4.4 2006/07 MEDIUM-TERM OPERATING BUDGET

Revenue Strategy

Municipalities must table a balanced and credible budget, based on realistic estimates of revenue that are consistent with their budgetary resources and experience. The needs of the residents and communities have to be met within the financial capacity and resource constraints of the Municipality. Unfortunately there has been no significant expansion in the revenue sources available to local authorities in order to serve all the needs of the community and render the services needed.

The Local Government: Municipal Systems Amendment Act (MSA), 2003 (Act 44 of 2003), requires a municipality to adopt and implement a tariff policy. Policies for the main services have been approved by Council. A draft policy for property rates has been approved in terms of the Local Government: Municipal Property Rates Act, 2004 (Act 6 of 2004).

Circumstances reasonably permitting, the Municipality should ensure that the tariffs levied in respect of the main services generate an operating surplus of 10% every financial year, or such a surplus as the Council may determine at the time that the annual operating budget is approved. Surpluses must be applied to relieve the burden of property rates and general services relating to future financial years.

The following Table 4.2 is a high level summary of the 2006/07 Medium-term Revenue Framework (classified per main category of income):

Table 4.2: Medium Term Revenue Framework

Schedule 1	Notes	Preceding Year 2004/05	Current Year 2005/06			Medium Term Revenue and Expenditure Framework		
		Audited Actual	Approved Budget	Adjusted Budget	Full Year Forecast	Budget Year 2006/07	Budget Year +1 2007/08	Budget Year +2 2008/09
Operating Revenue by Source		**R'000**	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**	**R'000**
Property rates		(1,364,535)	(1,553,500)	(1,553,500)	(1,553,500)	(1,670,113)	(1,783,279)	(1,927,529)
Property rates - penalties & collection charges								
Service charges - electricity revenue		(2,457,731)	(2,477,500)	(2,477,500)	(2,477,500)	(2,663,845)	(2,946,128)	(3,145,634)
Service charges - water revenue		(835,878)	(925,000)	(992,000)	(992,000)	(1,048,864)	(1,119,934)	(1,195,774)
Service charges - sanitation revenue		(194,398)	(217,000)	(217,000)	(217,000)	(233,289)	(249,097)	(265,965)
Service charges - refuse removal		(325,029)	(241,000)	(241,000)	(241,000)	(271,141)	(289,513)	(309,118)
Service charges – other								
Regional Services Levies – turnover		(433,504)	(400,000)	(400,000)	(400,000)			
Regional Services Levies – remuneration		(194,763)	(180,000)	(180,000)	(180,000)			
Rental of facilities and equipment		(62,588)	(47,464)	(47,657)	(47,657)	(51,934)	(55,453)	(59,208)
Interest earned - external investments		(104,901)	(40,421)	(40,421)	(40,421)	(42,442)	(44,564)	(46,792)
Interest earned - outstanding debtors		(57,336)	(120,000)	(120,000)	(120,000)	(129,008)	(137,749)	(147,077)
Dividends received								
Fines		(37,910)	(45,060)	(45,060)	(45,060)	(52,743)	(56,702)	(60,958)
Licenses and permits		(21,901)	(24,183)	(24,183)	(24,183)	(34,298)	(36,622)	(39,102)
Income for agency services								
Government Grants and subsidies - Operating	1	(338,510)	(650,449)	(691,940)	(691,940)	(1,319,280)	(1,436,713)	(1,582,367)
Government Grants and subsidies - Capital		(363,099)	(642,461)	(918,244)	(918,244)	(524,767)	(566,381)	(600,986)
Other income		(333,603)	(357,287)	(368,895)	(368,895)	(392,459)	(412,082)	(432,686)
Public contributions, donated & contributed PPE		(86,079)						
Gains on disposal of PPE		(1,910)		16	16	(14,500)	(13,875)	(14,400)
Total Revenue By Source		**(7,213,676)**	**(7,921,324)**	**(8,317,384)**	**(8,317,384)**	**(8,448,683)**	**(9,148,092)**	**(9,827,597)**

Note 1: Income generated from RSC Levies has been appropriated against Government Grants and Subsidies – Operating.

