FINANCIAL AND FISCAL COMMISSION

Policy Brief 2

Municipalities Can Boost Own Revenue by Optimising Property Rates

31 March 2020

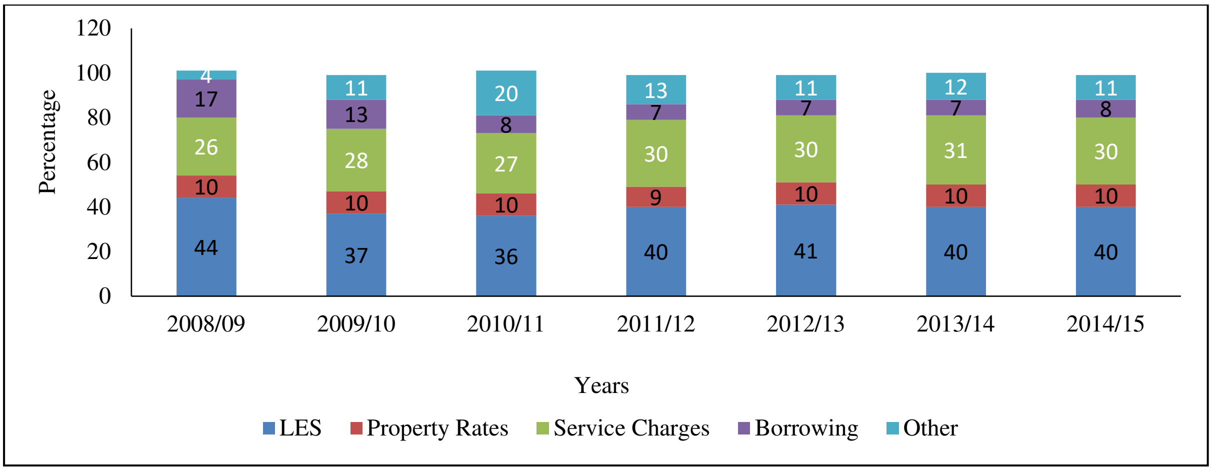
Executive summary

In terms of the Constitution of South Africa, 1996 (Act No. 108 of 1996) (Constitution) municipalities are expected to finance the larger share of their expenditure needs through municipal own revenues. However, this has not been the case as the majority of them are heavily reliant on intergovernmental transfers. This is because most of the municipalities are unable to optimise other traditional revenue sources provided for in the Constitution, due to internal and external factors. The Financial and Fiscal Commission (the Commission) carried out a study on the optimisation of the municipal own revenue instruments with a particular focus on property rates. As expected, the findings showed that metropolitan municipalities, secondary cities and large towns are the most efficient. On the other hand, the findings confirmed that inefficiencies are relatively high in small towns and rural municipalities. The results further confirmed that property tax collection depends on various factors, and the type of the municipality. The Commission provides recommendations in this Policy Brief on what can be done to improve revenue collection from property rates.

Background

In both developing and developed countries, property taxation is accepted as the most appropriate instrument to promote tax autonomy at the local level and is supported by legislation. It has an increasingly important role to play in the development of an urban strategy that underpins sustainable growth (see Bahl and Linn, 2014 cited in Ahmad, 2014). Regular and efficient administration of this tax is key to local economic development as it ensures financing of the government expenditures and development in the short- and long-term (see Stucere and Mazure, 2014; Martinez-Vazquez, 2012). In South Africa, property taxation is also regarded as an important municipal revenue source and the main tax for local government (LG). Section 229 of the Constitution, supplemented by other pieces of legislation, allows municipalities to impose rates on property. Also, in the White Paper on Local Government (1998), property taxation is regarded as a major source of discretionary own revenue for local government, and a tool that can enable the sphere to function effectively . However, the effectiveness of this tax in South Africa has been questioned by many, as some municipalities are experiencing challenges in fully utilising and efficiently administering it. Furthermore, relative to other major revenue sources, property taxes have been the lowest contributor to municipal own revenues (see **Figure 1**).

Figure 1: Municipal revenue shares



Source: National Treasury (2018)

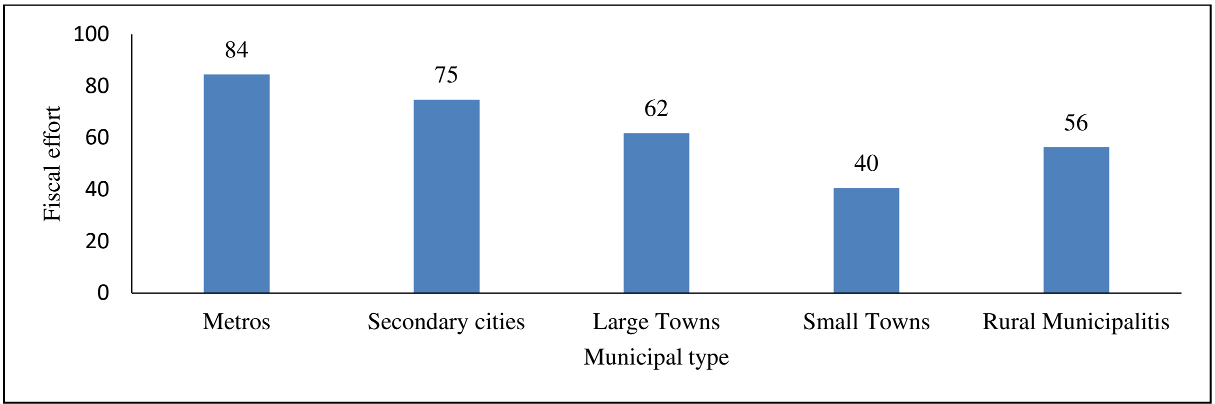
The low contribution of property taxes to municipal income has led to a significant increase of grant reliance in most of the municipalities. It raises questions as to whether municipalities are putting enough effort in collecting own revenue from their existing property tax capacity and what the constraints are. To address these questions, the study seeks to identify constraints to municipal revenue collection with a particular focus on property rates.

