Financial and Fiscal Commission Submission in terms of Section 229 (5) of the Constitution of the Republic of South Africa Act No. 108 0f 1996 as amended

Municipal Property Rates Amendment Bill 2010

1. Background

Section 229(1)(a) of the Constitution assigns municipalities the powers, among others, to impose property rates. The Constitution further stipulates that national government should enact legislation that will enable municipalities to exercise these powers and that before such legislation is passed, the Minister should consider the recommendations of the Financial and Fiscal Commission.

The Municipal Property Rates Act (MPRA) (No 6 of 2004) forms the basis for regulating the powers of municipalities to impose rates on property. The main objects of the Act are to:

- Exclude certain properties from rating in the national interest
- To make provision for municipalities to implement a transparent and fair system of exemptions, reductions and rebates through their rating policies and
- To make provision for fair and equitable valuation methods

This submission is made in terms of Section 229(5), Section 220(3) of the Constitution, and Sections 3(1) and 3(2)(a) and (b) of the Financial and Fiscal Commission Act of 1997 and assesses the merits and the demerits of the proposed Amendments to the MPRA submitted by the Department of Cooperative Governance and Traditional Affairs to the Commission in August 2010.

2. General Comments

While the Commission welcomes the spirit of th amendments which are primarily driven by the challenges that have been faced by government in implementing the Act, it is also the view of the Commission that the proposed amendments cannot be enacted outside of detailed assessment of their financial and fiscal implications on municipalities. The reasons for taking this view point include, *inter alia,* the following:

- Property rates constitute a major revenue source for municipalities.

- On average, 20% of operating revenues were derived from property rates during the 2008/09 financial year.

- With respect to the different categories of municipalities, property rates account for:

- 22% of total operating revenues in the case of Category A municipalities,

- 14% of total operating revenues in the case of the Top 21 cities, and

- 17% of total operating revenues for the rest of Category B municipalities

Thus, such ratios suggest that any amendments to the MPRA will have some fiscal and financial implications for municipalities. It is therefore pertinent that any policy or legislative development that has the potential to impact on the revenue raising ability and tax bases of municipalities, be subjected to rigorous assessment and that any interventions to ameliorate such impacts be indicated.

It is the Commission's view that the proposed amendments do pose fiscal implications for local government. One channel through which this is apparent is the proposal to exclude certain categories of public service infrastructure (psi) from rating (See Proposed Amendment of Section 17(g) of Act 6 of 2004). The rationale for excluding *psi* is that this is the norm in most other countries and that the very rating of psi may run contrary to national interest and act as a disincentive for investment. Whilst this reasoning is well understood, it is necessary that the Minister clarifies the fiscal implications of this (and other similar clauses) and how these potentially negative implications will be addressed. This is essential given that at present there are municipalities who earn income from levying rates on psi[1].

It is therefore imperative that a thorough and systematic Regulatory Impact Analysis (RIA) be done and be part and parcel of the motivation for the need to amend existing legislation. The RIA will assist in determining that regulations are efficient (i.e. regulations achieving their objectives at the least possible cost to society) and effective (i.e. regulations achieving the desired objectives of government policy with maximum precision). A RIA is essential in this case so as to ensure that proceeding with regulations can only result in an improvement in societal welfare, i.e. a situation where benefits of regulating outweigh the costs. It may even give the result that not all the desired outcomes can be achieved through regulation but by other alternative mechanisms. A RIA minimises the risks of having a regulation that will result in costs

[1] For example, eThekwini Municipality estimates that it will stand to lose approximately R13 million as a result of excluding PSI from rating alone.

