REVIEW OF LOCAL GOVERNMENT INFRASTRUCTURE GRANTS

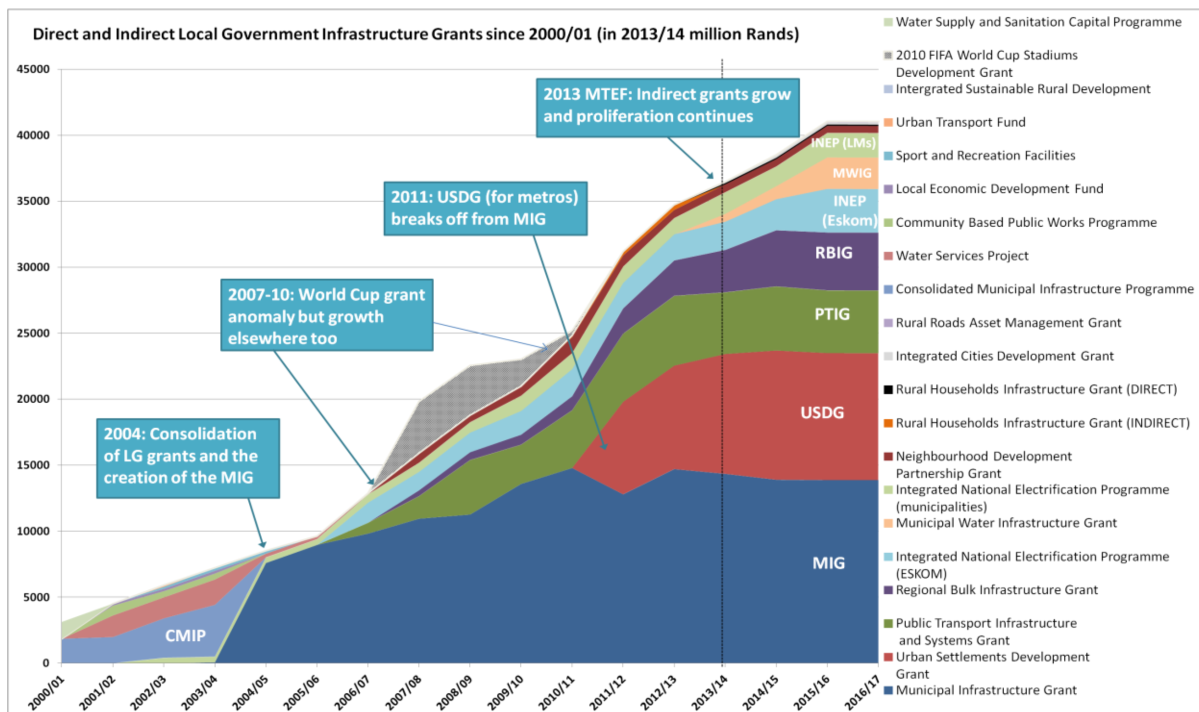
In collaboration with Sector Departments, municipalities and other stakeholders

Emerging Options for the Reform of the Local Government Infrastructure Grant System

June 2014

1. BACKGROUND

This discussion paper forms part of the Local Government Infrastructure Grant Review which aims to make evidence-based recommendations on evolving the current system of funding municipal infrastructure. A collaborative effort between National Treasury, the Department of Cooperative Governance (DCoG), the Financial and Fiscal Commission (FFC), the South African Local Government Association (SALGA), and the Department of Performance Monitoring and Evaluation (DPME), the review has also engaged other stakeholders at national and local government levels to ensure full consultation. Since the formal establishment of the terms of reference in October 2013 the review has established a working group and steering committee to pursue data analysis, literature reviews and widespread engagements to develop evidence that can inform changes to the grant system. The current grant system and its evolution since 2001 is summarised below:



Note: Allocations for the Human Settlements Development Grant (HSDG) are not included in this diagram as it is a provincial grant, though in some cases HSDG funds are transferred to municipalities to implement projects. In 2011/12 R2.2 billion in HSDG funds were shifted from the HSDG to the newly created USDG.

The review has sought to help ensure future changes are strategic in nature and the whole system is structured in a manner that encourages efficient and integrated service delivery from all stakeholders. This document sets out a range of potential changes to the local government infrastructure grant system based on this on-going interdepartmental review. The options for reform aim to improve the effectiveness and efficiency of conditional grants and ultimately improve municipal service delivery. They are the result of 'listening' workshops with municipalities and sector departments, data analysis of financial and non-financial performance information, and reviews of national and international policy and literature. In-depth discussion papers detailing these findings will be published online but this document gives a brief background to the provisional findings of the review to highlight the possible options for reforms to improve the functioning of the grant system.

2. STRUCTURE

This document commences with a review of the problem statement which is essentially the motivation for reviewing the capital grant system. It then deals with the agreed principles which are intended to guide proposed reforms. But the key objective of this document is to lay out options for reform. This range of potential options is based on the same five themes around which the initial round of consultations with municipalities and national departments (between February and May 2014) were structured:

- Grant Administration
- Allocation Mechanism
- Role of Incentives
- Renewal and Maintenance
- Grant Architecture (consolidation vs sector-based grants)

Under each theme the main issues identified during the review – either via engagements, from the data, or based on the literature and international experiences – will be briefly highlighted followed by the potential changes that could address these challenges. The options presented in this document are NOT proposals for reform that have been agreed to by the organisations undertaking the review. Instead they reflect a range of different options for possible changes to the system that the review team want stakeholders to engage with further and provide inputs on their views on which options might be beneficial.

Stakeholders are invited to submit comments on the different options presented in this discussion paper to the working group's emails by 25 July 2014: grantreview@treasury.gov.za and grantsreview@salga.org.za.

Further background information and a template document to allow stakeholders to respond specifically to the reforms set out in the boxes below can be found online at:
http://mfma.treasury.gov.za/Media_Releases/ReviewOfLGInfrastructureGrants/Pages/default_final.aspx

Before presenting the options, this document begins with a problem statement and brief summary of the principles for the grant system that were discussed and agreed to during the first round of consultations.

3. SCOPE OF THE REVIEW

While this document is focused on a review of the infrastructure grants system, it is recognised that this only partially addresses the concerns associated with municipal infrastructure and associated services provision. The capacity of municipalities to properly plan for infrastructure or to operate and maintain the resulting infrastructure adequately are concerns. The scope of this review is to evaluate and suggest reforms to capital grants rather than operating or capacity building grants, however provision of capital grants needs to be cognisant of the varying capacities of recipient municipalities and where possible include measures to improve the capacity of local government or build the right incentives for future O&M of assets. Further, with regard to the financing of infrastructure and associated services, municipalities using use own revenues to fund economic infrastructure or operate and maintain grant funded infrastructure is critically important. Yet some municipalities, particularly those serving economically weaker areas, do not achieve this balance between transfers and own source revenue leading, among other consequences, to inadequate operation and maintenance of infrastructure.

In acknowledging the role the grant system has in the broader field of municipal infrastructure and the necessity of structured national support for a sustainable system, the review has recognised that simply re-arranging current grant arrangements – i.e. which grants are administered by which departments –would be insufficient to bring about sustainable changes to municipal grants and infrastructure. Although improvements can be made in this regard, underspending of grants, poor targeting of grant funds, a lack of accountability over the use and outcomes of grants, and unsustainable management of grant-funded assets may continue under any configuration of grants. Therefore this review includes a range of options for changes to the way the grant system is managed (for planning, incentives, allocation mechanisms etc) before the options for changes to the architecture of the system are presented.

This review is also complimented by work elsewhere in government, including in the MIG policy review process, work on development charges, municipal own revenues, procurement process and the development of Integrated Urban Development Framework among others.

4. PRINCIPLES

Analysis of literature and domestic and international policy by the review's working group led to the drafting of seven principles which should guide South Africa's local government infrastructure grant system. The principles were then presented and refined following engagements with municipalities and national stakeholders in February and March 2014, resulting in the following final list:

1. Respect the Constitutional Mandates of Different Spheres

- The principle of subsidiarity means municipalities are responsible for the provision of certain infrastructure, such as water and roads; **funds must follow the assignment of functions**
- Fiscal, capacity and coordination related **economies of scale may exist at district or national level**; these should be harnessed where viable but only in consultation with the affected municipalities so as to maintain subsidiarity
- The Bill of Rights means progressively providing **access to a basic level of service** is a priority, but broader socio-economic development must also be targeted while respecting budget constraints
- The constitution requires that municipalities must be afforded the right to plan and implement their functions (including infrastructure projects needed to perform these) but the national sphere also has a responsibility to support and build capacity of municipalities to perform these functions.

