, debt impairment expenditure has been growing more rapidly than CPI since 2013 and even more since 2016.

Figure 7: Growth in debt impairment expenditure by all municipalities combined compared to growth in CPI between 2011 and 2021



Source: Author's analysis of municipal expenditure data from National Treasury's Municipal Budget Reporting Reform AA tables for all municipalities combined for 2015, 2018 and 2021 Medium Term Revenue and Expenditure Frameworks; CPI year-on-year for June each year as reported by Stats SA.

As reported in the 2022 State of City Finances report (SACN 2022), debt impairment expenditure in the eight metros and Msunduzi Local Municipality as a group increased by 42% from 2019 to 2020. This was the most significant single impact on municipal finances that resulted from the COVID-19 pandemic. In many municipalities, councils took decisions to halt debt collection and credit control measures entirely during the pandemic and data reported by the Fiscal and Financial Commission indicated that cash collection rates declined by between 5% and 10% across all municipal categories (Fiscal and Financial Commission 2021). Data suggest that debt impairment declined marginally in 2021 but still remained high. The extent to which municipalities can reintroduce credit control mechanisms and improve cash collection rates (and therefore reduce the need for debt impairment) going forward is still unknown.

Debt impairment is an expenditure item for municipalities, and tariffs must be increased to cover this. This can result in a dangerous downward spiral: customers do not pay, so debt impairment rises, tariffs increase and become less affordable, and levels of non-payment rise further.

4. Recommendations

While there is limited regulation and oversight of property rates, it is appropriate that municipalities have a high degree of discretion in setting these rates. Property rates are an important general revenue source, are a strongly progressive tax and are largely pro-poor. However, there does appear to be scope to provide better support and capacitation to municipalities regarding property rates, particularly concerning valuations. It is recommended that focus be given to the following areas and interventions made where necessary:

- Unfunded, underfunded or expanding municipal mandates are complex and must continue to be addressed through appropriate intergovernmental processes.
- Municipalities should be cautious about expanding service delivery standards or mandates in a constrained economic environment with significant affordability pressures on residents and businesses without carefully assessing the financial implications.
- Work on alternative revenue sources for municipalities,[18] prompted largely by the shifts in municipal electricity supply businesses, is under way in National Treasury and should remain a key priority.
- Municipalities must be supported to contain employee-related costs as a matter of urgency.
- Municipalities must reintroduce debt collection and credit control measures and contain increases in debt impairment. This must be accompanied by careful indigent management to ensure that subsidies are accurately targeted to those that need them.

Interventions on many of these areas, particularly those related to employee costs, debt collection and credit control, are likely to face resistance and require strong political support.

[18] Some of the options suggested have included property transfer duties linked to local property markets; additional fuel levies for local roads; vehicle licence fees; public transport permits; tourism or hotel occupancy taxes; street advertisement taxes (billboards); weigh-in bridges in mining areas; lease of fibre optic cables and sales of bandwidth; parking lot taxes; air pollution taxes; harbour taxes; licensing of mortuaries; and dumping site usage fees. A local business tax (a tax on payroll or on local turnover) is the option that has been most extensively explored to date. eThekwini submitted a proposal for such a tax in 2011 but National Treasury ultimately rejected the proposal, arguing that slow economic growth would make the introduction of a new tax unpalatable, as well as the fact that municipalities were not maximising their existing revenue sources.

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