FINANCIAL AND FISCAL COMMISSION

POLICY BRIEF

2/2013

Poor Maintenance and Renewal Threatens Municipal Service Delivery

EXECUTIVE SUMMARY

Well-maintained water and electricity distribution infrastructure is central to economic production. Adequate spending on asset care protects investment in infrastructure and contributes to sustainable service delivery. The Constitution assigns responsibility for the delivery of water, sanitation, electricity and refuse removal services to municipalities. As a result, municipalities in South Africa are responsible for managing and caring for infrastructure with a combined value of R1.156 trillion[1]. Responsibilities include asset maintenance (operational spending) and renewal (capital spending). Yet municipalities have no road-map to provide guidance on infrastructure maintenance and renewal. The result is poor asset management practice, with under-budgeting and under-spending on both maintenance and renewal. Research by the Financial and Fiscal Commission (the Commission) shows that, should current practice continue, infrastructure within municipalities will deteriorate from poor to very poor within the next five years. This endangers the ability of municipalities to ensure continuity of basic service delivery. For the Commission, the first step towards improvement is a tightening of the regulatory environment through the establishment of legislation (similar to the 2008 Government Immovable Asset Management Act (GIAMA) that is applicable at the national and provincial spheres) to guide municipalities on asset management.

[1] This value is as at 30 June 2012 and reflects the current replacement cost of municipal assets. In terms of definition, the current replacement cost refers to a cost-based measure of the replacement value of an existing asset with a modern asset of equivalent capacity.

BACKGROUND

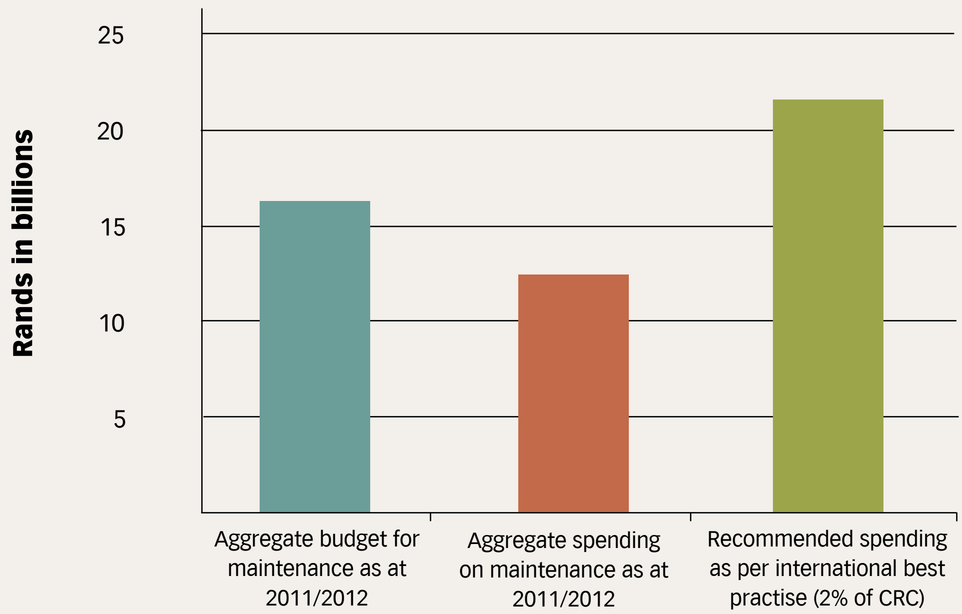
Well-maintained water and electricity distribution infrastructure is central to economic production and attracting businesses to particular localities, with the spin-offs of more jobs and a larger municipal tax base. Inadequate care of infrastructure can undermine service delivery and increase backlogs. Therefore, adequate and effective spending on asset care is an expenditure lever, capable of protecting investment in infrastructure and contributing to sustainable service delivery. However, during times of budgetary constraints, a soft target for cuts is spending on infrastructure maintenance and renewal, which is not immediately visible and hence politically less sensitive. Given the importance of this issue, the Commission investigated the state of municipal infrastructure, the extent of the renewals backlog, maintenance requirements at local government level and causes of insufficient spending on asset care. [2]

FINDINGS

The overarching finding is the absence of any legislation that adequately encompasses the full scope of asset management, as required in terms of international best practice. As a result, asset management practice is poor across the majority of municipalities because they have no road-map for planning, budgeting and spending on infrastructure maintenance and renewal.

Municipalities under-budget and under-spend on maintenance when compared to international best practice benchmarks.[3] Figure 1 illustrates (at an aggregate level) the variance between what municipalities budgeted for maintenance, what they eventually spent and the ideal (benchmark) level of spending.

Figure 1: Budgeted Versus Spending Versus Benchmark Allocation for Asset Maintenance (2011/12)



[2] For the full study, see Boshoff, L and Peters, S. 2013. Challenges, constraints and best practices in rehabilitating water and electricity distribution infrastructure, Chapter 8 in Financial and Fiscal Commission (2013). 2014/15 Submission for the Division of Revenue Technical Report, Midrand, South Africa.