2. Provide for Predictability and Stability

- Encourage sound financial management and planning processes by enabling municipalities to plan infrastructure investments for future years
- Very important for infrastructure funding due to benefits which occur over a medium to long term and frequent 'lumpy' and multi-year nature of infrastructure investment
- Municipal plans can take account of the value of future grant transfers. This ensures there is no incentive to over-commit or over-spend grant funds

3. Encourage Transparency, Simplicity and Accountability

- Grants must be **simply motivated** towards achieving recognisable **outcomes** to encourage accountability to **citizens and other spheres of government**
- Allocation criteria and processes criteria will vary across grants but these criteria must be known; especially if municipalities need apply

4. Integrate a Variety of Funding Sources and Aims

- Grants cannot meet all municipal infrastructure needs; **a mix of funding sources** from own revenues and private investment should be encouraged
- Infrastructure investment must **not solely target indigent or economic** customers; grants fund basic infrastructure for those who cannot pay but must also **catalyse investment** that is recoverable via tariffs from those can pay

- Grants must also integrate with broader government aims to ensure holistic **spatial development** outcomes occur over individual sector-based outputs

5. Be Sustainable and Unlock Growth

- Infrastructure choices (by whoever the implementing agent) must be based on **longer-term** operating, maintenance and renewal costs to the municipality
- Sustainability is also premised on having **capable municipalities** able to manage infrastructure which is funded through grants and other sources of finance; investments in infrastructure must take capability into consideration
- Recognising the **multiplier effect** of economic infrastructure investment is crucial in ensuring the longer-term **fiscal viability** of a municipality and its infrastructure assets; unlocking economic growth must therefore also be a priority and principle of the grant system

6. Involve Supportive National Departments

- National transferring officers (at national departments) must be geared towards the administration and accurate monitoring of conditional grants outputs and outcomes at municipal level
- Clear **information and support** must be given to municipalities to allow them to meet the conditions of the grant and implement national policy
- National government – along with other spheres and entities of government –must lead in ensuring local government is **suitably capacitated to implement** grants

7. Reflect Approach of Differentiation

- Municipal infrastructure needs change over time and are different across the country: grants must **avoid a 'one size fits all'** approach
- Funding mechanisms will need to change with future realities in mind too; grants should therefore be **regularly re-evaluated** without disrupting the stability of the system

5. GRANT ADMINISTRATION

In this section we discuss several possible changes to the way the conditional grant system is administered. During the first round of consultations stakeholders made a number of proposals for changes to the way the transfer of conditional grants is managed and monitored. These suggestions from national and municipal stakeholders can be grouped into the following objectives:

- The grant system should be structured to support good **planning** as this is essential for effective infrastructure rollout
- The **reporting system should be simplified** and focus on indicators that can be used to identify areas of under-performance so that targeted support can be provided to these municipalities
- National departments need **increased capacity to monitor, guide and support municipal infrastructure delivery**

Within each of these broad categories of changes there are many options for the detail of how each of these objectives could be achieved. The rest of this section discusses some of those options, and stakeholders are invited to give their views and suggestions on these options.

Structure grants to support long-term integrated planning

Throughout the review process, stakeholders have highlighted the importance of good planning in ensuring successful and sustainable delivery. The delivery of most infrastructure is the culmination of several years' work, beginning with the objectives set out in a municipality's Integrated Development Plan and sector plans, leading through feasibility studies, environmental impact assessments, project plans and budgets then going through tender processes and contracting before any construction can begin. Large infrastructure projects then often consist of several phases and can take multiple years to complete construction. However, the grant system typically has not been structured to take account of these complexities. Further, existing planning seldom places emphasis on financial aspects and particularly long term sustainability which needs to include an assessment of how O&M costs will be financed. The focus of the grant system has been on getting municipalities to spend the funds transferred within a year. Planning also needs to consider the infrastructure needs of businesses and non-poor customers and how municipal own revenues can be used to fund the infrastructure and operational costs of these services. Planning must not become a purely grant-funded activity as planning remains a core municipal function, though grant funds could be used for detailed planning and design costs associated with grant funded projects.

Reforms should move towards a longer-term approach that is cognisant of the many preparatory steps needed for the successful implementation of infrastructure projects.

It is proposed that the approach for the new grant system should be to structure it to take account of the requirements of good planning. To do this the following options (which are not mutually exclusive) could be considered:

- **Funding for planning** to be increased or at least clarify which funds can be used by municipalities for planning for projects to be constructed in future years. For example some grants allow a small percentage of an allocation to be used for planning future projects. These funds can generally only be used for project planning however and not for the earlier stages such as feasibility studies and environmental impact assessments. These rules can be amended and the amount of funds made available increased to allow municipalities to spend grant funds for the full planning cycle needed to develop infrastructure. However, there is also a risk that allowing municipalities to divert funds from

infrastructure spending to planning will be abused and funds will be used for more general operational expenses in the municipality that should be funded from other sources. To avoid this, strict conditions would have to be imposed and approvals from the National Transferring Officer would be required for funds to be spent on planning activities.

- Clarify what **support National Transferring Officers** can provide in assisting with feasibility studies. Many national departments and agencies such as the Municipal Infrastructure Support Agent (MISA) have expertise that municipalities can draw on in the early stages of project selection.
- **Enhance the role of National Transferring Officers in assessing project plans** before funds are transferred. If projects do not meet minimum criteria and feasible plans are not in place, then funds should not be transferred. This will lead to increased under-spending on grants in the short term, but should lead to better planning over the medium term.
- Gradually **introduce planning incentives into grants**, so that municipalities that meet specified criteria related to good multi-year planning receive additional allocations. Doing this will lead to larger allocations going to those municipalities that have planned properly, thereby increasing the probability that funds will be spent on projects that are completed successfully and deliver sustainable services to communities. Identifying the correct criteria to measure and reward through such an incentive will require careful structuring from national government and therefore this change should not be rushed.
- Place greater emphasis on long term investment planning. The **Infrastructure Investment Plan** is an example of an existing methodology for this that has analysis models, guidelines and training modules. Most importantly this type of planning allows for equity in access to services to be promoted and not sacrificed through providing high levels of services to wealthier households.
- Long-term planning will not be successful if the grant allocations are not stable and predictable. Municipalities need to know the quantum of funds they must plan for and be able to spend. To support this, **greater multi-year stability in grant allocations** could be introduced by introducing guarantees on the published outer years of MTEF allocations (perhaps 70% guaranteed for the second year of the MTEF and 50% for the third year). National Treasury could also be required to oversee the individual grant allocations made by departments, with the aim of minimising changes relative to the indicative allocations previously published. However, if there is evidence of non-compliance with planning requirements by a municipality then the allocations to that municipality should be able to be reduced and would no longer be subject to these protections.
- **Life-cycle planning** to be institutionalised. All infrastructure funded through grants should first undergo life-cycle costing so that there is a budget in place from the beginning for maintenance, refurbishment etc., broken down into local and national contributions. Though capital grants are the focus of this review, this type of planning would help illustrate the potential need or otherwise for operating grants in the future.
- **The requirements of different sectors need to be aligned.** Grant conditions should be such that planning for one grant takes into account the objectives of other grants and government as a whole. For example, USDG funded investments should align with the aims of the PTIG and the housing plans of the HSDG.
- Integration of grant conditions with the Spatial Planning and Land Use Management Act **(SPLUMA)** would assist in the project planning of grant funded assets to ensure they align with other government spheres and programmes

Improve the effectiveness of the reporting system to promote accountability

The current reporting system for conditional grants places a significant reporting burden on municipalities, but has not proven useful at producing data that can be used by national and provincial officials to monitor performance and target support and interventions. Data on the amount spent against each grant allocation is readily available (though not always consistent), but this is a very limited metric that says nothing of the quality, appropriateness or cost-effectiveness of the infrastructure delivered. The focus of the grant reporting system needs to focus more on the quality of indicators being measured and monitored, while also trying to reduce the sheer volume of reporting required. There is greater value to be derived from a few good indicators than multiple weak ones.

- Sector departments and National Treasury need to **re-evaluate all reporting requirements** and indicators to ensure that the data collected can be used to give a full picture of what funds have been spent on (e.g. type of infrastructure) and how efficiently (e.g. unit costs, time for completion).
- At the same time every effort should be made to **eliminate reporting requirements that do not add value** but increase the reporting burden of municipalities. Where possible, reporting should be simplified and the frequency of reporting requirements can be reconsidered.
- The quality of data can only be improved if **municipalities report fully and accurately** on their own performance. Where municipalities fail to comply with reporting requirements it may be necessary to withhold part of their transfers to encourage improved compliance.
- National departments need to improve their analysis of the data they receive and produce summaries and analysis of the data that can be used to inform decisions. A key to successful reporting systems is creating a cycle of benefit – reporting entities need a feedback loop that gives them information (e.g. comparisons) that they would otherwise not have.
- Emphasise the need for **rationalisation of reporting** and reduce the overlapping reporting burdens without diminishing useful data collected (as opposed to data that is merely 'interesting'). Fewer indicators need to lead to better quality information that can be verified. Several other initiatives are underway to improve the reporting mechanisms – this review should collaborate with them rather than replicate.
- Aims should include streamlining the current reporting, standardised reporting template, allowing central access from all interested parties.
- Greater **public access** to reports on progress on infrastructure projects should also be considered as a way of promoting greater accountability to the public and allowing citizens to monitor progress on the projects that affect them. Making information on projects easily accessible to the public can help to manage expectations while also reducing the scope for corruption as citizens can monitor progress far more closely and regularly than government officials.
- The reporting system needs to produce **data that can be used to routinely inform decision makers** on progress on the delivery of infrastructure. Data from the reporting system needs to be able to be packaged in statistics that are easy for decision makers to engage with and these should then be reported on regularly to forums of senior officials, ministers and MECs at both national and provincial level. Such forums could take the form of sector forums, MuniMECs or MinMECs, all of which could play a valuable role in monitoring progress and putting pressure on weak performers to improve. However, such forums can only operate effectively if they have good quality information, if they are only equipped with information on spending performance then they can only monitor and push performance on that one (very limited) dimension. It is therefore vital that a richer set of indicators that speak to outcomes is available for reporting on.

Improve the capacity of national government to manage and support the grant system

Changes are needed in national transferring departments to ensure that all national transferring officers have sufficient capacity to fulfil their mandates to administer grants, including determining allocations, monitoring performance and providing assistance to municipalities.

