



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

## **GUIDE TO THE MUNICIPAL ASSET TRANSFER REGULATIONS**

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## LIST OF ACRONYMS

ATF	Asset Transfer Framework (the regulations)
GRAP	Generally Recognised Accounting Practice
MFMA	Municipal Finance Management Act
MSA	Municipal Systems Act
PPP	Public-Private Partnership
PPP Regulations	Municipal Public-Private Partnership Regulations
SCM Regulations	Municipal Supply Chain Management Regulations
The Guide	Guide to the Municipal Asset Transfer Regulations
The regulations	Municipal Asset Transfer Regulations

## **PART 1            FOREWORD**

The Local Government: Municipal Asset Transfer Regulations were gazetted on 22 August 2008 (Government Gazette Number 31346), in terms of the Municipal Finance Management Act, No 56 of 2003. The Regulations took effect on 1 September 2008, and is applicable to all municipalities and municipal entities transferring and disposing of capital assets, or granting a right to use, control or manage capital assets.

This supporting guide was developed to assist municipalities and municipal entities in the implementation of the Regulations. This guide is also posted on the National Treasury website [www.treasury.gov.za/mfma](http://www.treasury.gov.za/mfma). All comments or suggestions to improve this Guide should be sent to the MFMA email address [mfma@treasury.gov.za](mailto:mfma@treasury.gov.za).

Thank you for your participation in effective implementation of the MFMA.

Chief Directorate: MFMA Implementation  
National Treasury

## PART 2        OVERVIEW

Municipalities are custodians of vast amounts of public assets worth billions of Rand, including land, buildings, infrastructure, plant and equipment that have been procured through public resources. On a daily basis these assets are being acquired, built, maintained and disposed of for the purpose of community service provision. There has been a need to improve transparency and accountability through a practical framework for a municipality or municipal entity which wishes to transfer or dispose of an asset. The regulations set out key principles and procedures and deals with the process to be followed by a municipality or a municipal entity when transferring or disposing of capital assets.

The Municipal Finance Management Act (MFMA) has identified the need to provide adequate safeguards by municipalities and municipal entities, in the transfer and disposal of capital assets. The regulations constitute the prescribed framework referred to in sections 14(6) and 90(6) of the MFMA, and also gives effect to section 168(1)(f), (g) and (p) to support and facilitate the effective implementation of the Act. The regulations cover all transfers and disposals of municipal assets, including transfers to private sector parties, other municipalities, municipal entities and national and provincial organs of state and the granting of temporary rights to use municipal assets (such as leasing of assets).

To assist in the identification and management of risks associated with the transfer and disposal of capital assets, the regulations adopt the following key principles which must be considered and implemented in the context of any asset transfer:

- Valuation principle, i.e. the need to attach a value to the transfer or disposal of a municipal capital asset, in order to ensure that the interests of the municipality or municipal entity and each of its stakeholders are not prejudiced by the transfer or disposal;
- Continuity of service principle, i.e. the need to ensure the uninterrupted continuance of a municipal service when a municipal capital asset that is being used in the delivery of that service, is transferred or disposed of, particularly when the asset is used in the provision of a minimum level of basic municipal service;
- Risk transfer principle, i.e. the need to transfer the risk relating to a municipal capital asset in conjunction with the transfer of the asset; and
- Asset preservation principle, i.e. the need to prevent the indiscriminate or unsustainable transfer or disposal of a municipal capital asset in order not to undermine the ability of the municipality or municipal entity to render or expand municipal services in the longer term.

The regulations will apply to the transfer or disposal of most municipal capital assets. A capital asset is defined to include all immovable assets such as land and buildings and certain movable assets which are used for the production or supply of goods and services, for rental to others or for administrative purposes, where a future economic or social benefit can be enjoyed, such as plant and equipment. Capital assets must have a life span of at least one year. A more rigorous and transparent process must be followed when transferring or disposing of certain classes of assets such as those required for the provision of a minimum level of basic municipal services and assets classified as high value.

The regulations consider two types of asset transfers, those involving “exempted” capital assets and those involving “non-exempted” capital assets. Sections 14(1) to (5) and 90(1) to (5) of the MFMA do not apply to the transfer of an exempted capital asset. An exempted capital asset is an asset transferred to another organ of state as a result of any of the following circumstances:

- a review by a municipality of its service delivery mechanisms for the performance of a municipal service in terms of Chapter 8 of the Municipal Systems Act (MSA), and the municipality appoints another organ of state to perform that service;
- a reorganisation of powers and functions between a parent municipality and its municipal entity;
- an assignment of any of the powers and functions of a municipality to another organ of state by national legislation or in terms of a power contained in national legislation;
- when municipal housing or land is transferred to a national or provincial organ of state for housing for the poor in terms of a national or provincial housing policy;
- when the transfer is required or permitted in terms of national legislation and that legislation determines the conditions of the transfer; or
- any other circumstance provided that the capital asset to be transferred to the organ of state is determined by resolution of the council to be not needed to provide a minimum level of basic municipal service and is surplus to the requirements of the municipality and municipal entity.