Total revenue increased by 1.58% against the 2005/06 adjustment budget and by 6.66% against the 2005/06 approve budget.

State of Revenue and Tariff-setting

The inflation forecast (CPIX) announced for 2006/07 is 5,2%. The growth parameters are set at between 3% and 6% by National Treasury, consistent with the target range of the inflation band. The growth parameters apply to tariff increases for property rates (assessment rates) and other charges (for services rendered) to ensure that all spheres of government support the national macro economic policies and targets, unless it can be shown that external factors impact otherwise.

The following principles and guidelines have been considered to the 2006/07 MTREF:

- The ability of the community to pay for services received;
- The average effect on consumer accounts;
- Realistic revenue estimates through a conservative, objective and analytical process based on realistically expected revenue, taking into consideration available actual revenue and estimated growth percentages;

- Identification and pursuance of grants from national, provincial and other agencies;
- The impact of inflation, the municipal cost index and other cost increases;
- Following an aggressive policy of collecting revenue;
- Requirements of tariff policies;
- Guidelines with regard to main services accounts; and
- Credible collection rates and collection improvement targets.

Tariff increases are unfortunately inevitable and necessary to ensure a city to run effectively and efficiently, with well-maintained services and facilities. Although a 5% tariff increase was considered at first it was made clear that such an increase can only fund the current level of services. In order to accommodate the acceleration of basic services and alignment to the 5SBP tariff increases were therefore calculated at 6% (with the exception of electricity for which 5,9% is proposed) which falls within the CTMM's policy targets (affordability requirements of tariff policies etc) and National Treasury guidelines. The proposed increases will be applicable as from 1 July 2006 with regard to assessment rates and main services.

The revenue estimates are as shown in Table 4.3 below.:

Table 4.3: Revenue Estimates

Revenue Category	Revenue with 5% Tariff Increase and Growth % Included	Additional Revenue for 5% Tariff Increase	Additional Revenue for 1% Additional Tariff Increase	2006/07 Budgeted Revenue	2007/08 Budgeted Revenue	2008/09 Budgeted Revenue
	R'm	R'm	R'm	R'm	R'm	R'm
Assessment rates	1 654,6	72,5	14,5	1669,1	1 782,6	1 903,8
Sanitation	281,1	11,0	2,2	233,3	249,2	266,1
Waste services	256,9	11,0	2,2	258,9	276,5	295,3
Water	1 026,5	49,0	9,8	1 036,3	1 106,8	1 182,1
Electricity	2 638,7	125,5	25,1	2 663,8	*2 844,9	*3 038,4
Total	**5 807,6**	**269,0**	**53,8**	**5 861,4**	**6 260,0**	**6 685,7**

Notes with regard to the 2006/07 budgeted revenue:

1 The revenue includes a 6% tariff increase with regard to water, sanitation, waste services and assessment rates and a 5,9% increase in electricity tariffs.
2 Owing to GAMAP, the new tariffs will effectively only apply for 11 months of the financial year with regard to assessment rates and waste services. This is owing to the fact that assessment rates and waste services for June will only be billed in July according to the current tariff, resulting in additional income for only 11 months. This will be the trend for every year.
3 Estimates are based on actual revenue and estimated growth patterns.
4 Revenue foregone is deducted.
5 *Excludes impact of Metro RED.

The detailed proposal for assessment rates and each main service is included in the Budget document.

National Grant (Regional Services Council Levies)

Regional Services Council Levies were payable by all businesses and employers operating within the CTMM's area of jurisdiction. National Government proposed to phase out this specific taxation vehicle, and has subsequently decided to replace the levy with a direct grant for the next three years.

The following is an extract as contained in the Division of Revenue Act (DoRA) 2006:

"Recognising that the RSC levies performed poorly with regard to the generally accepted principles of sound taxation (eg equity, efficiency, certainty, simplicity, ease of administration), the Minister of Finance announced in the 2005 Budget that RSC levies would be phased out on 30 June 2006. However, for municipalities to meet their expenditure obligations, especially in terms of poverty alleviation and social and economic development, it is important to maintain existing levels of revenue. The 2005 Medium Term Budget Policy Statement indicated that national government would compensate municipalities for lost revenue within the national budget framework, and that options for alternative tax or revenue sharing arrangements were under consideration.

