Source: Star, 2 July 2004

Report points to hazards in municipal borrowing

LYNDA LOXTON

Cape Town – The Financial and Fiscal Commission has cautioned the government against the dangers of allowing often cash-strapped municipalities to use their allocations from the treasury as security to raise loans.

In its latest annual report to the treasury on issues the department should consider when drawing up the next budget, the commisssion said this week that it was becoming increasingly concerned about the "moral hazards" in municipalities using funds meant to provide local infrastructure and services – called equitable share – to raise funds for other purposes.

The commisssion said that although its brief survey had shown that this was not yet a common practice, the fact that it was allowed even in terms of the new Municipal Finance Management Act, which is aimed at tightening up municipal financial management, could cause serious problems in the future.

It said the municipal borrowing market had remained largely untapped since 1994, with outstanding loans by municipalities at R20.1 billion at the end of 2002, marginally up by R300 million from the previous year.

The market was concentrated among a few lenders, and the borrowers were usually large urban municipalities.

The main source of municipal credit was the private sector, amounting to R12 billion, or about 60 percent of the borrowing. This was followed by the Development Bank of Southern Africa, amounting to R7 billion. The balance came from sources such as the Infrastructure Finance Corporation.

The government was committed to developing a strong municipal borrowing market. The failure of this idea to take off in a big way was mainly attributable to "the transition process and uncertainty in the legal framework, particularly in relation to recourse in the event of defaults, and the finalisation of municipal boundaries", the report said.

All municipalities had to submit full details of their finances, including borrowing arrangements, to the treasury.

But this did not include the extent to which the equitable share was being used as security for loans.

Legal opinion sought by the commisssion found that this was allowed in terms of the constitution and that the safeguards in the act did not apply in this case.

The fact that the equitable shares to municipalities were now being gazetted as part of the three-year medium-term expenditure framework could encourage municipalities to "increasingly use future equitable share allocations to leverage loan finance", the commisssion said. The three-year medium-term expenditure framework is scheduled to move to five years next year.

The government should consider the extent to which municipalities could do this, with different approaches probably needed for the different municipalities because of differences in revenue bases or human resources.

Well-off municipalities would be able to get loans without using their equitable shares as collateral, but municipalities with small revenue bases were likely to be more tempted to do so.

"The consequences will be felt mostly by residents who depend upon municipalities for the delivery of basic services."