A municipality or municipal entity will firstly have to determine the combined value of all capital assets it intends to transfer or dispose of in the particular financial year (such must also be reflected in its MTREF budget). If the combined value of such capital assets exceeds five percent of the total value of its assets (as determined from latest available audited financial statements), a public participation process must be followed for each of the capital assets to be disposed of, irrespective of each capital asset's individual value. (Refer ATF Regulation 5 and 8).

The process to transfer or dispose of non-exempted high value capital assets must commence with a request to the council to authorise a public participation process. A high value asset is an asset which is valued either in excess of R50 million or 1 per cent of the total value of the municipality's assets (whichever is the lesser), or a lower value determined by the council. The request must be accompanied by a comprehensive information statement which shows the reasons for the proposal, the asset value, the valuation method to be used, the benefits of disposal and the anticipated proceeds and expected gain or loss that could be anticipated if the proposal went ahead.

Upon the council authorising the public participation process the accounting officer must make public the information statement and invite the local community, the national government and the relevant provincial government, at least 60 days before the council will meet to consider the proposal, to submit any comments or representations.

At a meeting open to the public the council must consider the proposal and take into account all comments and representations and a range of prescribed considerations prior to deciding whether the asset should be transferred or disposed of.

A key consideration for the council is to decide whether the asset is required to provide a minimum level of basic municipal service or not. If it is agreed that the asset is required to provide a minimum level of basic municipal service, then the asset may only be transferred to another municipality, a municipal entity or a national or provincial organ of state subject to agreement over the continuation of the service. Such transfers are only permissible in those instances described above i.e. instances which make the asset exempted from the provisions of sections 14 or 90 of the MFMA.

When considering the transfer of a service, for example waste collection, a municipality must first identify all of the assets associated with that service. This includes plant, machinery, land, buildings as well as staff and if permitted or required by legislation, any associated liabilities, such as staff pension funds. Any subsequent transfer of staff must follow the applicable labour legislation and legislation regulating the transfer of liabilities associated with such staff. Such a transfer must be considered as a holistic exercise acknowledging all impacts it may have on the parties to the transfer and the sustainability of the service.

Such assets may only be transferred on the condition that any subsequent transfer of the asset may only occur with the permission of the municipality and that ownership of the asset must revert back to the municipality should the organ of state cease or be unable to provide the service which is attached to the asset.

The parties to the transfer must firstly agree if compensation is to be paid. If it is agreed that compensation is appropriate, such compensation is to be based upon the value of the assets to be transferred. This is determined by generally recognised accounting practice (GRAP) or in the absence of such standards any of the following methods:

- depreciated replacement cost;
- fair market value;
- historical cost with adjustments for wear and tear; or
- realisable value

Whilst the regulations pay particular attention to high value assets and those required to provide a minimum level of basic municipal service, it is acknowledged that the majority of assets (and therefore the majority of disposals and transfers) will fall outside this criteria. Nevertheless, it is incumbent on the municipality to introduce appropriate measures in its policies and procedures that will safeguard public assets. Capital assets not required for the provision of a minimum level of basic municipal service and all other assets not regarded as high value may be transferred or disposed of through the competitive bidding process contained in the Municipal Supply Chain Management Regulations (SCM Regulations).

Assets transferred to another organ of state in terms of certain exemptions will not need to go through the normal process of competitive bidding, where the transfer is guided by other legislation such as the MSA or Municipal Structures Act. This is discussed in more detail in Part 4 of this Guide.

The Asset Transfer Regulations also capture circumstances in which a municipality or municipal entity grants a right to use, control or manage a capital asset. These types of transactions include leasing, letting and hiring out arrangements and will apply to assets with a value in excess of R10 million for a period in which the right to use the asset exceeds three years.

The proceeds of the sale of any exempted asset transferred to another organ of state must first be applied to discharge any borrowing against that asset. However, in the case of an asset required to provide a minimum level of basic municipal service, in most circumstances any liabilities attached to the asset must be transferred to the organ of state.

Generally a municipality or municipal entity must receive fair market value for capital assets but where the plight of the poor or public interest demands otherwise it will be possible to consider a lesser value provided that the following matters are taken into account (Refer ATF Regulation 13):

- the interests of the state and the local community;
- the strategic and economic interests of the municipality or municipal entity;
- the constitutional rights and legal interests of all parties;
- whether the interests of the parties to the transfer should carry more weight than the interests of the wider community; and
- whether the local community would be better served if the asset is transferred at less than its fair market value.

These regulations do not apply to the transfer of capital assets associated with housing on municipal land and the transfer of that municipal land, for the poor to beneficiaries of such housing. It is considered that such assets should be provided to the poor based on need and not necessarily based on commercial principles provided that the process that guides the transfer remains fair, equitable, transparent and competitive. When municipal housing or land is transferred to a national or provincial organ of state for housing for the poor then such transfer must be in accordance with Chapter 3 of the ATF Regulations, national or provincial housing policy and is exempted from the SCM Regulations (Refer ATF Regulation 20).