- National Transferring Officers should be more proactive in using their powers in terms of the Division of revenue Act to **enforce compliance with grant conditions**. This will require departments to monitor performance more closely and may require additional capacity within grant administration units. Transferring officers should monitor compliance and performance and use the provisions in the DORA to withhold or stop allocations in cases of non-compliance. To do this effectively, departments need to align the payment schedules for their grants to reporting dates so that payments are only made after all reporting requirements have been met and verified.
- Section 10(8)b of the 2014 DORA (and preceding DORAs) already require that transferring national officers must evaluate the performance of all programmes partially or fully funded by a Schedule 5 or 6 allocation and submit such evaluations to the National Treasury. Yet the matrix below shows that some transferring officers do not submit such reports and even when they are submitted, the information provided is not always sufficient to fully analyse and evaluate its performance. The quality of these reports should be improved.
- **Indirect grants** can be used as a mechanism for national departments to build infrastructure in cases where municipalities do not have the requisite capacity to plan and manage the infrastructure projects. However, all indirect grants must be governed by service level agreements signed with municipalities to ensure they agree to have the infrastructure built on their behalf and commit to operating and maintaining it once completed (this ensures the respect of constitutional mandates– principle 1 above).
- In municipalities that have the capacity to manage infrastructure, but have a track record of weak performance and non-compliance with grant conditions **a new type of grant might be considered that provides more control to national departments**. Such a grant could work on a **cost-reimbursement** basis under which municipalities would be paid after work is completed (much like a contractor would be treated) and not on a fixed payment schedule. This would be a radical departure from the current structure of conditional grants where the default is to transfer funds unless there is a specific reason to withhold or stop an allocation. In order to avoid destabilising municipal budgets this approach should be used sparingly. This approach would need to include a process which determines how the municipality must perform in delivery over a certain period of time to fully take back control of the grant to ensure that the municipality has the incentive to build the capacity and leadership to fulfil its mandate.
- Any department that wants to administrator a new conditional grant must prove their capacity and internal prioritisation to administer a grant. They should also go through a rigorous grant design process based on the template that have been developed by the Technical Assistance Unit of National Treasury (but never fully enforced). Departments may also request assistance with grant design form the FFC.
- Analysis shows administration costs incurred by grant administrators can vary significantly and some grants have administration costs 10 times higher (as a percentage of the grant allocated) than others. Variation is to be expected given the different nature of grants requiring different levels of

support and oversight from the national department, but too low or too high administration costs can negatively impact service delivery. The RBIG and NDPG, both project-based and closely monitored grants, spend roughly 2% of their grant allocation whereas the administering departments for other grants such as the USDG, MIG and INEP spend well under 1% of the size of their grant on administration costs.

- Funding of grant administration to be **ring-fenced within a national department's budget**, so it cannot be siphoned for other means to the detriment of the grant/service delivery. The administration of grants is a key function of national departments and they need to prioritise resources towards the fulfilment of this function, no grant funds should be redirected towards the administration costs of national government.
- National departments to ensure that the different infrastructure grants to provincial and local government are aligned to achieve overall objectives.
- Finally, emphasis needs to be placed on the technical capacity of transferring departments. The number of engineers employed in national infrastructure management positions is relatively small given the large scale of grant funding. In this regard it is worthwhile noting Section 154 (1) of the Constitution which states: '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 to perform their functions'.

Matrix of grants' annual evaluation reports

Name of Grant	Regularly provides annual evaluation report	High level financial data	High level non-financial data	Broken down per province?	Broken down per Municipality	Broken down per financial year	Does the report speak to the outcomes and outputs as per the framework
MIG	no	No annual report, but included in monthly reports	no	No annual report, but included in monthly reports	No annual report, but included in monthly reports	no	no
RBIG	yes	yes	yes	yes	yes	no	yes
INEP (ESKOM)	yes	Yes but limited	yes	yes	no	yes	Yes but very limited
INEP (MUNICIPAL)	yes	Yes but limited	yes	yes	no	yes	Yes but very limited
PTIG	Not always	Yes but limited	yes	yes	yes	no	Yes but very limited
NDPG	yes	lacking	yes	no	no	no	no

Options for Reform

After each section we present a list of "options for reform" as a way of summarising some of the possible changes that could be made to the grant system. Stakeholders are invited to submit comments on these options to grantreview@treasury.gov.za and grantsreview@salga.org.za by 25 July 2014.

Options to promote improved planning:

- Include allowance for feasibility, planning and project preparation costs in conditional grant allocations
- Enhance the role of national transferring officers in assessing project plans before funds are transferred
- Introduce incentives to reward municipalities that comply with best practices for planning
- Ensure greater stability and predictability in grant allocations over the three year MTEF period

Options to improve the effectiveness of the reporting system

- Reducing the reporting burden where possible by streamlining reporting, simplifying systems and processes, focusing on outcomes rather than outputs, and consolidating where possible.
- Re-evaluate all reporting requirements with the aim of ensuring fewer / more strategic indicators can give a full picture of grant performance that is useful at the relevant level e.g. policy makers, provincial managers, while reducing the reporting burden where possible
- Strictly enforce reporting requirements on the performance agreements of senior leadership (political and official) of municipalities while reducing the reporting burden where possible
- Enhance the capacity of national departments to analyse and package data for use by policy makers
- Make performance information for municipalities and departments accessible to all.
- Use grant data for regular briefings and peer reviews in forums such as Community Meetings Council Meetings, SALGA meetings, portfolio and select committee meetings, MuniMECs and MinMECs, Cabinet meetings

Options to improve national government's management of the grant system

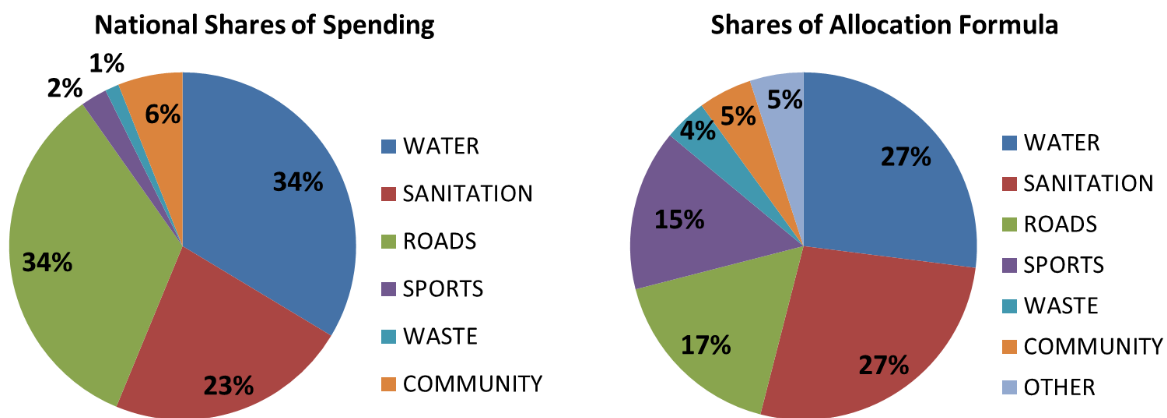
- National transferring officers should be more proactive in enforcing compliance with grant conditions.
- Indirect grants should be used to build infrastructure projects that municipalities do not have capacity to implement
- A new type of grant could be introduced through which municipalities only receive transfers after work is completed (rather than in terms of a payment schedule)
- New grants should only be introduced if it fits with the infrastructure grant system as a whole; pending that, departments must demonstrate that they have the capacity to administer the grant and provide technical support to municipalities.
- Funding for grant administration should be ring-fenced in the budgets of national departments to prevent it being diverted to fund other priorities
- All grants should be regularly reviewed to assess if: they are meeting their objective, the need still exists, and whether the grant should continue. This should not disrupt stability so windows for change to be limited, i.e. every 5 years?

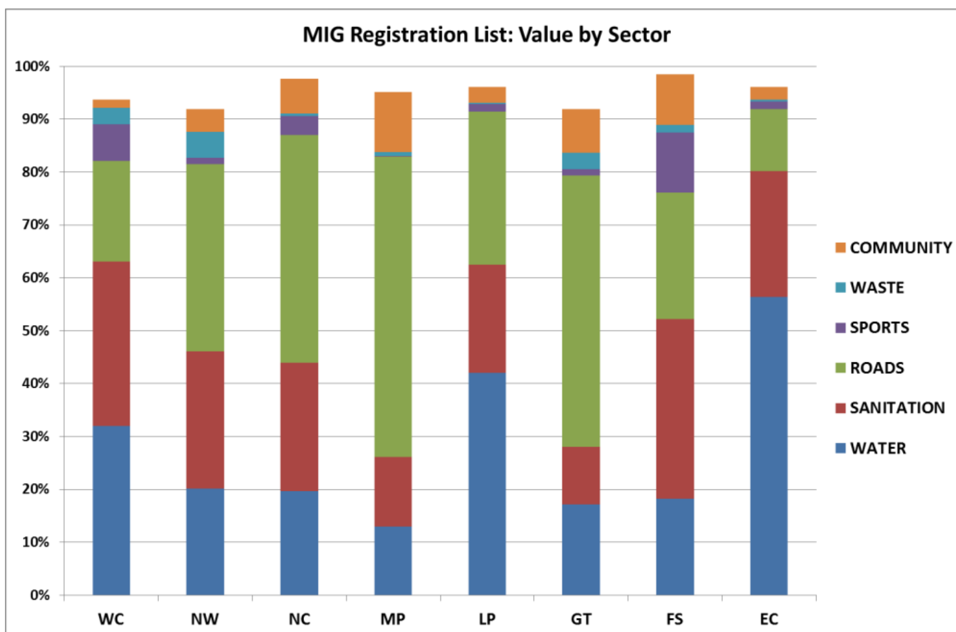
6. ALLOCATION MECHANISM

The allocation mechanism should be aimed at providing grant funding which responds to the infrastructure needs of municipalities as far as possible. This relates to the allocation of funding between different municipalities (ensuring a fair division of available resources) and the split between different service sectors. The allocation mechanism may also differ for direct and indirect grants given the different aims of each type of grant.