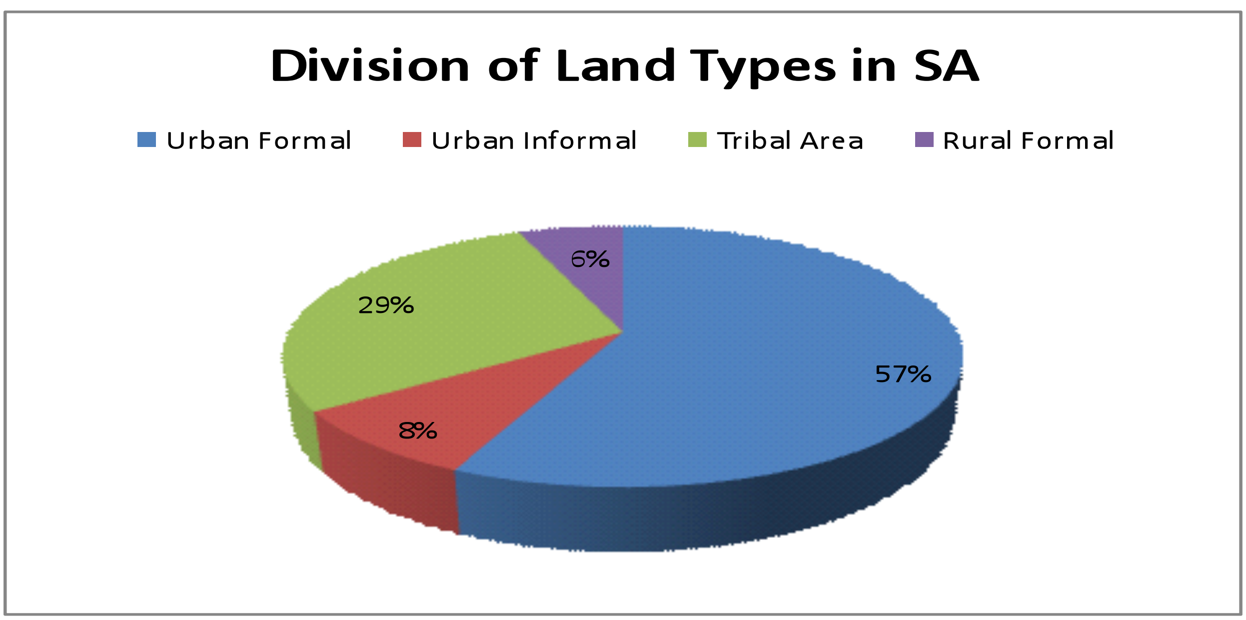
that are larger than the benefits, thus eliciting subsequent and costly revisions. Cost Benefit Analysis (CBA) is the overarching methodology for such assessments. It establishes the costs and benefits (both quantitative and qualitative) to society (business, consumers, government, other socio-economic agents) of regulating and if the latter is greater than the former, then regulation should proceed. In addition, there are other methodologies for RIA. These include the Break Even Analysis (BEA), Cost effectiveness Analysis (CEA) and the Multi-Criteria Analysis (MCA). The BEA, CEA and MCA are limited in scope and precision, but are also very useful tools of assessing these fiscal and financial implications of legislative changes.

3. Specific Comments

a. Dealing with Rural and Traditional Land

This relates specifically to the proposed amendment of Section 30 of the Act. Municipalities continue to face challenges in imposing rates on properties under traditional authorities due to, among other factors, the ambiguity over the ownership of such properties. In its Submission to the Municipal Property Rates Bill in 2003, the Commission raised this particular matter as a concern and as such welcomes this review. In certain municipalities, traditional land covers over 90% of a municipality's jurisdiction, such that the municipality's fiscal and financial survival is dependent on rates and other revenues from certain economic activities in these lands.

Figure 1



Souce 2007 Community Survey

Figure 1 confirms that almost 29% of land in South Africa is under traditional authorities. Furthermore, 93 of the 231 local municipalities have traditional land covering over 50% of their jurisdictions while 58 local municipalities have over 80% of their land under these traditional authorities. This highlights the fact that some municipalities are heavily dependent on revenues from these areas.

It is a known fact that municipalities face many challenges in valuing and rating properties in communal areas especially where traditional chiefs, who are the custodians of this land, have not been keen to get such properties valuated and worse still, property rates levied on them. In essence, the present Act is weak with respect to the issue of accountability - it makes no provision for addressing the administrative and political difficulties being faced in imposing property rates in traditional areas. This includes the ownership of such land and subsequently, which party is liable for the payment of property rates. This represents a critical aspect that requires strengthening and which is missing from the proposed Amendment Bill.

It is understandable that, given the limited financial resources that the majority of municipalities have access to, the exercise of valuing communal land without the 'return' of property rates, places a significant burden on the municipalities. That being said, it would be easy to assume, as the proposed amendment does, that the fiscal burden can be eased by allowing those municipalities who decide not to impose property rates on communal properties, the right not to value those properties. However, as expressed in the preceding section, it is important that an evaluation of the costs and benefits of this decision be used to support this proposed amendment.

b. Capacity Challenges

With respect to Section 58 of the Act and the proposed amendment thereof, it is the Commission's view that whereas capacity constraints pervade the whole of government; they tend to be more severe at the local level. The proposed amendments are detailed in terms of, for example, the experience and qualifications required of valuators, valuation appeal boards and monitoring personnel. The reality however, is that numerous municipalities suffer from high vacancy rates at senior levels (e.g. municipal manager or chief financial officer posts). Based on the existing capacity challenges experienced at the local level, it is unlikely that all municipalities will be able to attract valuators with the type of skills and experience as required in the proposed Amendment Bill. Relative to other pressing senior management vacancies in municipalities, it is possible that fulfilling this particular requirement of the proposed Amendment

Bill may not be very high on the list of priorities of municipalities. In this regard, the Commission recommends that the Constitutional imperative expressed in Section 154[2] be practically effected through regulations or policy other than through legislation.

c. Monitoring and Accountability

An important aspect of the intended set of amendments is the need to strengthen the monitoring provisions within the current Act. However, the amendment to Section 81 which calls for MECs of Local Government to check the quality of valuation rolls raises the issue of accountability of municipalities. In essence municipal accountability to the Council should not be compromised for that of the provincial government.