Furthermore, most public-private partnership (PPP) agreements will not be subject to these regulations as the transfer or disposal of assets associated with these initiatives are separately regulated by the MFMA and Public-Private Partnerships Regulations (PPP Regulations). The Asset Transfer Regulations exempt a number of other municipal transactions, in instances when those transactions are adequately regulated by other legislation.

## PART 3      INTERPRETATION AND APPLICATION

### Summary

Chapter 1 of the Asset Transfer Regulations contains the general principles and definitions which guide implementation (*regulations 1, 2 and 3*) of the regulations. Chapter 3 of the regulations outlines the circumstances in which an asset transfer is exempted from sections 14(1 – 5) and 90(1 – 5) of the MFMA (*regulations 19, 20 and 21*), and Chapter 5 provides a list of exemptions from the regulations (*regulation 50*).

Part 3 of this Guide summarises the governing principles contained in the regulations and help identify key terms and concepts relating to capital assets, transfer and disposal, powers and functions and the parties to a transaction. This Part also describes when sections 14 and 90 of the MFMA do and do not apply and the circumstances where a transaction is considered to be exempted.

### 3.1    GOVERNING PRINCIPLES

#### 3.1.1 Governing principles

These regulations are governed by four overriding principles (*regulation 3*):

- 1) **valuation principle:** a capital asset to be transferred or disposed of must be given an appropriate value so that the municipality, municipal entity or any of its stakeholders are not prejudiced by the transfer or disposal;
- 2) **continuity of service principle:** when a capital asset used in a municipal service is transferred or disposed of, that service must continue without interruption, particularly when the asset is being used to provide a minimum level of basic municipal service;
- 3) **risk transfer principle:** when a capital asset is transferred, the risk attached to that asset must also be transferred; and
- 4) **asset preservation principle:** indiscriminate or unsustainable transfers or disposals that undermine the ability of a municipality or municipal entity to provide or expand services should not be considered.

These four principles should always guide the municipality or entity intending to transfer or dispose of any capital asset. Any doubt over the interpretation or application of the regulations should be resolved within the context of these principles so that the 'spirit' of the legislation always prevails.

This means that the municipality or entity should ensure that all assets are first valued, and that at the start of any process to transfer or dispose of the asset, all of the consequences of that transfer or disposal are very carefully considered.

For instance in a municipality that has contracted an external service provider to carry out its meter reading and inspections, the council in view of the proposed contract also wishes to sell its fleet of inspection vehicles. Before it does this, it must first consider whether the sale of those vehicles would impact on this or any other service.

The municipality should then ask itself: are these vehicles also used to transport works staff to various jobs around the municipality and if so, what alternatives are available and what are the costs and benefits of these alternatives? When the contract with the external service provider comes to an end, will the municipality be able to negotiate from a position of strength given that it no longer has the necessary inspectorial vehicles to take back that function itself and if not what plans has it made to mitigate against this weakness?

There would be many other considerations for a municipality or entity prior to deciding this matter. This Guide contains a number of further examples in the form of case studies which are used to illustrate some of the many other factors that must be considered when transferring or disposing of certain assets.

## 3.2 ASSETS

### 3.2.1 Types of assets

#### Assets

In these regulations an asset means a tangible or intangible resource capable of being owned. Tangible assets include physical assets such as land, buildings, plant and machinery; intangible assets include goodwill and human capital, and similar assets that cannot necessarily be seen. Assets are very often subject to different classifications such as strategic, biological, infrastructure or network assets, although these are not differentiated in these regulations (*regulation 1 – definitions*).

It is important that a municipality and each of its municipal entities have a fully up-to-date assets register that records the name, type, location and value of each asset that

it owns. The information contained within this register of assets will be required when the municipality or entity makes a decision on whether it chooses to transfer or dispose of an asset or not.

## **Capital Assets**

It is important for a municipality or entity to determine its capital assets within the ambit of these regulations, since the definition of a “capital asset” for purposes of transfers or disposals or to grant rights to use/ manage or control in terms of these regulations may be different from what are understood as capital assets for purposes of generally recognized accounting practice (GRAP).

A capital asset may be immovable (including land, property, buildings), or movable (including plant, machinery, equipment, furniture, computers), provided that in the case of a movable asset, it has a life span of at least one year, and can be used to produce or supply goods and services, for rental to others or for administrative purposes (where a future economic or social benefit can be enjoyed). A capital asset may include things such as a swimming pool or dam or even a gas or chemical able to be used for some benefit for the municipality and the community (*regulation 1 - definitions*).

As these regulations cover only the transfer or disposal of capital assets, items that are not capital assets within the ambit of the “capital asset”-definition such as stationery or stores and other consumables would not be applicable.

## **High Value Capital Assets**

### **A. When are all assets to be transferred or disposed of to be regarded as “High Value”?**

The transfer, disposal and granting of rights to use, manage or control capital assets by municipalities and entities takes place in the broader context of the MFMA that requires transparency and accountability within the budgetary and financial planning processes and within objectives agreed with the community in the integrated development plan.

The municipality or municipal entity will firstly have to determine the combined value of any capital assets it intends to transfer or dispose of in the particular financial year (such must also be reflected in its MTREF budget).