Current position relating to allocations by sector

An analysis of MIG spending with both the national split, in relation to what the formula provides for, and the provincial splits, is given below:





Spending on roads is much higher than envisaged in the formula which could suggest an inaccurate provision in the MIG formula or that municipalities (for a variety of reasons) choose to spend more on roads than national government would recommend. The large provision for sports and recreation facilities in the current formula (15% following a 2011 parliamentary decision) – which is not the same as the original design – is clearly not being fulfilled by municipal spending patterns. The provincial variation of MIG spending shows that municipal discretion in the way funds are prioritised between sectors generally responds to local

needs (for example responding to the large water backlogs in the Eastern Cape). But regardless of how municipalities spend the MIG, the formula split has not been updated for 10 years and updates to the MIIF model[1] suggest that the current sector split (shown on the right hand pie chart above) may no longer be appropriate and could be updated to better reflect the reality of municipal infrastructure needs over the next decade.

Direct grants: Formula vs. project based allocations

In the case of direct grants the funding is paid into the municipality's account and the municipality is responsible for management of the project. But the method for allocation varies. Both the literature review and the engagements with stakeholders highlighted several pros and cons to both formula based system (such as the MIG) and project-based allocations (such as INEP). These include the stability, transparency and equity that formula-based allocations provide, compared to the flexibility, emphasis on planning, and potential for more strategic national investment that project-based allocations encourage. Therefore it was acknowledged that a mixture of both formula- and project-based allocation mechanisms may be required in the grant system and the appropriate mechanism is dependent on the aims of the grant.

However, several issues were raised with the current formulas in use. The sectoral split used to allocate MIG funds has remained largely unchanged since its inception in 2004 and is also used for the USDG formula, despite the investment needs of municipalities clearly changing significantly over this decade. Furthermore, the formulas currently allocate based on the need for new infrastructure and has no component that considers the extent of existing infrastructure in a municipality that may require capital investment to renew, refurbish or replace it[2]. In light of the need for more sustainable management of existing infrastructure (see Renewal and Maintenance section) this was seen as shortcoming of the grant system that could be resolved by the allocation mechanisms. However it must be noted that most of the costs of renewal of municipal infrastructure should be paid for from the tariffs (which should include provision for the costs of infrastructure). Only infrastructure serving poor households should be considered for renewal funding from grants.

Indirect grants: national responsibility for project selection

In the case of indirect grants, projects should directly respond to key national priorities and programmes contained in the national development plan, so as not to replace or overlap with general municipal infrastructure responsibilities. The selection of projects to be funded is made by the transferring department and, considering the above need to focus on strategic national priorities, it will indicate the nature of projects to be supported, the approach to differentiation and the divide to be applied between direct and indirect grants. Project selection criteria also need to be identified.

[1] Which assesses the nationwide municipal infrastructure needs per sector

[2] Note that the original design of the MIG formula had a component which allocated for infrastructure renewal. However this was never utilised. Further, the original MIG policy provided for the inclusion of renewal projects but has not been implemented in practice.

Options for Reform

- Include components within formula grants that account for existing infrastructure
- Update MIG formula sector split with latest data
- Maintain a mix of both formula based allocations (to ensure equity) and project based allocations (for strategic projects) and evaluate the mechanism on a grant by grant basis
- Consider the use of hybrid allocations for some grants; formulas for a basic allocation and project applications to supplement this with more strategic investment
- Where indirect grants are to be applied, establish planning requirements to be met for national transferring departments.

7. ROLE OF INCENTIVES

Arguments for incentives

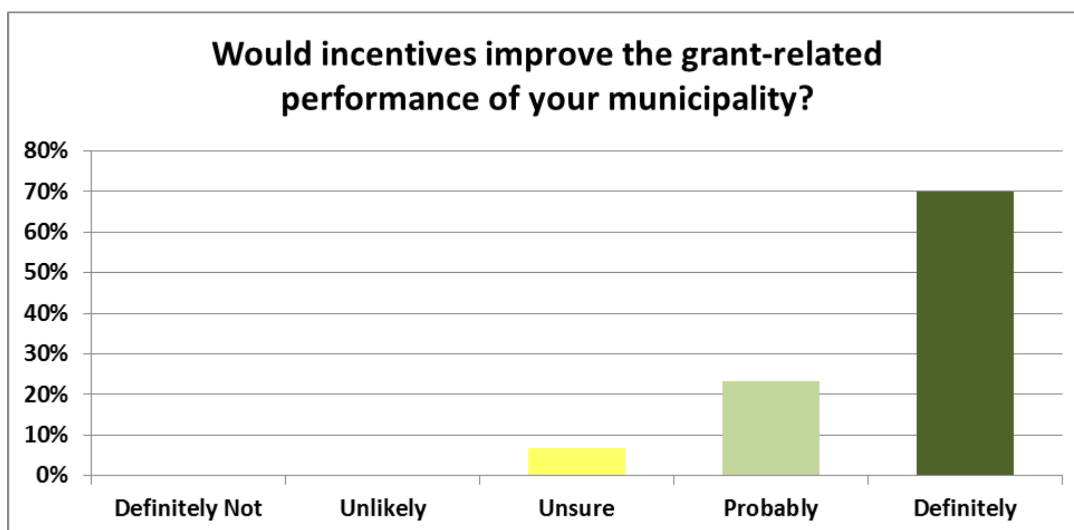
The review's work has found a variety of inputs on the topic of incentives. Most notably the theoretical literature and international experience considers properly aligned incentives to be crucial to the successful outcomes of grant funded programmes, but South African stakeholders often point to a lack of municipal capacity to respond to incentives as a constraint on implementing incentive grants here.

The literature review[3] acknowledged the capacity context and noted that "any incentive scheme to promote intended outcomes in a developing country context should include capacity building measures for local councillors, local administration and local populations". There was found to be principal-agent nature in many grant programmes, where national government is the 'principal' but the municipality, the 'agent', may not act in the manner envisaged by the principal. Incentives and regulation – much of which is contained in the current Division of Revenue Act – are ways to bring the two institutions together and focusing on a common goal. Performance based systems, such as those in Nepal, were highlighted as having a positive impact and the following benefits were listed:

- better compliance with legal and statutory requirements;
- improved planning and public financial management at the local level;
- greater attention being paid to, and improved performance in, cross-cutting areas such as environmental management, good governance and transparency;
- more focused capacity building;
- consistent use of capital grants to finance investments in core poverty alleviation areas.

As highlighted before, performance or incentive grants are heavily reliant on data which the grant administration section highlighted was noticeably absent in the South African local government context.

Municipal officials, in responding to an online questionnaire, appeared to acknowledge these benefits with the overwhelmingly positive response to the following question:



[3] Full paper forthcoming at http://mfma.treasury.gov.za/Media_Releases/ReviewOfLGInfrastructureGrants/Pages/default_final.aspx

Discussions on incentives in breakaway groups at municipal and national sector workshops however were more cautious. Many officials raised concerns about incentive-based grants adversely impacting citizens that reside in poorly performing municipalities, whereas those responsible for the poor performance (i.e. municipal decision makers) may not experience any punishment[4]. However, persistent poor performance by some municipalities means this is the status-quo at present; households lose out due to poor use of grants by the institutions and officials responsible. Incentives therefore could help turnaround such poor performance.

The *integrated cities development grant* currently allocates based on various performance indicators that are designed to incentivise certain good practices. The criteria for that grant are:

- no decrease in total debt to revenue ratio in 2012/13 (20 per cent)
- no Section 57 vacancies for longer than 6 months in 2013 (20 per cent)
- financially unqualified audit opinion by AG (with or without findings) for the last financial year (30 per cent)
- decrease in total value of irregular, fruitless and wasteful expenditure identified by AG (20 per cent)
- timely submission of 2014 BEPP and performance indicators (10 per cent)

As the grant is in its first full year this review cannot yet analyse performance to assess the impact the incentives had on performance but reception among the metropolitan municipalities has thus far been positive. The designing and monitoring of nuanced indicators however would be difficult for a grant that allocated all municipalities but it is clear from the domestic, international and theoretical analysis that incentives must not be limited to indicators that have the potential to be 'gamed' – such as the percentage spend indicator often used to evaluate a grant's success. Data availability for such indicators across all 278 municipalities is currently lacking but the aforementioned reforms in the reporting and administration of grant spending should allow the system to generate more reliable data that could inform incentive grants.

Avoiding perverse incentives

Elsewhere stakeholders discussed the perverse incentives currently in the system. One municipal PMU manager said that in the private sector he would be rewarded for completing a project under-budget, yet when dealing with municipal grants he was praised for spending the whole allocation regardless of cost. This encouragement to inflate costs or just spend allocations without the necessary planning is a perverse incentive that requires addressing.

As municipalities are responsible for most household infrastructure but not for the delivery of housing – which is a provincial function funded largely via the *human settlements development grant* (HSDG) – it was found that there is frequently a lack of integrated planning between the relevant spheres and arms of government. The availability of cheap land can (perversely) incentivise the construction of houses away from the central areas that make sense for municipalities to extend services to. Reforms in metropolitan areas (see Grant Architecture section) have tried to align different funding arms in the urban built environment but proper intergovernmental planning remains an issue. A final perverse incentive concerns investment in

[4] One workshop attendee even suggested that incentives/punishments should apply to officials'' salaries rather than municipalities' grant allocations

the renewal of existing infrastructure; many grants, including the MIG, are considered[5] by the implementing officials to be solely for the creation of new infrastructure.

