TRAINING MODULE 6:
BUDGET, FISCAL AND PLANNING REFORMS

Slide 1

As part of the urban reforms, the budget, fiscal and financial reforms aim to enable municipalities to contribute to spatial transformation, leading to faster, more inclusive economic growth, and a reduction in poverty, unemployment and inequality.

The budget, fiscal and financial reforms assume that:
- planning reforms are in place
- that budgets are a direct reflection of credible outcomes-led planning
- and that reporting practices enable transparency, for all of society to hold government accountable.

This module will cover the following:

1. Budget reforms - including the Municipal Standard Chart of Accounts (mSCOA) and the Budget Circular
2. Fiscal Reforms - looking at the Local Government Grant Review, and
3. Financial Reforms - including the National Strategy for Municipal Borrowing, Development Charges, Land Value Capture Support, and Long Term Financial Model and Strategy

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Slide 2

There are two key budget reforms: the establishment of the municipal standard chart of accounts (mSCOA), and the annual budget circular. These will now be discussed.

MSCOA

The mSCOA is a key reform to the business process in a municipality.

In 1999, the National Treasury embarked on a budget reform programme for national and provincial government departments, with the objectives of improving accountability and modernising the accounts of government, by aligning reporting with international leading practices. The aim of this reform process was to provide better quality information to legislatures to assist in the policy-making process as a vital input into expanding service delivery, and to reinforce parliament's oversight role. Since 2004, the Economic Reporting Format and SCOA are fully operational and used by all national and provincial departments. The successful implementation of SCOA contributed to growing positive public perception, locally and internationally, and strengthened public sector accountability and reporting.

National Treasury ultimately has the responsibility for compiling national "whole-of-government" accounts, including consolidated local government information for national policy. This information is obtained from all municipalities, each of which operates according to their own organisational framework. Thus, National Treasury must specify a national standard for the collection of local government budget and financial information. Municipalities need to appreciate the benefit of "whole-of-government" data collection as it informs national reporting, benchmarking, and fosters an improved understanding of the contribution of the local government sphere. This will be one of the key benefits of getting municipalities to budget and report according to the Government Finance Statistics categories, since these categories transcend any structural changes in a dynamic local government environment.

The Municipal Budget and Reporting Regulations (MBRR) became effective on 1 July 2009. The main objective of the MBRR is to formalise norms and standards which are envisaged to improve the credibility, sustainability, transparency, accuracy and reliability of municipal budgets. The budget formats prescribed in the Municipal Budget and Reporting Regulations go a long way in identifying the categories of municipal information required in developing a municipality's budget. The next step is to ensure that the detailed information captured in the implementation of the budget is properly and credibly aligned. Although Local Government has its own peculiarities, the success achieved at the National and Provincial level from implementing the SCOA could be equally beneficial for Local Government in improving data quality, achieving a greater level of standardisation, and uniform data sets. These are critical for 'whole-of-government' reporting.

The primary objective of mSCOA is to achieve an acceptable level of uniformity and quality from the collection of Local Government data. This will require a classification framework specific to Local Government, incorporating all transaction types, appropriation of funds, spending on service delivery, capital and operating spending, policy outcomes, and legislative reporting requirements to the maximum extent possible.

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The Budget Circular

MFMA budget circulars are published annually to guide budget planning for the medium-term revenue and expenditure framework. For example, the budget circular for the 2021/2022 MTREF was published on 8 March 2021 and 4 December 2020. Generally, the budget circular is published toward the end of the calendar year - six months prior to approval of the budget - in time for municipalities to start preparing their budgets, which are approved by the end of May each year.

All municipal budgets may be found online at municipalmoney.gov.za

National and provincial budgets are also available online at: vulekamali.gov.za, and imaliyethu.org.za

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Fiscal Reforms and the Local Government Grant Review

In 2014, the National Treasury, in collaboration with *COGTA*, the Financial and Fiscal Commission, *SALGA*, and the DPME, initiated a review of the Local Government Infrastructure Grants.

The review sought to introduce changes to the system of local government infrastructure grants to:

- Introduce greater differentiation in the type of grants going to different municipalities, enabling the system, to better respond to the different circumstances and needs of rural and urban municipalities.