If the combined value of such capital assets exceeds five percent of the total value of its assets (as determined from its latest available audited financial statements), a public participation process must be followed for each of the capital assets to be

disposed of, irrespective of each capital asset's individual value. (Refer ATF Regulation 5). In this event we would suggest to fast track the process that the public participation process for all the combined assets, be combined with the annual budget consultation process, whilst ensuring in cases of assets to be identified per ward is also discussed during that consultation process with communities and specifically wards that are to be affected by such transfer or disposal.

If the combined value of capital assets to be disposed of or transferred during the financial year **does not exceed five percent** of the total value of its assets, the municipality or entity will have to assess whether each individual capital asset to be disposed of in that particular year is a high value capital asset (Refer ATF Regulation 1 for the definition of "high value"). For each high value capital asset a public participation process must be followed.

If it appears that **any or all** of the assets are "high value", council must be approached to authorize the public participation process. In order to approve such council will require the minimum information statement. (Refer ATF Regulation 5(3) or 8(3)). After this approval has been obtained, the administration may proceed with the public participation process. Only the municipal council can authorize a public participation process. Hence, it requires proper planning and a forward looking approach to this matter.

## **B. Determining whether individual assets are "High Value"**

As stated above, **only if** all the capital assets to be disposed of or transferred in a particular year **are not high value**, will it be relevant to determine in respect of individual capital assets to be transferred or disposed of in the year, whether they are high value.

A high value capital asset is a capital asset whose fair market value exceeds R50 million or 1% of the total value of all the capital assets of the municipality or entity, whichever is the lower (in a single transaction), or otherwise a value determined by the council provided that value is less than the R50 million or 1% threshold.

For example:

- A municipality has recorded in its accounting records total capital assets worth **R600 million** after depreciation.
- The 1% threshold (1% of the total value of assets) equals **R6 million** ( $R600\ 000\ 000 \times 0.01 = R6\ 000\ 000$ ).

- Council has determined its own threshold to recognize any asset with a value of **R4 million** as a high value capital asset.
- The municipality wishes to sell its main administration building based on its fair market value for **R5 million**.
- The high value threshold is either R50 million, 1% (R6 million), or the amount determined by council (R4 million) – whichever is the lower.
- The lowest figure is the council determined threshold of R4 million.

Therefore the sale of the administration building would be regarded as a high value asset transfer as its fair market value of R5 million exceeds the R4 million threshold amount determined by Council.

High value capital assets may therefore vary from municipality to municipality depending on the size of the municipality's asset base and the threshold policies of the municipality (*regulation 1 – definitions*).

It is important to note that even if an asset is not “high value”, council may still make the disposal subject to a public participation process or the administration can recommend such to council when providing the mandatory information envisaged in regulation 7 or 10, if a particular asset, although not having a “high value” is of great significance for a particular community.

The process to transfer or dispose of a high value capital asset is much more rigorous than that for assets of a lesser value. It is likely that high value transfers or disposals will have a potential to significantly impact on the municipality and its community and therefore, additional steps are required to ensure meaningful public consultation and transparent processes are followed. Capital assets are further categorized into “exempted” and “non-exempted”, which may or may not be “high value”, and this categorization may impact on the process of transfer or disposal.

### **Exempted Capital Assets**

An exempted capital asset is an asset exempted by sections 14(6) or 90(6) of the MFMA and regulation 20, from the rest of sections 14 or 90 and the SCM Regulations. An asset is only considered to be exempted when the transfer is made to another organ of state, and that transfer is the result of any one of the following six circumstances:

- 1) when a municipality reviews its service delivery mechanisms in terms of Chapter 8 of the MSA, and appoints another organ of state to undertake the service;
- 2) when there is a reorganisation of powers and functions between a municipality and its municipal entity;
- 3) when a municipality's powers or functions are assigned to another organ of state as a result of national legislation or a power contained in national legislation;
- 4) when municipal housing or land is transferred to a national or provincial organ of state for the poor in terms of national or provincial housing policy;
- 5) when the transfer is required or permitted by national legislation that determines the conditions of the transfer; or
- 6) any other circumstance not provided above, on condition that the asset to be transferred is considered by council to be not needed to provide a minimum level of basic municipal service and is surplus to the requirements of the municipality and entity.

In any of the above situations, the asset to be transferred is considered exempted from section 14 and 90 of the MFMA and the SCM Regulations. In these situations, Chapter 3 of the regulations will apply.

### **Non-Exempted Capital Assets**

If the transfer or disposal is not the result of any of the above transactions, the asset to be transferred or disposed of will be considered to be a non-exempted capital asset where sections 14 and 90 and the SCM Regulations will apply. In these situations therefore:

- the municipality or municipal entity may not transfer or dispose of a capital asset needed to provide a minimum level of basic municipal service;
- the municipality or entity in making the decision as to whether an asset is required to provide a minimum level of basic municipal service, must make that decision and consider the fair market value, and economic and community value to be received for the asset at a meeting open to the public; and
- any transfer must be fair, equitable, transparent, competitive and consistent with the municipality's supply chain management policy.