Research findings

Property rates collection effort

Property tax collection effort is quantified for each municipality in the sample using the data envelopment analysis (DEA) method. The results are in the form of efficiency scores, where a municipality with a score of 1 (100 per cent) is regarded as efficient, while a municipality with a score less than 1 is considered inefficient. **Figure 2** shows the achieved average scores (tax effort) by municipal type.

Figure 2: Fiscal effort by municipal type



Source: Commission computation

None of the municipal groups has an efficiency score of 1, which implies that none of the groups is fully utilising the property tax revenue source. As expected, metropolitan municipalities are the most efficient followed by secondary cities and large towns, while small towns, followed by rural municipalities, are the least efficient. Small towns and rural municipalities are only collecting 40 per cent and 56 per cent respectively of what they are supposed to collect given their property tax base, respectively. In other words, these municipalities can still collect 60 per cent and 44 per cent more revenue respectively, without expanding their property tax base.

Looking at individual municipalities, the findings show that in metros, all the municipalities are collecting above 60 per cent of what they are supposed to collect. However in secondary cities, two municipalities, namely, Mbombela and Rustenburg are found to be collecting only 40 per cent of their property tax base. In large towns, 10 out of 27 municipalities are collecting between 30 per cent and 40 per cent of the property tax base. In the case of small towns and rural municipalities, it is clear that the tax effort is very low, as most of the municipalities are collecting less than 50 per cent. Rural municipalities such as Amahlathi, Blue Crane Route, Laingsburg, Mohokare, Intsika_Yethu and Senqu are the least successful in terms of collecting municipalities as they only collect 10 per cent of what is expected given their property tax base. The municipalities in this group are predominantly small towns.

Constraints to property rates revenue collection

On the constraints to optimising property rates, the results suggest that the factors affecting municipal tax effort vary depending on the municipal type used. In metropolitan municipalities, income and intergovernmental transfers are positive drivers of municipal tax effort, while unemployment is a negative driver. In the case of secondary cities, municipal tax effort is positively affected by formal housing and access to basic services, but negatively affected by unemployment, lack of administrative capacity, traditional housing and intergovernmental transfers. For large towns and small towns, the results show that municipal tax effort is positively influenced by disposable income, but negatively influenced by unemployment and lack of administrative capacity. Intergovernmental transfers also have a negative effect on tax effort in small towns.

The findings from the survey showed that there are internal and external factors that negatively impact on the ability of municipalities to optimise property tax collection. The issues are interrelated and can be categorised as:

- ***Poor billing and credit control systems:*** This was one of the major constraints to municipal tax effort. This is attributed to various factors, such as unreliable and unavailable data, and the manner in which valuations are conducted as the bills and tariffs applied on properties are based on the valuation rolls. In most cases, valuations are done on a sample of properties and are not comprehensive, leading to disingenuous data. Some municipalities do not have the correct information to inform the billings and collection due to delays at the deeds office. Another key issue is that municipalities find it difficult to enforce payment in areas supplied by Eskom, as they have no enforcement tool in those areas. The respondents highlighted the unwillingness of Eskom to assist municipalities with disconnections in those areas. The biggest impact of this is that even if a municipality has an effective credit control policy, it cannot be applied when the municipality is not responsible for the enforcement instrument;
- ***Affordability and willingness to pay:*** The respondents viewed this as a hindrance to municipal tax effort, as consumers are willing to pay in some cases but cannot afford to do so, while in other instances consumers can pay but are not willing to do so. Affordability and willingness to pay is driven by factors such as income levels and economic activities. Low levels of economic activity lead to low income levels, high poverty levels and unemployment, which make it impossible for consumers to prioritise property rates. In some instances, consumers can afford to pay but are not willing to do so due to dissatisfaction with the services provided by the municipality, incorrect invoices and lack of awareness about the benefit of paying for property rates;
- ***Areas under traditional leadership, political will and land invasion:*** Municipalities are unable to bill in areas where land is controlled by traditional leaders. They do not have a record of the properties falling under these areas because property owners do not submit building plans and have no formal title deeds since they acquire land from traditional leaders. With regards to land invasion, municipalities are unable to bill unregistered properties; and
- ***Poor human resource capacity:*** This is one of the key constraints to municipal tax effort. Some municipalities do not have the required human resource and administrative capacity to do proper and reliable valuations.

Recommendations

With respect to optimising traditional own revenue sources, the Commission recommends that:

(a) The Minister of CoGTA, in consultation with the President of SALGA should ensure that the credit control systems of Eskom and municipalities are aligned by means of an MOU, and that Eskom assists municipalities with credit control via electricity disconnections within the municipality’s area supplied by Eskom;

(b) Provincial governments facilitate the process of municipalities in the same district municipality pooling their resources to attract qualified property valuers, where there is a need do so in order to ensure that properties are accurately valuated, and to share the costs associated with the valuation process;
(c) The Minister of CoGTA, in consultation with the Minister of Finance and provincial governments should assist local municipalities to build capacity for property rates collection.

References

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