In line with the spirit of Section 154 of the Constitution, the proposed Amendment Bill could adopt a more 'friendlier' approach that calls on provinces to provide technical and/or financial support to municipalities so as to enable compliance by weaker municipalities. Thus this need not imply amending the legislation but rather strengthening current processes around Section 154 of the Constitution.

d. Adequate Timing so as to Ensure Financial and Budgetary Stability of Municipalities

With respect to limitations on the levying of rates, the MPRA in Section 16 makes provision for any sector of the economy to request the Minister to limit the amount of rates that can be levied on a property where such a levy is considered prejudicial to national economic policies. The proposed Amendment Bill requires that any such application be submitted to the Minister within 12 months of the date of imposition of the applicable rate. It is the Commission's view that in cases where the Minister decides to limit the extent of property rates,

- The Minister of Finance must be consulted and concur with the decision,
- Appropriate notice should be given to municipalities of this intention.
- A time-frame for phasing in these reductions should also be stipulated in clear terms, as a sudden decrease in the property rates income of a municipality can affect its budgetary and financial position.

[2] Section 154 of the Constitution states the following: *"The national government and provincial governments, by legislative and other measures, must support and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and perform their functions"* (Constitution of the Republic of South Africa, Act 108 of 1996).

e. Proposed Amendment of Section 17(j) of ACT 6 of 2004: *Tightening the Protection of the Poor from Rating*

In principle the Commission supports the need to provide relief to indigent households. In this case, the exclusion of poor households from being liable for property rates is generally not opposed by the Commission so long as it does not duplicate other relief efforts for the vulnerable at the expense of eroding the fiscal capacity of municipalities. In acknowledgment of the comprehensive social assistance system currently implemented by government, one needs to consider the affordability of such initiatives to the overall fiscus. This point emphasises the Commission's primary position regarding the need for a thorough fiscal impact assessment of the proposed amendments. Should these exemptions be applied, it may be necessary to review the intergovernmental transfer system as it applies to local government and explore ways to compensate municipalities for the potential losses in revenue either through the equitable share or other grants.

Part of the amendment to Section 17(j) proposes that the Minister be allowed to stipulate the level of support or the monetary thresholds by which properties below such a threshold cannot be rated. The Commission is of the view that such an amendment would infringe upon the fiscal authority of the local government sphere and that the determination of such thresholds should remain within the control of municipalities. To this end, it is critical to maintain a balance between the need, on one hand, to ensure more equal treatment of the poor, while on the other, not eroding the authority and accountability of the local government sphere.

f. Proposed Amendment of Section 20 and 83 of Act 6 of 2004: Principle of Differentiation

The Commission acknowledges the greater recognition that the Proposed Amendment Bill attributes to the principle of differentiation (with respect to considering municipalities by "category, type, budgetary size, or other") (See Proposed Amendments of Sections 20 and 83 of the Act). However, we would caution against being excessive in this regard as it may result in inconsistencies in the application/implementation of the Act. The Commission recommends that the basis for differentiating between municipalities should not be open-ended (which the use of the word 'other' implies).

g. Proposed Amendment of Section 1 of Act 6 of 2004: Definition of Agricultural Property

Although the Commission notes the strides taken to ensure greater clarity in defining a number of key concepts, still, the proposed amendments contain terms or phrases that may bring about confusion. One example relates to the proposed definition of agricultural property (See Proposed Amendment of Section 1 of the current Act) and the use of the word '*intensive*' to delineate which types of property will be considered agricultural and which will not. It is the Commission's view that this term is subjective and for purposes of clarity and uniformity it would be best to clearly spell out what constitutes:

- *intensive* cultivation of soils
- *intensive* rearing of livestock and game
- *intensive* propagation and harvesting of fish

h. Proposed Amendment of Section 1 of Act 6 of 2004: Game Farming

The proposed amendment to the definition of what constitutes agricultural property includes the aspect of game farming. The Commission is of the view that where the conversion of pure agricultural land into game farming threatens food security, appropriate disincentives, such as the levying of higher property rates, be applied. However, the Commission feels that this type of decision be underpinned by a more thorough evaluation of the advantages and disadvantages of such an approach.

i. Proposed Amendment of Section 3(4d) of Act 6 of 2004: Clarity of Phrases Used

The proposed amendment relates to the criteria to be used when determining exemptions, rebates and reductions for properties used for agricultural purposes. The precise inclusion is that the contribution of agriculture to the social and economic welfare of farm workers and *other members of the public* be considered. The Commission recommends that the phrase 'other members of the public' be clearly defined so as to avoid any ambiguity or misinterpretation.

j. Transitional Arrangement Number 30: Incorrect Specification of Dates

This section details the dates for which Section 8 of the Proposed Amendment Bill would come into effect for different municipalities. With respect to bullet number (a), the implementation date stated is July 2015. It appears that this is an error and that the date should be July 2011.

4. Recommendation

In line with the provisions of Section 229 of the Constitution and the FFC Act, the Commission recommends that the proposed amendments should not be enacted until such a time that a detailed assessment of the financial and fiscal implications of the proposed amendments has been conducted.

Furthermore the Commission is of the view that an assessment of the financial and fiscal implications of legislation that cuts across spheres should be a standard part of the criteria that determines the desirability of such amendments.

Dated at Midrand this the 30th day of August 2010

Bongani Khumalo
Deputy Chairperson
Financial and Fiscal Commission