To ensure a smooth transition from the old to the new system, allocations in the short- to medium-term will be based on historical RSC levy income collected. Actual RSC levies collected as obtained from audited financial statements for the 2004/05 financial year were used (and where not available, unaudited ones were used) and converted to a base for the 2005/06 financial year using actual growth rates in RSC levies income for the last three years. Growth rates were adjusted to 5 per cent in instances where lower growth rates were realised. A correction was made to the base amounts of metropolitan municipalities to take account of the zero-rating of property tax that will be implemented from 1 July 2006. The base amount (2005/06) was then allocated in terms of available funding for the 2006 Budget (R7 billion in 2006/07, R8 billion in 2007/08 and R9 billion in 2008/09). Similar to RSC levies, the replacement grant should be prioritised towards basic services and infrastructure development in under-serviced communities.

Overarching legislation will be submitted to Parliament during the first quarter of 2006 to deal with the abolition of RSC levies.

The following amounts have been included in DoRA 2006 and have therefore been included in the 2006/07 MTREF against Government Grants and Refunds.

- 2006/07 - R701,7 million
- 2007/08 - R801,9 million
- 2008/09 - R902,2 million

The 2006/07 MTREF therefore excludes any future provision of RSC levy revenue, although assessments due prior to 1 July 2006 will continue to be collected.

Equitable Share

The local government equitable share allocation is based on achieving the Constitutional requirements as provided for in sections 214 and 227 of the Constitution. In terms of these provisions, local government is entitled to an equitable share of nationally raised revenue to enable municipalities to provide basic services to low-income households and to assist municipalities in maintaining functioning administrations.

The equitable share allocation to the local sphere of government takes account of the fiscal capacity, fiscal efficiency, developmental needs, extent of poverty and backlogs in municipalities, to the extent that such information is available.

Furthermore, the equitable share to local government is determined pursuant to the DoRA, which is passed annually to take into account the current fiscal situation.

The equitable share grant is an unconditional grant and municipalities are free to regard it as general revenue, rather than earmarking it for specific programmes. Municipalities should, however, as a matter of cooperative governance, prioritise its budget towards poor households and national priorities such as free basic services and the Expanded Public Works Programme (EPWP).

Expenditure Framework

The following table is a high level summary of the 2006/07 Medium-term Expenditure Framework (classified per main category of expenditure) for the CTMM based on the outcomes of the LTFS:

Table 4.4: Medium Term Expenditure Framework

Schedule 2	Notes	Preceding Year 2004/05	Current Year 2005/06			Medium Term Revenue and Expenditure Framework		
		Audited Actual	Approved Budget	Adjusted Budget	Full Year Forecast	Budget Year 2006/07	Budget Year +1 2007/08	Budget Year +2 2008/09
Operating Expenditure by Vote								
Employee related costs		2,092,836	2,383,044	2,374,409	2,374,409	2,515,501	2,631,205	2,723,297
Remuneration of Councillors		33,255	38,628	38,629	38,629	40,752	42,178	43,655
Bad debts		315,161	128,161	128,161	128,161	106,649	106,649	109,783
Collection costs		37,775	40,637	40,637	40,637	42,669	44,803	47,043
Depreciation	2	466,304	515,239	515,239	515,239	592,729	667,233	736,471
Repairs and maintenance		867,935	910,168	895,745	895,745	959,173	1,037,303	1,118,740
Interest paid		230,518	297,000	297,406	297,406	345,900	386,653	404,630
Bulk purchases		1,628,481	1,819,880	1,886,880	1,886,880	1,990,742	2,164,941	2,299,515
Contracted services							88,754	130,985
Grants and subsidies paid		6,505	11,000	11,000	11,000	11,550	12,128	12,734
General expenses		1,409,575	1,783,962	1,879,150	1,879,150	1,995,654	2,030,772	2,196,910
Internal recoveries		(472,024)	(648,855)	(671,755)	(671,755)	(701,342)	(736,410)	(773,230)
Operating Expenditure by Vote		**6,616,323**	**7,278,863**	**7,395,500**	**7,395,500**	**7,899,977**	**8,476,209**	**9,050,531**

Note 2: Includes depreciation charges for externally funded assets; offset by transfer from reserve accounts.