- Pivot from focussing almost exclusively on rolling out new infrastructure to including a greater focus on the management and renewal of existing infrastructure, to ensure the sustainable provision of services, while still extending infrastructure where needed.
- Ensuring greater value-for-money is achieved from the funds spent. To achieve this, improvements are needed in planning for appropriate infrastructure solutions before construction begins and in the monitoring of progress during implementation (by municipalities, national government and local communities).
- Ensure greater coherence in the management of the grants system by national government through improving coordination among national departments, strengthening monitoring and capacity building efforts within departments managing grants and requiring better assessments and planning before the introduction of any new grants.

Further details on the LG grant review are available at: LG Grant Review

Every year the Division of Revenue Act is enacted reflecting the legislative changes and requirements in relation to the grants for local government. The DoRA can be accessed on the National Treasury website every year after the Budget Speech.

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Financial Reforms

There are 4 financial reforms:

- National Strategy for Municipal Borrowing
- Development Charges
- Land Value Capture Support
- Long Term Financial Model and Strategy

Collectively the financial reforms intend to improve the financial sustainability of municipalities.

These will be discussed next.

Slide 6
National Strategy for Municipal Borrowing

Municipalities have substantial experience with municipal borrowing and financial emergencies provisions, which were drafted more than 15 years ago in terms of the MFMA. Municipal infrastructure needs have evolved, and cities understand these better. National Treasury in close coordination with the cities, has therefore undertaken a review of the legislation, its impact, and the current context.

Government's policy is to rely on market discipline to prevent municipalities from becoming over-indebted. Lenders invest in municipal debt instruments at their own risk, based on the creditworthiness of municipalities. This avoids over-borrowing and bailouts that have plagued other emerging economies.

A municipality that wants to use borrowing to invest in infrastructure must be creditworthy: it must have adequate revenue to support its obligations and the management and financial capacity to make strategic borrowing decisions.

National legislation defines a clear set of rules around transparency, disclosure, and consultation, and prescribes penalties for violation. In line with the fiscally decentralised orientation of the Constitution, it is the responsibility of municipalities to borrow wisely, and of financial institutions to lend prudently. National government does not guarantee municipal borrowing, and will not assume responsibility for municipal debts.

Despite the successful implementation of the original borrowing framework, there are still some limitation:

- Borrowing is not as long term as initially intended (it does not relate to the useful life of assets).
- Although the secondary market has developed, it is not as vibrant as anticipated,
- and the role of Development Finance Institutions in municipal infrastructure financing needs to be clearly defined to avoid crowding out the private sector.

These limitations and issues were not articulated in the original policy framework. To address these challenges, National Treasury has updated the borrowing policy framework, while remaining committed to the principles underlying the original policy framework.

The updated policy framework explicitly clarifies the following issues:

- Longer tenors: The updated policy framework encourages municipalities to borrow for longer tenor (beyond 20 years), to better match the useful life of the assets being financed. Borrowing is considered as the most efficient way to pay for municipal infrastructure assets that have a long life. By matching payment for the infrastructure with the time when benefits are received, governments can provide the benefits of infrastructure investments while deferring the payment. The importance of matching the term of financing to the useful life of the asset was recognised in the White Paper on Local Government and in the original Policy Framework.
- Active secondary market in municipal debt instruments: An effective and efficient secondary market requires a significant stock of securities to be traded. In South Africa, a vibrant secondary market in municipal debt securities has yet to emerge. One of the constraints is the limited quantity of municipal bonds in the market. The updated policy framework proposes options that can be explored to increase the stock of municipal bonds.
- Role of Development Finance Institutions (DFIs) and how they are required to play in the municipal space: The update to the Policy Framework requires that publicly held financial institutions such as DFIs should pursue developmental goals, rather than lending in direct competition with profit-oriented private sector lenders. The policy framework outlines a set of developmental and social goals that should guide public lenders in the municipal space, and inform the developmental mandate to be pursued by DFIs. Developmental and social goals include:
    - Financing basic infrastructure and services in rural areas;
    - Supporting the development of long term financial strategies in municipalities of any size;

  - Extending the tenor of borrowing for municipal infrastructure beyond 20 years, to better match the useful life of the assets being financed;
  - Supporting the development of a liquid secondary market for municipal debt securities;
  - Supporting spatially transformative development within South Africa's cities, so as to increase access to opportunities for all citizens;
  - Ensuring that appropriately priced credit is available to creditworthy municipalities whose borrowing needs are too small to attract the interest of the capital markets or commercial lenders; and
  - Supporting municipalities to assess their own creditworthiness, and supporting efforts to improve their creditworthiness.
- **Alternative financing mechanisms allowed to leverage borrowing:** Alternative and innovative infrastructure finance mechanisms such as project finance, revenue bonds, tax increment financing, and pooled financing mechanisms, are explained and encouraged - but subject to the restrictions and requirements contained in the MFMA.