Whilst the requirement to hold a public meeting to consider the decision to transfer or dispose of a movable capital asset may be delegated to the accounting officer to make a decision in some cases (refer section 14(4)), all transfers or disposals of this

nature will be regulated by sections 14 and 90 of the MFMA and Chapter 2 of the regulations.

### **Subsidiary Assets**

A subsidiary asset is an asset that forms an important part of a capital asset, for instance a component of an electricity grid such as a substation or power lines or the software programme necessary to run a computer. It also means an asset that forms a part of the operation or maintenance of that capital asset, such as the land or plant used to house or run the electricity grid.

The term is used to describe an asset which is essential for the operation of another capital asset, which if not considered a part of the capital asset would impact on the function and value of the capital asset.

Subsidiary assets are particularly relevant in these regulations in the transfer of a service, power or function. In these instances, the regulations allow certain subsidiary assets to be transferred with the transfer of that service, power or function. The following subsidiary assets may be included in the transfer:

- movable and immovable assets used for or in connection with the service, power or function to be transferred (including investment property);
- intangible assets which are an integral part of that service, power or function;
- short and long-term receivables associated with that service, power or function; and
- investments, cash and bank balances or reserves derived from the performance of that service, power or function.

Subsidiary assets are always linked to the capital asset being transferred and therefore a municipality or entity will not need to consider whether they should be regarded as high value or otherwise, they may be either – provided that their transfer comes as a result of the transfer of a service, power or function (*regulation 1, 15(2) and 25(2)*). It therefore follows that if the capital asset, to which the subsidiary asset is linked, is of high value, that the public consultation process on that capital asset must include consultation on all the subsidiary assets linked to that capital asset also. Leaving the subsidiary assets out of the consultation process will distort the transparency of the transaction as a whole.

If the transfer of the capital asset is exempted (ATF Regulations Chapter 3), the transfer of the subsidiary asset is also exempted, if it is transferred as part of the same transaction.

Attachment 3 provides an illustration of how all municipal assets are categorized for the purposes of these regulations.

### **3.2.2 Valuation of assets**

When a municipality or entity wishes to consider the transfer or disposal of a capital asset, the value of that asset must first be determined in accordance with the accounting standards that the municipality or entity must apply when preparing its annual financial statements. This is consistent with application of GRAP standards and any of the following valuation methods must be used (*regulation 1, 5(4) and (5) and 29(1) and (2), see also GRAP Standards*):

- *depreciated replacement cost*: this is the cost to replace the asset less depreciation to take account of the age and condition of the asset;
- *fair market value*: this is the value that would be agreed between a knowledgeable and willing buyer and a knowledgeable and willing seller;
- *historical cost, adjusted for depreciation and impairment*: this is the original purchase price less adjustments for depreciation and impairment;
- *realisable value*: this is the amount that could be obtained from the transfer less any transfer and completion costs.

It is advisable that a municipality or entity attach an appropriate value to any asset it proposes to transfer or dispose of, well before commencement of the actual process of transfer or disposal. This will allow the municipality or entity to properly consider the costs and benefits of the transfer or disposal. To ensure external factors, such as high inflation, greater demand, high growth, alternative uses, and so on are considered, a re-valuation of the asset may be required more frequently to reflect changes in values.

#### **“Total Value of Capital Assets” and “The Total Value of Assets”**

It is important to note that there is a difference between the "total value of assets" versus "the total value of capital assets" in the context of the ATF Regulations. In this regard please refer to the definitions for "asset" and "capital asset" in ATF Regulation 1.

There are many places in the regulations where the phrase "total value of its assets" occurs. For example regulation 5 provides that: "...any capital asset a municipality intends to transfer or dispose of... exceeds five per cent of the **total value of its assets**...."

When considering the value of assets in terms of the MFMA, it is important to be guided by the governing principles set-out in ATF Regulation 3. It is important to attach a value to the transfer or disposal of a municipal capital asset in such a manner, in order to ensure that the interests of the municipality or entity and of its stakeholders are not prejudiced by the transfer or disposal.

When transferring assets to another organ of state, ATF Regulation 29 provides that the value of a capital asset must be determined in accordance with the accounting standards that the municipality or entity is required by legislation to apply in preparing its annual financial statements. In the absence of sufficient guidance in those accounting standards regarding the valuation of assets, any of the valuation methods set-out in ATF Regulation 29(2) must be applied.

When transferring assets in terms of an ordinary commercial transaction as envisaged in ATF Regulations Chapter 2, there is similar guidance provided in regulation 5(4) and 5(5).

When determining the "total value of assets" or the "total value of the capital assets", it should be viewed in accordance with the accounting standards that the municipality or entity is required by legislation to apply in preparing its annual financial statements, in the absence of which it may in council policy approve any of the other methods prescribed in ATF Regulation 29 or 5. The total value will be the "net" total value.

