



# Ratings Afrika

✉ 1018 CRESTA 2118 SOUTH AFRICA ▪ Tel +27 11 478-5438

## THE RUINATION OF THE SA MUNICIPAL SECTOR CONTINUES

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**Analysts:** Leon Claassen and Charl Kocks

### 1. Introduction

Ratings Afrika has published its annual Municipal Financial Sustainability Index (MFSI<sup>®</sup>) for the financial results of the 104 largest local municipalities plus the 8 metros in South Africa, thus 112 in total. The analyses are based on the municipal financial year ending in June 2023.

The MFSI<sup>®</sup> 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<sup>®</sup> is thus a numerical gauge, in line with Ratings Afrika's definition of municipal 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."

All comments in this document are specific to the 112 municipalities included in our 2023 analyses.

### 2. Financial results

The results of the latest MFSI<sup>®</sup> once again confirm the ruination of the South African municipalities under the leadership of the current elected councillors and their appointed executive management teams. The exception is the majority of the Western Cape municipalities and Midvaal in Gauteng. Ratings Afrika has been warning of this disastrous trend since 2011.

It is incomprehensible that the Government cannot see or acknowledge what is happening and start taking the necessary steps to save the country from disaster. Since Ratings Afrika published its first MFSI<sup>®</sup> in 2011, the financial sustainability of the South African municipal sector has deteriorated dramatically.

Residents and businesses are suffering from poor, and in some cases almost non-existent service delivery. Economic growth is threatened by the inability to maintain and develop infrastructure. A most important additional point is that Eskom and the water utilities are dependent on municipal payments to remain viable themselves. All-in-all, Central 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.

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 unsound governance the majority of the South African municipalities are still operating at deficits. For the 2023 municipal financial year, the aggregate operating deficits for the 112 municipalities included in our index amounts to **R27 billion**. Although it is down from R33 billion in 2022, it remains a dire situation. The lower deficit is mainly the result of Tshwane's deficit that came down from R4,2 billion in 2022 to R524 million in 2023. The effect of these operating deficits is that the municipalities do not generate sufficient funds from their operations to fund the services they are supposed to deliver. Very poor service delivery is the consequence. Furthermore, they do not generate any funds to invest in infrastructure for the betterment of the residents. 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 getting progressively worse with a staggering **R84,5 billion** for 2023, up R20 billion from R65 billion in 2022. It is no wonder that service delivery is breaking down in most municipalities and that infrastructure is crumbling at an unprecedented pace. At this rate 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 liquidity (or cash) positions of the indexed municipalities:

<b>Financial results 2023, in 112 municipalities covered</b>					
	<b>Operating surpluses</b>	<b>Operating deficits</b>	<b>Liquidity surpluses</b>	<b>Liquidity shortfalls</b>	<b>Collection rate (ave.)</b>
<b>Local municipalities</b>	<b>Rm</b>	<b>Rm</b>	<b>Rm</b>	<b>Rm</b>	<b>%</b>
Eastern Cape	80,1	1 517,2	699,7	3 445,2	77,4
Free State	-	2 339,5	179,5	-15 056,3	63,3
Gauteng	42,7	3 078,6	418,7	11 471,4	79,6
KwaZulu-Natal	91,5	1 500,7	1 895,5	2 093,7	91,7
Limpopo	107,1	1 370 0	987,4	1 789,5	84,0
Mpumalanga	-	5 876,0	-	21,174,7	76,0
Northern Cape	-	628,0	5,1	1 601,4	85,8
North West	434,2	1 929,6	-	9 332,7	71,6
Western Cape	475,4	376,6	5 165,2	451,0	97,6
<b>Total - local municipalities</b>	<b>1 230 8</b>	<b>18 616,2</b>	<b>9 351,2</b>	<b>66 424,7</b>	<b>83,0</b>
<b>Total - metro municipalities</b>	<b>3 716,7</b>	<b>8 801,7</b>	<b>17 032,7</b>	<b>18 120,7</b>	<b>85,6</b>
<b>Total - 112 municipalities</b>	<b>4 947,5</b>	<b>27 418,9</b>	<b>26 383,9</b>	<b>84 545,4</b>	<b>83,2</b>

**Table 1**

The practical reality of the liquidity shortfalls is that these municipalities do not have the cash available to 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 material 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 83,0%. The Western Cape municipalities' collection rate at 97,6% is the only provincial average that is higher than the benchmark of 95%. The metros do not do not much better than the local municipalities, with an average collection rate of 85,6%. Cape Town is the exception with a collection rate of

96,3%. The very low average collection rates show a lack of commitment from, or inability of, the management and political leaders to collect what is due for services delivered and for property.

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 central government’s inability to implement free market economic policies that would stimulate economic activity in the private sector. Without the necessary liquid funds, service delivery in most municipalities will continue to worsen. To prevent a total collapse of these municipalities, the only solution is for the Government to bail them out to the amount of R85 billion. This will however only bring the municipalities onto a level footing to pay their creditors as stipulated by the MFMA. Unfortunately this R85 billion charge will have to be borne by already overburdened taxpayers.