[3] Best practice dictates that infrastructure assets are costed according to the current replacement cost (CRC) method and that maintenance spending is calculated at 2% of CRC.

The research found that a capital renewals programme is needed to address the backlog[4] and turn the tide towards a position of tolerable infrastructure standards. This would require municipalities to spend annually at least an additional R4 billion per sector (water and sanitation, and electricity), whereas current levels of investment in capital renewals are between R600 and R800 million per year. Based on current investment levels, in five years' time the condition of water and sanitation, and electricity infrastructure will deteriorate from poor to very poor, the capital renewals backlog will deepen and a much greater capital renewals programme will be needed to restore acceptable standards.

Table 1: Summary of Estimated Renewals Backlog

Target Condition Standard		Water and Sanitation			Electricity		
		Amount	% CRC	Years[1]	Amount	% CRC	Years
1	Optimum	R 39 billion	19%	10	R 41 billion	22%	11
2	Sub-optimal	R 19 billion	10%	5	R 25 billion	11%	7
3	Absolute Baseline	R 4 billion	3%	1	R 8 billion	5%	2

The current methodology for valuing municipal assets, used as the basis for maintenance budgeting needs, is not in line with international best practice. In South Africa, maintenance provisions are benchmarked as a percentage of the operating budget. This assumes that a municipality will generate sufficient revenue and has balanced cost and revenue streams. However, this practice is fundamentally flawed, as the intergovernmental transfers system means that assets are created without corresponding increases in municipal revenue, partly because much of the infrastructure created is of a non-revenue generating nature (e.g. libraries) and partly because infrastructure with revenue potential (e.g. electricity and water) is subsidised. Conditional grants also create assets without financing operational and maintenance costs over the lifecycle of the asset.

The International Infrastructure Management Manual advocates estimating maintenance budget needs as a percentage of current replacement cost. For the period 2005/06–2011/12, the total amount not spent on maintenance ("deferred maintenance" in annual financial statements) is R16.46 billion. This is equivalent to the 2011/12 maintenance budget, which means that one year's maintenance is foregone every six years. However, if measured against the accepted international benchmark, municipalities should have spent R21.66 billion on maintenance in 2011/12.

The results presented indicate significant under-spending on both asset renewals and maintenance. However, as municipalities tend to spend less than 80 per cent of their maintenance budget, it is questionable whether providing additional funding will have any meaningful impact. Despite the need, increasing funding provisions for asset care will have limited value given the current regulatory, planning and institutional arrangements. Areas that need addressing first are the quality of the existing regulatory regime, the poor asset management practice, and the current system of intergovernmental funding for capital versus maintenance expenditure.

[4] A renewals backlog is considered to exist when the condition of infrastructure has deteriorated below the level considered acceptable. Exactly what that level is, varies across municipalities. As a result, the backlogs cited in this research have been calculated based on the three scenarios. These have been characterised as optimum (desirable), sub-optimal (can be considered acceptable under duress), and absolute baseline (where there could reasonably be cause for widespread concern and anxiety). Under the Optimum scenario, very exacting standards are selected and assets are not allowed to deteriorate to where there is a high risk of failure. As a result, the renewals backlog would be highest under this option. At the other end of the spectrum is the Absolute Baseline scenario. Under this option, assets are allowed to deteriorate to where they are close to break-down. With this option, the renewals backlog would be smaller but there would also be significant concern around ongoing ability to deliver.

CONCLUSION

The lack of priority attached to asset care needs to be urgently addressed so that public investment in infrastructure is protected, thus contributing to increased sustainability and continuity of delivery of basic services.

With respect to maintaining and rehabilitating water and electricity distribution infrastructure, the Commission recommends that:

- National Treasury, in collaboration with relevant stakeholders such as DCoG and the South African Local Government Association (SALGA) develops local government-specific infrastructure asset management legislation, similar to the Government Immoveable Asset Management Act at national and provincial level. The proposed legislation should:
  - Cover decision-making, planning and control over the acquisition, use, safeguarding, and disposal of local government assets, to maximise their service delivery potential and benefits and to minimise their related risks and costs over their entire life.
  - Define asset management practices appropriate to the different categories of municipality, given the nature, extent and complexity of infrastructure, the financial and administrative capacity of the municipality, and other relevant factors.
- National Treasury devises local government infrastructure asset management guidelines. These guidelines should be positioned within the broader system of capacity development and performance oversight. Technical assistance should be provided to municipalities to prepare and implement credible infrastructure asset management plans.
- Provincial and national authorities must increase scrutiny of the operating implications of capital funding so as to ensure that municipalities are able to adequately maintain and renew infrastructure.

FURTHER READING

Boshoff, L. 2009. Municipal Infrastructure Asset Care in South Africa: A Reality Check. [Online]. Available: http://www/iatconsulting.co.za

NAMS and IPWEA (National Asset Management Support Group and Institute of Public Works Engineering Australia). 2011. International Infrastructure Management Manual. Wellington: NAMS.

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