### **3.2.3 Valuation of liabilities**

When a liability is to be transferred with an asset, the value of the liability must also be determined in accordance with GRAP. Such calculations are only necessary where borrowings are transferred in terms of exempted capital asset transfers to other organs of state in the circumstances described. Again in the absence of guidance through GRAP, any of the following methods must be used (*regulation 26, 29(3) and (4), see also GRAP standards*):

- *settlement value*: the amount that will be paid or the value of the service that will be provided to settle the liability;

- *net present value*: the value after discounting a future settlement value to a present value.

Discounting means bringing back a future Rand value to today's Rand value, for example, a debt worth R1 million at a future point in time, will be worth less than R1 million today as inflation and other factors must be taken into account. The opposite may apply when trying to equate old values to today's monetary value.

### **3.3 TRANSFER, DISPOSAL AND RIGHT OF USE**

#### **3.3.1 Transfer of an asset**

These regulations refer only to the transfer, disposal and granting of a right to use a capital asset and subsidiary assets – they do not relate to all assets generally.

In the regulations an asset transfer is where ownership of the asset is transferred as a result of a sale or similar transaction. This would amount to any normal sale agreement, in which consideration is provided for exchange of the asset and would also include trade-ins or swaps of assets, or any other agreement including where ownership is transferred free of any compensation in the form of a donation, gratuity or promise.

In each situation, the critical element is whether ownership of the asset has passed from one party to another party (*regulation 1 – definitions*).

#### **3.3.2 Permanent disposal of an asset**

Asset disposal refers to a process when ownership is lost other than by means of a transfer, for instance when an asset is demolished, dismantled or destroyed. In this situation, ownership of the asset is lost by one party but not passed on to another party.

Asset disposal is not relevant to exempted capital assets in these regulations, as the nature of an exempted capital asset precludes circumstances of disposal, in other words for an asset to be exempted, it must be transferred to another organ of state in one of the circumstances described and not disposed of (*regulation 1 – definitions*).

#### **3.3.3 Right to use, control or manage an asset**

A right to use, control or manage an asset may include a lease, letting or hiring out arrangement for longer than one month where ownership is not lost or transferred to another party but temporarily let for a purpose. In this situation, ownership of the asset

is retained by the party that has the legal ownership of the asset (*regulation 1 – definitions*).

If a municipal hall for instance were to be hired out to any person for weekdays or weekends whether on a regular or ad hoc basis, as it would be in the normal course of operations, these regulations would not be applicable – the municipality would develop its own administrative arrangements on how best to manage this facility in accordance with council policy. If on the other hand the municipality decided to lease the hall to one party exclusively for an extended period greater than 12 months the regulations would apply – the municipality would be required to undertake considerations stipulated in Chapter 4 (*regulation 1 - definitions*).

In the following instances the granting of such a right to use, control or manage the asset will be considered to be an asset transfer (*regulation 33(3) and Chapter 2 or 3 will apply*), if the right to use the asset:

- is set for an indefinite or undetermined period,
- is for a period which effectively exceeds the life of the asset,
- confers an option to buy or acquire ownership in the asset; or
- allows the person using the asset to become the beneficial (but not legal) owner.

Whether a person can be regarded as the beneficial owner will have to be determined on a case-by-case basis. For example, where a municipality leases a piece of land to a farmer in terms of a twenty year lease, although the municipality remains the legal owner, the farmer is for all practical purposes the beneficial owner of the land. Although on the face of the transaction the municipality retained legal ownership, the right of the farmer to use the land for such an extended period, results in the farmer benefiting from the transaction as if he / she is the “owner”. This is an important and often complex concept which may require close consideration when intending to consider the transfer of such rights. Municipalities and entities should carefully consider in each instance whether the transfer of a right to use an asset to a third party could be considered to result in the third party becoming the beneficial owner of the asset. Section 33 of the MFMA also requires other procedures to be followed in the case of long term transactions, exceeding three years.

## **3.4 POWERS AND FUNCTIONS VERSUS A SERVICE**

### **3.4.1 Municipal powers and functions**

A municipality and its entity may only conduct activities in line with the objects of local government supporting the powers and functions assigned to municipalities in terms of the Constitution.

A power or function of a municipality or its entity is any activity that it is legally allowed to perform for example water and sanitation services. These powers and functions are set out in *Schedule 4 (Part B) and Schedule 5 (Part B) of the Constitution* (see *Attachment 1*).

### **3.4.2 Municipal services**

A municipal service is a service that a municipality in terms of its powers and functions (refer above) provides or may provide to or for the benefit of the local community, irrespective of whether the service is provided by the municipality itself or by an external service provider (*MSA - section 1*).

### **3.4.3 Commercial services**

A commercial service (*regulation 1 - definitions*) is a service that is rendered by a private sector party or an organ of state on a commercial basis to a municipality or entity. A municipality or entity must procure commercial services through its supply chain management policy. For example, providing electricity reticulation is a municipal service whereas an independent contractor which performs the task of servicing the equipment of the municipality is providing a commercial service. If a non-exempted capital asset is transferred as part of an integral component of the performance of a commercial service to that service provider, the asset must be transferred for compensation reflecting fair market value of that asset. (*Refer regulations 12(2)(b) and 13(1)(b)*). It will be important to capture this as part of the tender specifications when procuring the commercial service.