### 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®.

<b>Average MFSI® scores - 2019 to 2023, in 112 municipalities covered</b>					
<b>Province</b>	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>
Eastern Cape	26	26	31	28	30
Free State	19	18	19	22	23
Gauteng	31	34	34	33	33
KwaZulu-Natal	40	38	44	39	40
Limpopo	32	38	42	39	41
Mpumalanga	29	28	27	25	23
Northern Cape	33	34	30	34	32
North West	22	22	23	23	28
Western Cape	55	53	53	53	53
<b>Average local municipalities</b>	<b>36</b>	<b>36</b>	<b>38</b>	<b>36</b>	<b>37</b>
<b>Average metro municipalities</b>	<b>48</b>	<b>42</b>	<b>43</b>	<b>40</b>	<b>43</b>

**Table 2**

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 Western Cape’s average score was very consistent over the last couple of years.

The weakest provinces are Free State and Mpumalanga, with average scores of 23 in 2023. The trends are however different. The Free State has improved from an average of 19 in 2019 to 23 in 2023, whereas Mpumalanga declined from 29 in 2019 to 23 in 2023. The largest improvement was in North West that increased by five points from 23 to 28; and the Eastern Cape and Limpopo each improved by two points, indicating that it is possible to slowly turn the situation around.

However, the provinces’ average local municipality score for 2023 remains extremely low at 37 out of 100, albeit one point higher than in 2022. This indicates very poor financial management practices and discipline. Furthermore 55% of the municipalities (58 local municipalities out of the top 104), achieved a score of less than 35, rendering them seriously unsustainable and perhaps even dysfunctional in terms of normal service delivery. Some 74% of the municipalities could not achieve a score of 50, indicating that the majority’s financial sustainability is very weak.

The average score for the metros is showing a slight improvement of three points from 40 in 2022 to 43 in 2023. At this level of financial sustainability the majority of the metros remains a concern. They are considered to be the economic engines of the South African economy. Service delivery failure by the metros can cause immeasurable damage to the economy.

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 Department of Cooperative Governance and Traditional Affairs (COGTA) and the respective provincial administrations, other than in the Western Cape, has so far been ineffective in improving the financial sustainability at municipal level, as the situation has been continuing unchecked for many years.

#### 4. Performance of individual municipalities

In spite of the overall disturbing picture painted by the recent analyses, there remain municipalities that are performing well, demonstrating that with commitment to sound financial management and dedication it is possible to maintain high levels of financial sustainability and service delivery. For 2023, Midvaal and Mossel Bay are the most financially sustainable municipalities, each with a score of 74. Only three other local municipalities achieved a score of 70 or more on the Index. They are: Saldanha Bay with a score of 73, and Swellendam with a score of 72 and Swartland (Malmesbury) with a score of 71. These high-scoring municipalities demonstrate consistency over the last five years. 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 financial shocks.

Cape Town is the only metro that is still considered to be highly sustainable financially in 2023 with a score of 70, outperforming the rest of the metros by a large margin. Its achievement is remarkable considering that the average of the metros is only 43 in 2023. Underpinning Cape Town's high score is an operating surplus of R1,8 billion and cash reserves of R12,6 billion that can be utilised for infrastructure development and provide a considerable buffer to absorb financial shocks. Nelson Mandela Bay improved its score on the index from 50 in 2022 to 56 in 2023, indicating a strong effort by the finance team to strengthen its financial sustainability.

The highest scoring local municipalities by province in 2023 are shown in Table 3:

<b>Highest scoring local municipalities by province in 2023, in 112 municipalities covered</b>		
<b>Province</b>	<b>Municipality</b>	<b>Score</b>
Eastern Cape	Senqu (Lady Grey)	57
Free State	Metsimaholo (Sasolburg)	46
Gauteng	Midvaal (Meyerton)	74
KwaZulu-Natal	KwaDukuza (Stanger/Ballito)	63
Limpopo	Lepelle Nkumpi	62
Mpumalanga	Nkomazi (Malelane)	38
Northern Cape	Ga-Segonyana (Kuruman)	46
North West	Moses Kotane (Mogwase)	35
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 2023 by province are shown in Table 4.

<b>Lowest scoring local municipalities by province in 2023, in 112 municipalities covered</b>		
<b>Province</b>	<b>Municipality</b>	<b>Score</b>
Eastern Cape	Amahlathi (Stutterheim)	7
Free State	Matjhabeng (Welkom)	10
Gauteng	Lesedi (Heidelberg)	21
KwaZulu-Natal	Newcastle	15
Limpopo	Modimolle (Nylstroom)	20
Mpumalanga	Lekwa (Standerton)	13
Northern Cape	Emthanjeni (De Aar)	16
North West	Naledi (Vryburg)	17
Western Cape	Matzikama (Vredendal)	17

**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. 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.

Mangaung is the lowest-scoring metro with a score of only 27 in 2023, although it is an improvement from 24 in 2022. This situation remains very concerning as it points to a situation bordering on dysfunctionality. Mangaung realised an operating deficit of R811 million in 2023. Mangaung's liquidity shortfall is R936 million, indicating an inability to pay its service providers including Eskom and the water utility.

## **5. Conclusion**

As depicted by the results of the latest MFSI<sup>®</sup>, the financial sustainability of the majority of the municipalities, and concomitantly their service delivery capacity, remains dismal and 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.

Presently it is only a large number of the Western Cape municipalities that demonstrate adequate levels of financial sustainability, giving them the financial capacity to deliver services and develop infrastructure while at the same time building the reserves to absorb financial shocks. The other provinces could take guidance from the Western Cape municipalities on how to run financially sustainable municipalities.

Unless there is a concerted effort from the municipalities themselves, the provinces and national government to strengthen their governance and financial management this very bad situation will continue. Service delivery will break down further, the quality of live for most residents will deteriorate and economic activity will be stifled. The time to act is now!

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