Incentivising co-funding

The relatively weak conditions in many grants with respect to municipalities counter-funding grant-funded infrastructure can also promote grant dependency and contravenes 'principle 4' listed above. The literature highlights various means of structuring grants to increase municipal own contributions, such as the introduction of matching-grants. Depending on the priority of a project, and the ability of the municipality to raise its own counter-funds, a national grant could pay a percentage of the total project cost once the municipality funds the rest – this is a process used with success in France and Canada where fiscally weak municipalities get bigger match-funding incentives than the more prosperous municipalities.

Incentivising revenue raising

As the sustainability of investments made through capital grants is premised on having sufficient operating revenue the option to have an incentive in the capital grant design to promote better revenue management could be considered. The literature review found conditional grants in Germany to include such provisions whereby allocations where positively influenced by higher collection rates of local taxes.

Incentivising capacity and establishment of good systems within municipalities

In many cases the grant system invests in municipalities which do not have the capacity to manage the resulting infrastructure over the long term. In this case the term 'capacity' includes not only having professional staff in place but also systems to manage the services relating to infrastructure such as customer databases, metering with associated energy and water balance data, asset registers, etc. An incentive to promote the employment of technically and financially qualified staff or the contracting of such staff, and to promote the implementation of better systems, has the potential to make a big difference.

Incentivising resource conservation

DWA has noted the wasteful expenditure which occurs when new water supply infrastructure is provided while water resources are wasted through a poorly managed existing water supply system. This applies equally to energy. Either conditions or incentives are required to avoid unnecessary capital expenditure.

[5] Even if grant frameworks do not explicitly rule out investment in existing infrastructure

Options for Reform

- Use a gradual and differentiated approach to the introduction of incentives. Firstly the system must aim to avoid the perverse incentives listed above with the following reforms:

- *Introduce* matched-funding (especially for economic-related infrastructure) to avoid grant dependency

- Increased accountability and analysis of data (e.g. unit costs) to avoid reliance on % spend as the main performance indicator, which can lead to inflated costs at the expense of service delivery

- Grants not restricted to 'new' infrastructure, to avoid current perverse incentive to persistently build new infrastructure rather than sustainably manage existing infrastructure

- Aim to integrate planning between different spheres and arms of government to avoid grants not being aligned with each other

- Secondly the system can positively incentivise the establishment of capacity, systems and good planning:

- Application and planning processes like those introduced to the health and education grants distributed to provinces

- Accessing funds for renewal conditional on municipalities demonstrating ability to manage and maintain infrastructure e.g. through creating credible asset registers and spending appropriately on maintenance

- Thirdly, once capacity is in place to appropriately respond to incentive systems and data availability on non-financial performance is improved, introduce outcome orientated performance-based grants (this may take several years):

- Establish incentive grant for local municipalities, like the current *integrated cities development grant* does for metropolitan municipalities, which rewards performance as measured against a set of predetermined and context-specific outcomes (note this is after sufficient capacity building has been completed to ensure municipalities can comply with best-practices)

- Introduce incentive elements into the allocation mechanisms of current grants so good performance – as determined by a range of financial and non-financial indicators – in one year is rewarded with higher allocations in the next year

8. RENEWAL AND MAINTENANCE

The strongest alignment between municipalities and national sector departments was on the issue of asset management. All stakeholders raised concern that the current grant system is not finding an appropriate balance between the creation of new infrastructure which targets households currently without services, and the sustainable management of existing assets that can ensure connected households do not lose access to services. Many recent service-delivery protests were cited as high-profile examples of poor asset management; protestors' complaints were not of a lack of connection to basic services but often due to poor functionality of an existing service. To assist in the analysis and recommendations surrounding sustainable asset management the renewal (/refurbishment/replacement) and maintenance of infrastructure are discussed separately:

Maintenance

Although data in municipal budgets on maintenance is not comprehensive, analysis shows that the amount spent by municipalities on maintenance is well under 2% of the 'write down value'. Yet the amounts budgeted for maintenance are 3% to 4%[6]. This is echoed in the municipal engagements whereby technical officials and engineers were largely unaware of the maintenance funds in the system (via the *local government equitable share and own revenues*) and believe that money is used elsewhere. These inputs suggest that financial officials acknowledge the importance of maintenance when budgeting yet struggle to retain it as a priority during the financial year – a predicament echoed internationally and in the literature. Data analysis by the FFC repeats these above concerns and suggests that every six years, one year's maintenance is foregone and no municipal type managed to spend according to budget between 2005 and 2011. In some municipalities or sectors it may even be that the LGES funds combined with tariffs are not sufficient to cover maintenance even if it is prioritised, though an absence of reliable data and the fact that 34% of municipalities do not properly maintain accurate and up-to-date asset registers that are GRAP compliant[7] means a conclusive analysis is absent. Regardless of the need, the literature review was clear that a sustainable intergovernmental fiscal system required that maintenance be funded by local government. A lack of maintenance is deemed a symptom of poor financial control and systems at the local level, therefore warning against more maintenance funding from national to local government. Likewise, funding maintenance can create various perverse incentives in the grant system as without liability for the maintenance of an asset, a municipality may 'over-engineer' infrastructure rather than make sustainable investment choices (as highlighted by principle 5) or be rewarded for poorly maintaining assets in the past.

Ultimately, the need for or desirability of nationally funded maintenance remains a significant unknown due to the poor systems and lack of data. Furthermore, this review's focus on *capital* grants rather than the *operational* funding of infrastructure means it cannot make concluding statements regarding the necessity or desirability of maintenance funds for municipal infrastructure. However, given the intrinsic link between infrastructure grants and maintenance of assets (especially in sectors such as roads) and its importance for successful service delivery, options for reform can open the door for further detailed work on the area.

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[6] It should be noted that each element of infrastructure has very different maintenance requirements and therefore a flat percentage should not be used as a measure of sufficient or insufficient maintenance.

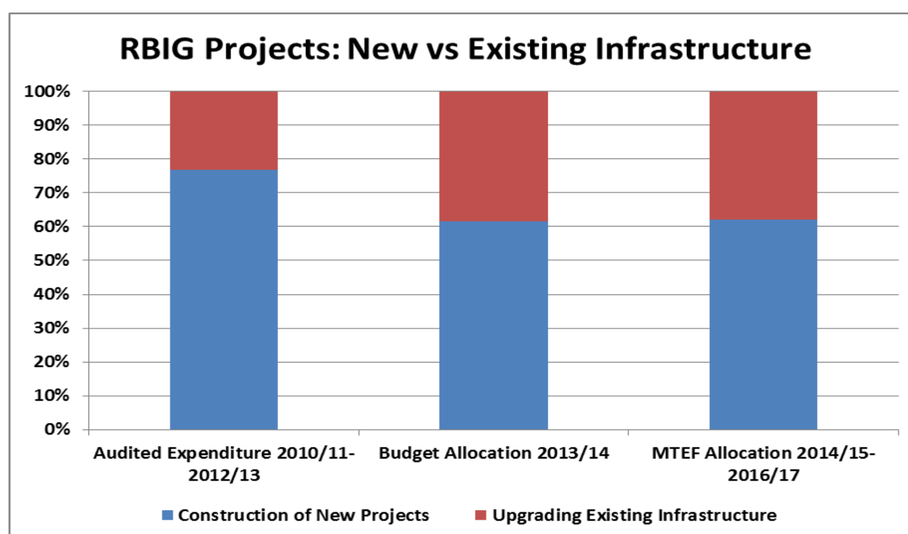
[7] And questions remain over the credibility or suitability of some asset registers

Options for Reform

- Emphasise the monitoring of maintenance funds within municipal budgets – together with the use of tariffs and equitable share funds used to fund maintenance – to provide more information on the need
- Promote full life-cycle costing as a condition in grant frameworks to ensure municipal investment decisions are sustainable ones
- Provide more guidance and funding from national government to improve the systems surrounding the management of maintenance – such as the creation of credible asset registers

Renewal

Related to the above discussion of maintenance funding is the use of capital grants for investment in existing infrastructure. The rehabilitation, renewal or replacement of assets is a capital investment yet engagements with stakeholders showed that both municipalities and national sectors view the grant system as focusing on the creation of new assets. While the MIG was created in 2004 with the intention of balancing the removal of backlogs with renewal of infrastructure, the interpretation has changed, as mentioned above, with the formula now allocating according to the number of households without access to a service, while the grant system as a whole is often viewed as backlog-targeting with a focus on extending infrastructure. Regardless of whether this was the purposeful design of the grant system, this interpretation has led to the creation of a substantial and ever expanding municipal infrastructure asset base. Some of this infrastructure has now been shown (by analysis by DWA for example) to be falling into disrepair and needs renewed capital investment. DWA's own grant, RBIG is shown below to be largely funding the construction of new projects however there has been a shift over recent years towards more upgrading and augmenting of existing infrastructure so that over the next three years the split is roughly 60:40 (New:Existing).