Attachment 4 illustrates how these regulations differentiate between a municipal service and a commercial service, and how both must fall within the municipality's powers and functions.

## **3.5 PARTIES TO A TRANSACTION**

### **3.5.1 Organ of state**

An organ of state is defined in regulation 1 and includes a national or provincial government department or entity, a municipality or a municipal entity or any other organ of state as envisaged in section 239 of the Constitution. Examples of organs of state include a national government department, a provincial government department, a public entity such as Eskom and a municipal entity such as Johannesburg municipality's Pick-It-Up. Each is effectively controlled by a sphere of government to exercise a constitutional power (*regulation 1, MSA – section 1, Constitution – section 239*).

### **3.5.2 Private sector party**

A private sector party is a person who is not an organ of state, for instance an individual or a private company *as defined in the Companies Act, as amended (section 1 of the MSA and regulation 1 – definitions)*. Any capital assets transferred to a private sector party must be done in accordance with the ATF regulations and the supply chain management policy of the municipality or municipal entity.

### **3.5.3 Service provider**

A service provider is an organ of state or private sector party who is appointed by a municipality or municipal entity to perform a municipal or commercial service.

A private sector party or organ of state may be appointed by a municipality or entity as a service provider to perform a municipal service in terms of Chapter 8 of the MSA. Chapter 8 describes the process involved in the provision of a municipal service by using an external service provider. Procurement here will depend on the circumstances of the transaction.

The appointment of a private sector party or organ of state for a commercial service however, must be procured through the supply chain management policy of the municipality or entity.

It should be pointed out that the definition of a service provider in these regulations is broader than that contained within the MSA, which restricts a service provider to a party or parties that provide a municipal service (*MSA – section 1*).

The service provider definition in these regulations addresses the need to capture all transactions involving both municipal and commercial services (*regulation 1 – definitions*).

## **3.6 TRANSFERS OF CAPITAL ASSETS IN AN EMERGENCY**

### **3.6.1 Emergency transfers of capital assets**

The MFMA in section 29 provides for a municipality to incur certain expenditure in emergency situations, subject thereto that such expenditure is unforeseen and also simultaneously unavoidable. This section only applies to real emergencies for example natural disasters like fires or floods. Poor planning for example to repair roads or water infrastructure will not be unavoidable or unforeseen.

The above section adequately provides for emergency situations. Since the transfer and disposal of municipal capital assets is of public significance, the full ATF regulations' processes and requirements will apply to all transfer and disposal transactions, also for emergency transfers and disposals.

## **3.7 WHEN SECTIONS 14 & 90 OF THE MFMA DO NOT APPLY**

### **3.7.1 Exempted versus non-exempted capital assets**

As stated, sections 14(1-5) and 90(1-5) of the MFMA and the SCM Regulations do not apply in instances where the transfer is to another organ of state and results from any one of the following (*Chapter 3 of the regulations, regulation 20*):

1. when a municipality reviews its service delivery mechanisms in terms of Chapter 8 of the MSA, and appoints another organ of state to undertake the service;
2. when there is a reorganisation of powers and functions between a municipality and its municipal entity;
3. when a municipality's powers or functions are assigned to another organ of state as a result of national legislation or a power contained in national legislation;
4. when municipal housing or land is transferred to a national or provincial organ of state for the poor in terms of national or provincial housing policy;
5. when the transfer is required or permitted by national legislation that determines the conditions of the transfer; or
6. any other circumstance not provided above, on condition that the asset to be transferred is considered by council to be not needed to provide a minimum level of basic municipal service and is surplus to the requirements of the municipality and entity.

This means that in terms of the circumstances described above, a municipality or municipal entity may consider the transfer of a capital asset needed to provide a minimum level of basic municipal service to another organ of state, subject to conditions outlined in Chapter 3 of the regulations. The municipality or entity will not necessarily need to make its decisions at a meeting open to the public provided that it can satisfy itself that its assets will be protected and any service to be transferred will continue without impediment. In most of the instances set out in regulation 20 a public participation process is required as part of the process requiring the transfer of the asset. It is the final decision of the municipality whether an exempted capital asset is transferred to another organ of state for compensation. Chapter 3 provides certain factors that should be considered before a decision is made regarding compensation. In each of these instances, i.e. when the transfer involves the transfer of exempted capital assets, Chapter 3 of the regulations apply (*regulations 2 and 20*).

If the transfer results from something other than the above, such as an ordinary commercial transaction with an organ of state or private party, then sections 14 and 90 of the MFMA, the SCM Regulations (including the disposal management system) and Chapter 2 of the regulations will apply (*regulations 2 and 21*).

Permanent disposals of capital assets are governed by Chapter 2 of the regulations.