With the compilation of the 2004/05 as well as the 2005/06 Medium-term Budgets, an intensive analysis of departmental expenditure was undertaken by the Budget Office of the Finance Department in consultation with the respective strategic units. This process was aimed at identifying operational capacity within the context of improved service delivery and efficiency. In many instances, these interventions and management strategies resulted in reductions at line-item level.

Taking into consideration the fact that the LTFS is modelled based on the outcomes of the previous financial planning process and other factors such as the mandatory conditions of the Restructuring Grant, the departmental base-line allocations determine the operational budgetary limitations relating to affordability, and departments had to align resource allocations to the Five Year Programme and the strategic objectives and key performance areas thereof.

Some of the salient features relating to the expenditure framework are:

- Remuneration costs (percentage expenditure reduction/operational efficiencies and gains);
- Repairs and maintenance (infrastructure repairs and maintenance a priority);
- Balanced budget constraint (expenditure cannot exceed revenue);
- Capital programme aligned to asset renewal strategy; and
- Operational gains and efficiencies resulting in additional funding capacity on the capital programme.

In terms of the operational gains and efficiencies implemented in addition to the review of expenditure trends, compared to the draft expenditure framework as tabled at Council on 17 February 2006, an efficiency gain of 1,57% was obtained specifically relating to the 2006/07 financial year, resulting in additional capital expenditure capacity which increased by 10,68% for the said financial year.

In addition to the above, departments were requested to review the level of services rendered on behalf of national and provincial government (agency services), and cost the under-funded portion of the services being rendered. The outcome of the costing analysis indicates that an amount of R202 million will be subsidised by the CTMM in the 2006/07 financial year and escalates to R231 million in 2008/09. As most of this cost relates to fixed costs (salaries etc), it will not be possible to reduce the subsidised portion in the 2006/07, but strategic units will have to enter into consultation with the respective national and provincial departments to address the subsidy gap in the new financial year.

Basic Social Package

The basic social package is an affirmation of the Municipality's commitment to push back the frontiers of poverty by providing a social welfare to those residents who cannot afford to pay for services owing to adverse social and economic realities.

The social package will also assist the Municipality in meeting its constitutional obligations as it comes to progressively realise the social and economic rights of its residents. However, in order for the CTMM to continue to deliver these basic services in a financially sustainable manner, all residents will have to pay for services that they consume over and above the free basic services provided by the Municipality.

The Municipality cannot avoid increasing tariffs, and the social package will assist in partly relieving the potential financial burden of the tariff increases on the poor. The estimated cost of the social package (revenue forgone) amounts to approximately R388,3 million for the 2006/07 budget cycle.

The table below gives a breakdown of the costs:

Table 4.5: Cost of Social Package

Service	Social Package	Budget 2006/07 R'million	Estimated Number of Households Benefiting
Water	6 kℓ	138,8	354 000
Electricity	50 kWh	88,6	360 000
Sanitation	5,88 kℓ	91,2	351 000
Waste Services	85 ℓ containers at subsidised charge	8,1	125 000
Assessment rates (Property rates)	R10 000 (site value exempted)	61,6	76 150
Total		**388,3**	

All households in Tshwane have access to the above free services, with the exception of waste and property rates. The estimated number of households benefiting in this regard is indicated above. However, households consuming services at levels greater than the free service allocation pay tariffs designed to recover the net cost of free services after taking into consideration the equitable share.

The number of households in informal areas that receive free services and the cost of these services (e.g. the provision of water through stand pipes, removal of refuse in bulk containers) are not taken into account in the table above.

4.5 CAPITAL BUDGET

The compilation of the capital budget in terms of internal capacity (council funds)/affordability was based on the outcome of the LTFS and funding options targeting an aggressive infrastructure investment framework, directly informed by the