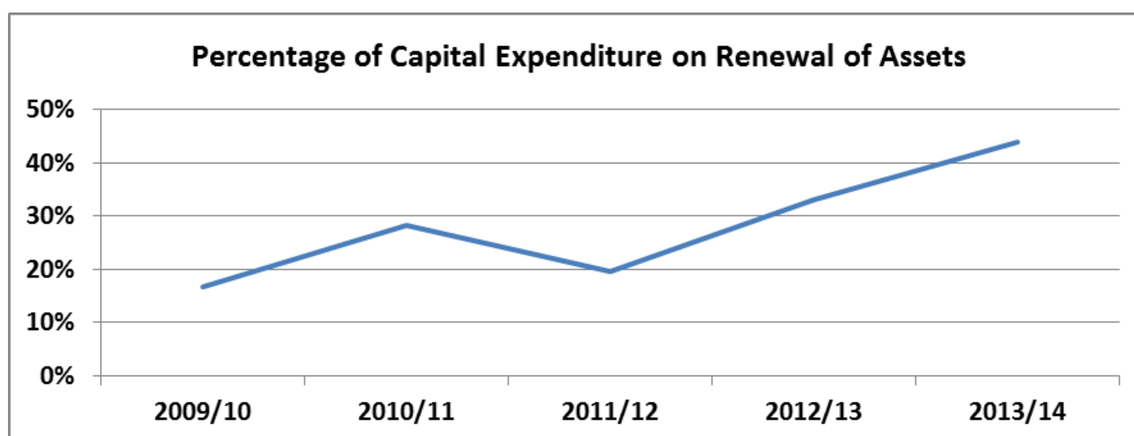


A shift in emphasis is needed therefore from the creation of infrastructure that only targets new backlogs and investment in previously grant-funded social infrastructure that still services the poor. Appropriate depreciation accounting should also be able to play a role in funding renewal and replacement of

infrastructure but as the data analysis shows, municipalities are struggling to prioritise renewal funding in their capital budgets – illustrated briefly in the table below.

(million Rand)	2011/12 - 2012/13		
	Budgeted for Renewal	Audited Spend on Renewal	% Spend
A	17 252	13 348	77%
B1	1 712	908	53%
B2	784	247	32%
B3	1 013	461	46%
B4	552	196	36%
C1	9	5	57%
C2	171	46	27%
Total	21 493	15 212	71%

Budget analysis also shows that municipalities are spending an increasing percentage of their capital budget on existing infrastructure – in 2009/10 only 16.6% of capital expenditure was on renewal of assets whereas in 2013/14, 44% was budgeted to be spend on renewal – but grants are not currently viewed by stakeholders as able to keep up with that trend due to the focus on eradicating backlogs with new infrastructure.



Conditionality around using grants for capital investment in existing infrastructure is required to ensure the grant is still targeting the appropriate recipients without creating perverse incentives for the municipality. Much like the fiscal framework's approach to new infrastructure, renewing economic infrastructure that targets rate-paying households or non-residential users should be self-funded via an appropriate tariffs policy and depreciating of that asset over time. Grant funds should therefore only be used for renewal of infrastructure that targets the poor, with own-revenue contributions if it is mixed-use.

The need for renewal or rehabilitation of infrastructure is very dependent on the quality and extent of maintenance the asset received. To avoid incentivising poor maintenance, grants should only be for infrastructure that have fulfilled their normal asset life and not been run-down due to poor maintenance with the knowledge of national funding for renewal. Or for municipalities that can prove they have fulfilled certain maintenance requirements. Knowing this investment need is also crucial to any developments on

funding renewal infrastructure and as has been highlighted previously, many of the problems surrounding the poor asset management at municipal level stem from the absence of credible asset registers detailing the state and extent of assets. There is a need then to ensure that such systems are a precursor to accessing grants for renewal, as a way of promoting – as well as funding – better asset management via the infrastructure grant system.

Options for Reform

- Include windows within existing grants explicitly for the renewal of social (grant-funded) infrastructure
- Update grant formulas to not only allocate for the need of existing infrastructure but also allocate based on the need for renewal of existing 'social infrastructure' (that serves the poor)
- Conditionalise funding on the municipality having a credible asset register which they prove they use to prioritise spending
- Renewal funding only for infrastructure that serves the poor and has been properly maintained by the municipality – to avoid perverse incentives

9. GRANT ARCHITECTURE

Differentiation

One of the principles for South Africa's grant system identified by this review is to 'reflect the approach of differentiation'. This means grants must not be structured homogenously across the country's hugely varied 278 municipalities but should be appropriate for that local context – be it a growing city, a largely agricultural rural area, or any other municipal setting in between. The establishment of the *urban settlements development grant* (following on from the *MIG cities grant*) and other urban-focused grants (i.e. the *public transport infrastructure grant* and *integrated cities development grant*) has enhanced differentiation in recent years but it is still largely a binary distinction: urban or non-urban. To enhance this differentiation, the emerging options presented as part of the grant architecture will distinguish between three broad categories:

- Metropolitan municipalities
- Emerging cities
- Towns and rural municipalities

While a metropolitan status is conferred by the Municipal Demarcation Board and described in the Municipal Structures Act, the definition of an emerging city must be agreed to (in collaboration with other stakeholders) in order to see which municipalities fall into which category and how grants need to differ between these categories.

Metropolitan municipalities

There have been a number of significant reforms to grants in recent years, with the aim of promoting more integrated and efficient cities as envisioned in the National Development Plan. These include the introduction of the USDG as a supplementary grant to metros' capital budgets and the ICDG's role as an incentive grant to integrate these different grant and non-grant funding streams. The *integrated city development grant* was introduced in 2013/14 and provides a financial incentive for metropolitan municipalities to integrate and focus their use of all available infrastructure investment and regulatory instruments to achieve a more compact and efficient urban spatial form. All projects funded by infrastructure grants including the *urban settlements development grant, public transport infrastructure grant, neighbourhood development partnership grant* and *integrated national electrification programme* (INEP) must form part of a Built Environment Performance Plan (BEPP) that encourages municipalities to **plan how the outputs funded from each of these grants will contribute to coherent outcome** for the city as a whole.

Despite the consolidation and integration in urban grants that has taken place the INEP and PTIG remain separate grants.

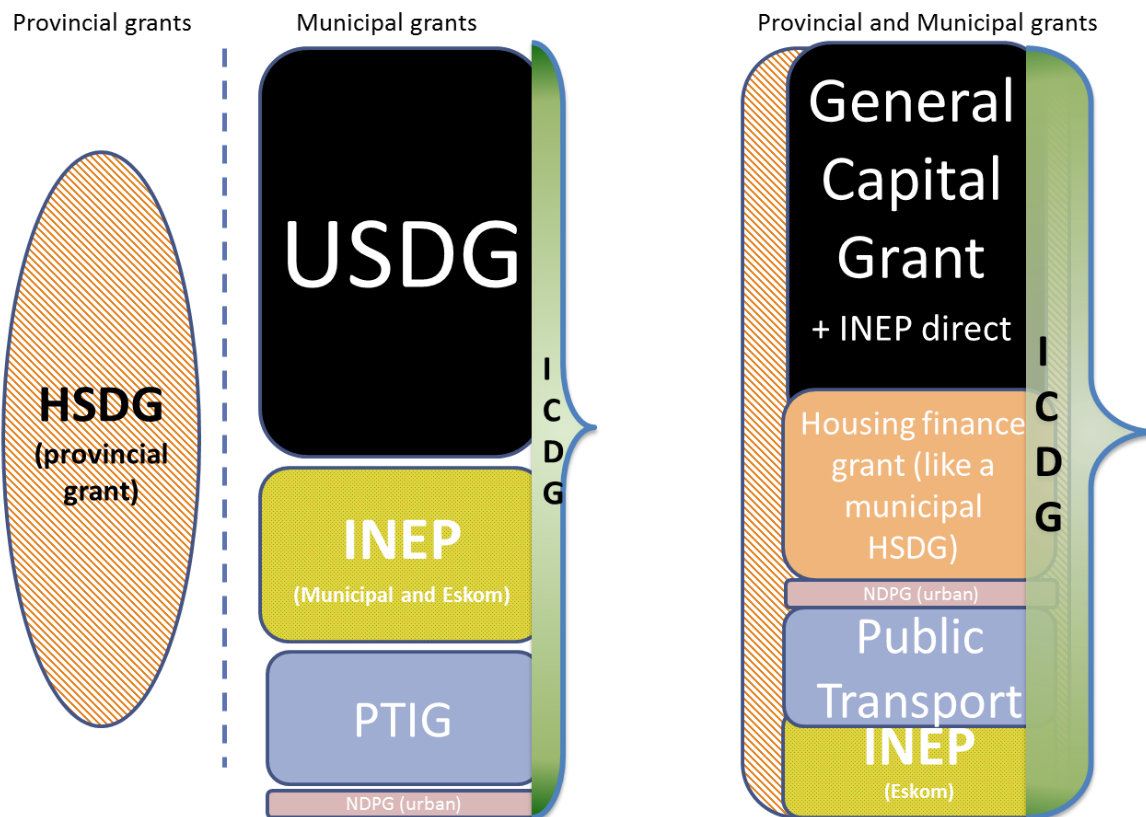
- The PTIG was conceived as a specific-purpose public transport grant for carefully selected cities. The grant has already funded the construction of the first phases of new Bus Rapid Transport (BRT)systems in some cities, but as more cities enter the construction phase the grant has insufficient funds to meet the proposed pace of rollout in all cities. At the same time, the grant has a history of under spending, with less than half of funds being spent in some years due to delays in implementation. The grant also faces other challenges including high operating costs on new BRT

systems and lower than expected ridership; and the need for more differentiation in the public transport systems in different cities. The current model also does not require significant financial contributions from cities (though they do bear substantial long-term risks), as a result there is an incentive to over-engineer systems that national government will pay for. Changes to the way projects are assessed and funds are allocated could assist in resolving these problems. As part of this, a change to formula based allocations should be considered as a way of giving cities greater certainty over the size of their future allocations and encouraging them to plan within these and make greater contributions form their own revenues.