As at June 2021, the revised 2017 Policy Framework for Municipal Borrowing and Financial Emergencies is at Cabinet Committee consultation stage and will be published on the National Treasury website once approved where the quarterly updates of the Borrowing Bulletin are found, that is: the Municipal Borrowing Bulletin.

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Development Charge

A Municipal Development Charge is a once-off, upfront charge imposed by a municipality on landowners who intensify their land use. Its purpose is to fund the provision of bulk or connector infrastructure that either needs to be installed or expanded by the municipality to serve the new development, or to recover the cost of pre-installed excess infrastructure capacity that is consumed by that development. A development charge does not fund the costs of infrastructure maintenance, rehabilitation or replacement, which are addressed through monthly taxes and tariffs. A development charge should reflect the actual cost of that infrastructure, and thus is not a tax. However, it is also not a conventional tariff as it is multisector in nature and imposed as a single, upfront charge.

This is a common infrastructure financing instrument in many countries, particularly fast-growing jurisdictions. Its popularity derives from the ability to shift the cost of financing infrastructure from municipal balance sheets (funded by debt and financed through recurrent revenues) to those of property owners (mortgage finance). This expands the total envelope of resources available for municipal infrastructure investment, while also ensuring that adequate financing is available to meeting ongoing infrastructure needs.

National Treasury has developed a policy framework to significantly enhance the framework for the management of Development Charges by municipalities. This addresses issues related to their definition, calculation, imposition, terms, and forms of payment (including services agreements), responsibilities of municipalities to deliver associated infrastructure, and the protection of national subsidies for poor households. This policy framework was developed through extensive consultation with municipalities and concerned national departments. Key aspects of the policy framework require enactment through an amendment to the Municipal Fiscal Powers and Functions Act, and the amendment process is currently underway.

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Land Value Capture Support

The concept of land value capture broadly refers to a methodology through which incremental increases to property values, created through some public investment or regulatory action, are recouped or redirected by the state using various incentives, taxations, or fees. Although property value can also increase through market forces and investment by private landowners, Land Value Capture does not attempt to recoup these value increases, but is rather aimed at recouping those value increases experienced by private landowners but stimulated by public sector action and investment.

Land value capture, or land-based financing, presents an opportunity for municipalities to access alternative revenue or co-financing strategies. In South Africa, municipal property rates is the single biggest form of land-based financing. Potential other mechanisms include tax increment financing, special assessment district, development charges, leveraging municipal real estate, density bonuses, sale of development rights and land readjustment scheme.

The Land Based Financing Tools to support urban development in South Africa can be accessed on the CSP website. Other information on Land Value Capture can be accessed using the link displayed.

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Long Term Financial Model and Strategy

A Long-Term Financial Strategy is a credible, bankable capital investment and financing plan for decision-makers in the metro, that can also be presented to the finance community.

Municipalities are constantly being challenged, having to balance a number of tasks such as:

- providing adequate services to their populations and businesses;
- building infrastructure that supports service delivery and national economic growth;
- driving spatial transformation that provides equal opportunities to the growing population;
- optimising the mix of grants, own revenue sources, borrowing and development charges to provide the required services;
- spending wisely and efficiently on the right projects and initiatives in making strategic investment decisions that promote growth and service delivery within a healthy fiscal position;
- and more recently having to respond to the impacts of COVID 19.

The National Treasury therefore aims to support municipalities to develop more sustainable and integrated infrastructure development programmes, informed by spatial and strategic plans, and financed in the most effective and efficient manner over the longer term. This can be done through the development of a long-term financial model (LTFM) that:

- Supports decisions on investment selection

- Assesses the financial impact of policy choices, by forecasting future financial performance and impact of infrastructure projects on borrowing capacity
- Informs a long-term financial strategy, policy and commitments that articulates a sustainable, efficient and effective borrowing strategy and practices by the municipality and provides a clear statement of intent for lenders

The financial model will be able to project a baseline scenario (business as usual) into the future. This will help the metro understand its fiscal position over the long-term, its headroom for investment and borrowing, as well as main drivers of revenues and costs going forward. Based on this understanding, the model will then allow the metro to model a range of policy decisions and understand their impact on the fiscal position of the metro.