- The INEP which funds electricity connections is the only basic service (water, sanitation, electricity, waste and roads) not currently part of the USDG. While licencing in the electricity sector means the indirect portion of the INEP grant implemented by Eskom is still required, there is no reason the direct portion could not part of a bigger grant package.

Some of the urban reforms are still underway and the devolution of the housing function from provinces to accredited metropolitan municipalities is yet to be finalised, though a capacity building grant was introduced in 2014/15 to help the transfer of this function. This review found – as has been discussed elsewhere and was a key reason for the planned accreditation – that the different means of funding houses and funding the services to those houses was frustrating implementing officials. Whether the *human settlements development grant* and the function is transferred to municipalities or not, there is a need for greater alignment of this programme with municipal plans (as outline in the BEPP and other planning documents) to ensure efficiencies in service delivery.

The review's engagements found these reforms to have been well received by metros so the proposals for metros are therefore to further entrench and support these reforms by continuing to move towards more integrated funding with greater incentives and support to achieve the desired built environment outcomes. The following diagram describes this general direction of reform:



Proposals therefore involve:

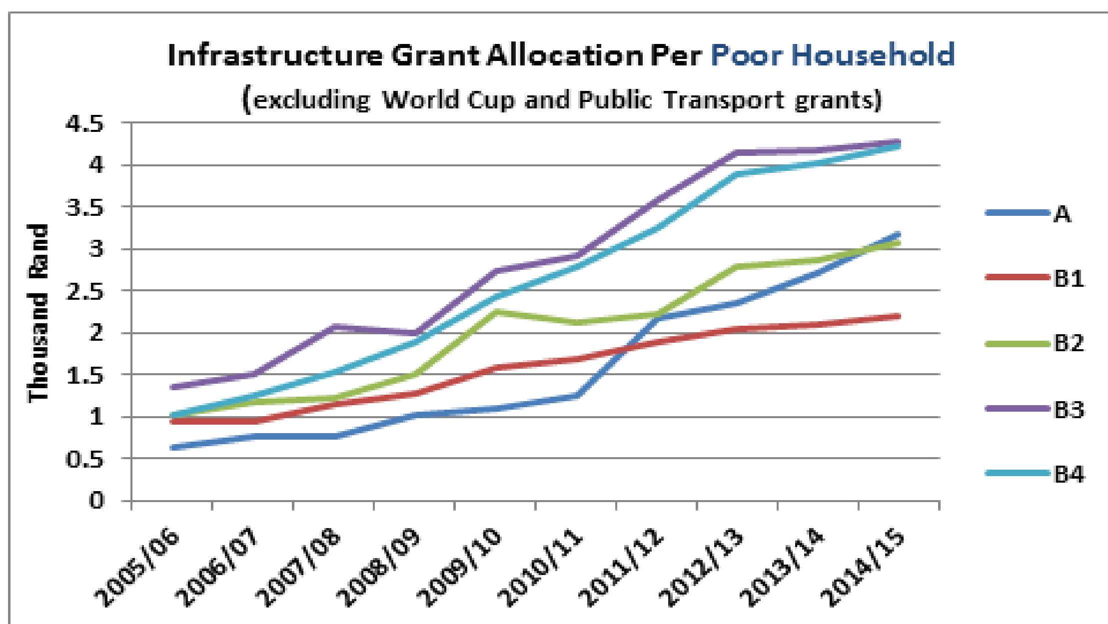
Options for Reform
• The integration of the *integrated national electrification programme* (INEP) grant into a consolidated urban grant package • Enlarging the ICDG to further incentivise integrated planning of a city's whole capital budget • Ensuring the PTIG is more closely aligned to other infrastructure and spatial transformation programmes in municipalities while remaining a specific-purpose capital grant • Make the PTIG a formula-based general transport grant that could also be integrated in a consolidated urban grant package • Accreditation of the housing function would mean parts of the *human settlements development grant* would need to be transferred directly to metropolitan municipalities

Emerging Cities

Many of the reform processes related to metropolitan municipalities mentioned above had set out to eventually include not just the metros but a range of emerging cities too, such as Rustenburg in the North West or Msunduzi in KwaZulu-Natal. Neither the *MIG Cities* nor the *USDG* has yet delivered on these

intentions and the data analysis shows a significant 'funding step' between the smaller metropolitan municipalities and secondary cities:

- Buffalo City, for example, had a *USDG* allocation of R673 million in 2014/15 but had it been part of the *MIG* formula (which allocates according to demographics, poverty and backlogs) it would have received a 65% lower allocation of R237 million and less than cities such as Mbombela and Polokwane.[8]
- While metropolitan municipalities receive an average of R4900 per poor household in infrastructure grant allocations in 2014/15 – above the national average of R4700 – emerging cities and large towns receive under R3700 per poor household. In the graph below the public transport infrastructure grant and Fifa World Cup grant, which largely targeted metros, are excluded from the analysis yet secondary cities still experience a significant funding gap:



Options for Reform

- Is there a need for a separate funding mechanism for emerging cities?
- If so, how should this category of municipality be defined and what objective criteria can be used to identify suitable recipients?
- The establishment of a consolidated funding packages – like the former *MIG Cities* – could help establish an intermediate step between the urban grant packages and the more rural focused grants
- Integrated planning that can unlock growth potential and overcome built environment challenges would be key to such a grant, what else is needed to meet the needs of emerging cities?
- Can the grant system adapt to better support growth investment? Via bulk infrastructure investment for example

[8] USDG allocations also include funds shifted to the USDG from the HSDG

Towns and Rural Municipalities

Key issues raised:

- Burdensome reporting due to numerous overlapping grants (reporting dealt with in full under grant administration section)
- Planning, implementation and capacity challenges are bigger issues for municipalities than the grant architecture[9], which is more a concern of national government due to budget implications
- Sector departments' impatience with municipal performance is evidenced in the rise of indirect grants and desire for more control over municipalities spending via sector-based grants
- Bigger issue at hand is whether municipalities are viewed as independent governments that require national funding for their own priorities, or whether they are a service delivery arm of national departments. If they are the former, as the Constitution sets out, what role can sector departments productively play in the management of this funding?
- Data analysis shows the MIG spending varies depending on the needs of the local area and encourages the municipal discretion it was set up to provide – for example the Free State's MIG spending focuses on sanitation whereas the Eastern Cape focuses on water projects (see diagram in the Allocation Mechanism section).
- Slow spending of the MIG has attracted concern from stakeholders at the national and provincial level and the official and political level over recent years. The table below shows the trend in spending below and a concerning increase underspending in recent years. However, as highlighted in the Role of Incentives section, evaluating performance on such an indicator alone would be hasty. Increasing oversight of the MIG – as evidenced by the stopping and reallocating exercise in the 2013/14 financial year – could have limited the wasteful spending and improved the outputs of the grant even if underspending increased. Unfortunately a lack of data makes conclusive analysis difficult.

[9] As one questionnaire respondent from KZN put it: "*The main issue lies within the municipalities and not with the grants per se. Its bad planning and bad oversight within the municipalities and political interference. Also the inability of municipalities to implement proper SCM processes causes massive delays etc.*"

MIG Spending Trends 2004/05 – 2012/13

Financial Year	Transferred	Expenditure	% spent	unspent funds
2004/05	4,439,942	4,368,489	98%	**71,453**
2005/06	5,436,161	5,251,226	97%	**184,935**
2006/07	5,751,834	5,587,137	97%	**164,697**
2007/08	8,261,788	7,816,444	95%	**445,344**
2008/09	8,376,142	8,086,045	97%	**290,097**
2009/10	8,738,699	7,818,608	89%	**920,091**
2010/11	9,924,806	8,545,922	86%	**1,378,884**
2011/12	11,443,489	9,248,418	81%	**2,195,071**
2012/13	13,879,161	10,963,074	79%	**2,916,087**
Total	**76,252,022**	**67,685,363**	**89%**	**8,566,659**

Sector specific policy issues to consider in designing the architecture of the grant system

Electricity

- The licencing arrangements that see Eskom licenced for electricity distribution in many areas of the country (particularly in more rural areas) while municipalities are licenced in other areas mean that electricity infrastructure will need to be funded through both direct (municipal) and indirect (for Eskom areas) grants for the foreseeable future.

Water and Sanitation

- Water and sanitation are currently funded through 5 different grants in non-metropolitan areas (MIG, MWIG, RBIG, RHIG, and WSOS). The split between these grants is based largely on the institutional arrangements through which they were created. Whether water and sanitation funds are transferred through a larger consolidated grant (including funding for other sectors) or sector specific grant, the allocation of the funds for water and sanitation should be reconfigured based on the part of the value chain being funded, for example:
  - Local water resources infrastructure
  - Bulk infrastructure
  - Expansion of reticulation networks
  - Provision of on-site services
  - Refurbishment of schemes
- Water and sanitation are both governed by the Water Services Development Plan in a municipality and are typically part of the same municipal department. It therefore makes sense to manage water and sanitation funds together in the grant system (and not as separate services).

Solid Waste Management

- Many municipal landfill sites do not meet the criteria to be licenced and in some areas new landfill capacity is needed. Developing landfill sites are very costly projects, but new sites are only typically needed once every few decades. The 'lumpy' nature of this investment means that project-based allocations (rather than formula-based) may be more appropriate.

Roads

- Although in some areas the construction of new streets is needed, the major challenge municipalities face in this sector is the maintenance and refurbishment of roads. Unlike other basic services, there is no explicit funding in the local government equitable share for road maintenance (though non-poor households and businesses pay property rates towards the cost of streets). Reforms should therefore consider allowing some grant funds to be spent on the maintenance and refurbishment of roads.
- The accounting practice relating to the replacement of the wearing course of roads, whether this be bituminous or gravel, needs to be clarified. Some municipalities put this as capital (which is a majority approach) and others put this as maintenance and then find that they do not get enough money for maintenance.
- The Rural Roads Asset Management Grant currently funds district municipalities to collect data on the condition and usage of all municipal roads and bridges in their areas. Local and district municipalities should in future use this data to prioritise spending on road maintenance and refurbishment. This should also help classify which roads are a district responsibility and the funding of district roads will need evaluation once the nature of grants for roads are finalised. Future grant structures should include incentives to reward municipalities for using this data effectively to plan their road maintenance and refurbishment work.

Community Services

- Several smaller sectors also require infrastructure and are sometimes neglected in the rush to provide access to basic services. These sectors include sport and recreation, community facilities (such as community halls), cemeteries and crematoria, early childhood development facilities, fire services, public transport facilities (such as taxi ranks), local markets and municipal buildings.
- A standard classification for this grouping of services and associated infrastructure is included in NT reporting standards:
    - *Community and social services* including community facilities (such as community halls), cemeteries and crematoria, public toilets and early childhood development facilities.
    - *Sport and recreation* including, it is assumed, municipal parks, built open spaces (such as squares) and beaches.
    - *Public safety* including, it is assumed, fire services, municipal policing facilities and disaster management centres.
    - *Housing* (but not assumed to include capital investment in housing provision)
    - *Health* (limited to offices for municipal (environmental) health staff as primary health care is not a municipal function).
- In poor municipalities, grant funds are the major source of funding for infrastructure for these sectors, yet they are often underfunded due to priority being given to basic services. This can result in municipalities having too few community amenities as they develop. The national department Sport and Recreation South Africa in particular is concerned that infrastructure for

the sports sector is underfunded yet municipalities feel they cannot invest in sports infrastructure with their MIG funds when basic infrastructure backlogs still exist.

- Creating separate funding streams for each of these sectors will produce a large number of very small grants, however having a consolidated grant for all community services would allow meaningful grant allocations to be made, leaving it up to the municipality to choose which sector to spend on. The advantage of this arrangement would be that community services would not have to be traded off against basic services any more.
- Funding maintenance for these sectors is a particular challenge as they tend not to generate any revenues and the local government equitable share does not include sector-specific funding for them (though it does fund community services more generally).

Direct and Indirect Grants

Acknowledging the varying capacity of municipalities and the frustration national sector departments can sometimes feel when municipal service-delivery is slow or not adhering to some of the principles listed above, indirect grants have had an increasing role in recent years. However that role must be structured in the grant architecture. **'Strategic infrastructure'** that is a national priority or has a regional nature than crosses municipal boundaries is differentiated from '**primary or basic infrastructure'** which can be readily provided by individual municipalities and is part of their core functions and mandate. As such options have been based around direct (often formula driven) grants for basic infrastructure whereas a project-based grants – at times indirect – will deal with the 'strategic' component. This is consistent with the original design of MIG where a top slice called 'Special Municipal Infrastructure Fund (SMIF)' was provided for but has not been implemented.

Options for Reform

- Five scenarios are presented in the diagram below
- Option 1: Full consolidation
- Full consolidation of all infrastructure funding into one grant
- Windows would allow space for indirect portions and/or more direct sector involvement in projects of strategic or national importance, otherwise the basic reticulation remains a municipal responsibility funded by a direct grant
- INEP Eskom grant remains separate in each option due to licencing (some municipal areas cannot supply electricity so rely on Eskom)

- Option 2: Majority consolidation (into two basic services and community services grants)
- Two consolidated grants split based on whether the funds are for basic services (water, sanitation, electricity, waste and roads) or more general community services (sports, street lighting, LED etc)
- Taking sports out of the basic services package should allow better and fairer investment choices without the need for ringfencing
- Would see INEP direct and the water grants incorporated into one fund, along with most of MIG
- Would need renewed interaction of the sector departments with the administering department

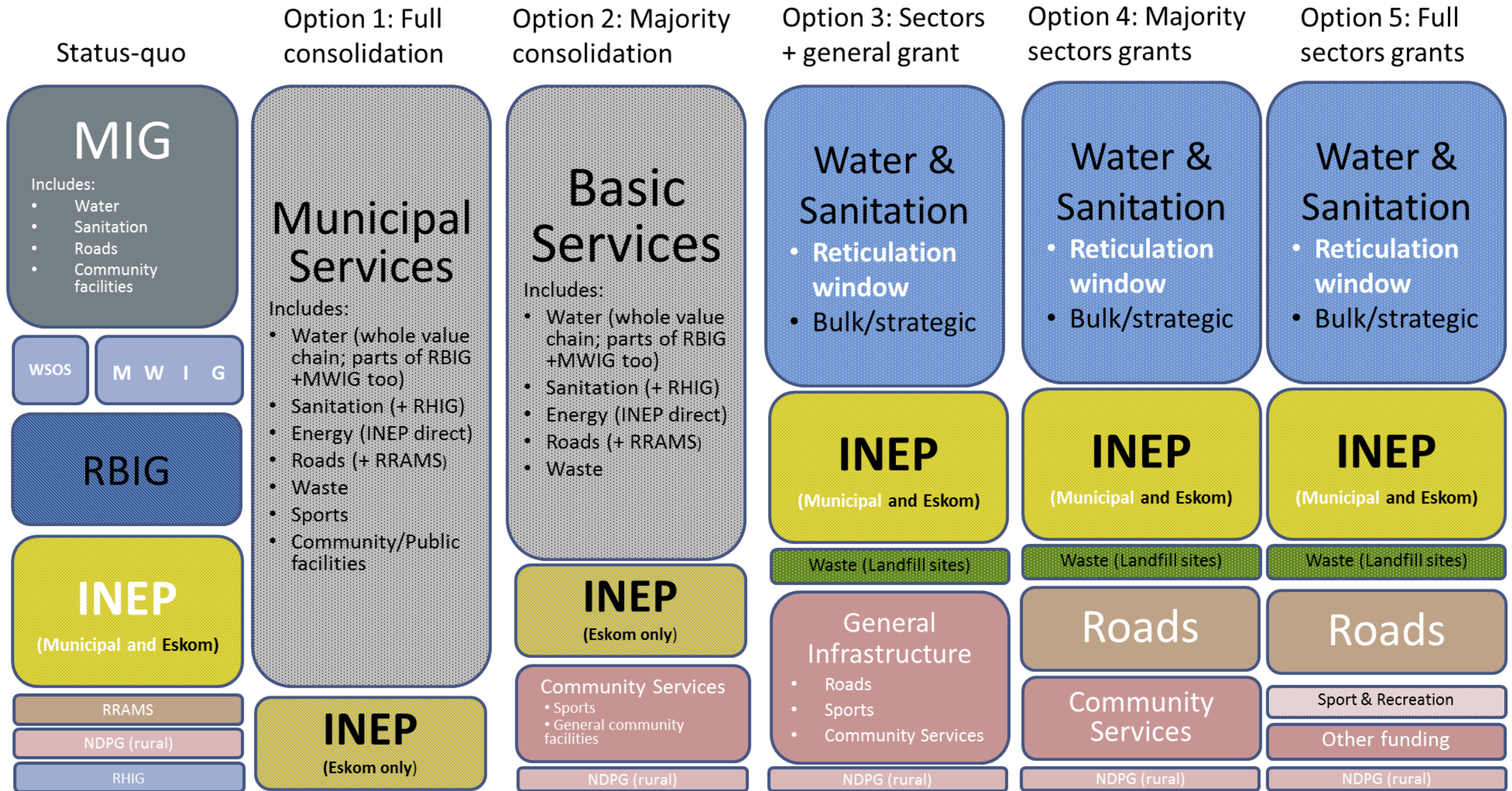
- Windows would allow space for indirect portions and/or more direct sector involvement in projects of strategic or national importance, otherwise the basic reticulation remains a municipal responsibility funded by a direct grant

- Option 3: Sector grants with a general fund (including roads)
  - Join the funding for water and sanitation currently in the MIG with other grants focusing on water and sanitation (RBIG, MWIG, WSOS, RHIG) to create a large sector specific grant
  - As before this would be a largely direct grant with windows for potential indirect allocations if projects meet certain criteria (focusing on bulk issues beyond municipal boundaries for example)
  - Leave the electricity grant as unchanged with a direct and indirect component
  - Create a waste grant from the funds within MIG that is project-based and bulk focused
  - The remaining MIG funds (for roads, sports, micro-enterprises and more) will remain in a consolidated fund that allows some municipal discretion over investment choices despite the largely sectoral nature of other grants

- Option 4: Sector grants with a community services grant (excluding roads)
  - As above but with roads as a separate stand-alone grant
  - Full emphasis on sector grants with only a small community services grant that consolidates funds for more general municipal infrastructure (sports, street lighting)

- Option 5: Full sectoralisation of grants
  - As above but with sports and recreation also as a separate stand-alone grant
  - Full emphasis on sector grants with little or zero general funds to assist municipalities in investing in municipal priorities

Note the below applies only to the 'Towns and Rural Municipalities' category



KEY: White text = exclusively direct grant. Black text = direct grant with potential for indirect