**Table 1 - Capital Asset Transfer Scenarios & Applicability of s14 & 90 of MFMA**

	<b>CIRCUMSTANCES OF THE TRANSFER OR DISPOSAL</b>	<b>EXEMPT STATUS</b>	<b>APPLICABILITY</b>	
			<b>MFMA S14/S90</b>	<b>REGS CHAPTER</b>
1	Following a review of its IDP, the municipality has found it necessary to review its water services function. It resolves to change its method for delivering that service, electing to form a multi-jurisdictional service utility (MJSU) with two other municipalities. It decides to transfer all of the water services assets of its service utility to form the new MJSU.	Exempt	No	Chapter 3 ATF
2	As part of the IDP review, the municipality elects to separate sewage disposal from its water services function, and after going through a competitive bidding process in accordance with its SCM policy, appoints a private sector company to carry out this function. The municipality seeks to consider whether it should transfer the assets associated with that function to the company.	Non-exempt	Yes	Chapter 2 ATF & SCM Regs
3	As a result of disbanding the original Water Services Utility in favour of the MJSU, the municipality finds that certain assets are left over which are no longer considered necessary to provide the water service and are therefore surplus to the municipality's requirements. It seeks to sell these assets to a neighbouring municipality at market related prices.	Exempt	No	Chapter 3 ATF
4	The neighbouring municipality purchases all but two of the remaining surplus assets. The municipality intending to sell these remaining assets decides to advertise their general sale using its disposal management system as contained in its SCM policy. A private sector company which also contracts to the newly formed MJSU bids successfully to purchase both assets.	Non-exempt	Yes	Chapter 2 ATF & SCM Regs
5	After a number of months' operation, the newly formed MJSU finds that the efficiencies created by having four municipalities carry out the service has resulted in it being able to perform the required service with less plant. It wishes to sell forty utility vehicles. After examining all options, it is resolved by the entity with the agreement of the municipalities that it can sell thirty of these vehicles to another adjoining multi-jurisdictional service utility.	Exempt	No	Chapter 3 ATF
6	The remaining ten are found to be in poor condition, but the neighbouring municipality has expressed an interest in them to help it build its own fleet requirements. It resolves to provide these vehicles to the municipality free of charge.	Exempt	No	Chapter 3 ATF
7	The municipality receiving the vehicles finds two vehicles to be dangerous and un-roadworthy and decides to scrap them.	Non-exempt	Yes	Chapter 2 ATF & SCM Regs

Table 1 above provides a number of different scenarios relating to the review of a service in which various capital assets are transferred or disposed of, and shows the exempt or non-exempt status of the asset and when sections 14 or 90 of the MFMA and which Chapter of the Asset Transfer Regulations (ATF) or the Municipal Supply Chain Management Regulations (SCM Regs) will be applicable.

Attachment 5 provides a decision tree illustrating the process required to determine whether the asset to be transferred or disposed of will be considered to be an exempted capital asset or a non-exempted capital asset.

### **3.8 WHEN THE REGULATIONS DO NOT APPLY**

#### **3.8.1 General exemptions**

The regulations do not apply to any of the following (*regulation 50*):

1. securities or guarantees provided by a municipality or municipal entity to a lender used as collateral for municipal borrowing (see MFMA Chapter 6);
2. transfers of money owed by consumers (to a municipality or entity) to a collection agency duly appointed to collect municipal debts;
3. cash deposited in a bank account in the name of the municipality or entity, or investments made by a municipality or entity in accordance with its investment policy;
4. security deposits in the name of the municipality or entity required for obtaining goods and services; or
5. pre-payments made for short-term insurance or other related services.

In addition to this, specific Chapters of the regulations do not apply to PPP arrangements (*refer 2.7.2*), to the transfer of housing on municipal land and the transfer of that land for the poor to the beneficiaries of that housing.

#### **3.8.2 Public-private partnerships**

The ATF Regulations does not apply to a PPP arrangement. Chapter 2 relating to the transfer of non-exempted assets does not apply when such an asset is transferred in terms of a PPP agreement (*regulation 4(3)(a)*). Chapter 4 will similarly not apply if the rights to use, control or manage capital assets are provided as part of a PPP agreement (*regulation 33(2)(a)*). Whilst exempted from the provisions of sections 14 and 90, PPP's must still comply with section 120 of the MFMA, as well as the PPP Regulations and SCM Regulations.

### **3.8.3 Transfers of municipal housing and land**

Chapters 2 and 4 do not apply to the transfer of housing on municipal land and the transfer or granting of a right to use that land for the poor to beneficiaries of such housing. In these instances, sections 14(1) to (5) and 90(1) to (5) of the MFMA and the SCM Regulations will apply, in addition to any other related legislation or national or provincial policy surrounding transfers of municipal land and housing.

Chapter 3 deals with transfers of housing on municipal land to other organs of state.

These transfers together with other issues concerning municipal land transfers and disposals are discussed in detail in Part 7 - Transfer and Disposal of Municipal Land and Housing.

Table 2 below provides a number of different scenarios relating to the transfer of assets or a service in which various capital assets are transferred or disposed of, and shows the exempt or non-exempt status of the asset, highlighting when the regulations will apply, and which Chapter of the regulations will be applicable.

**Table 2 - Capital Asset Transfer Scenarios & Applicability of the Regulations**

	CIRCUMSTANCES OF THE TRANSFER OR DISPOSAL	EXEMPT STATUS	APPLICABILITY	
			REGS	REGN CHPTR
1	As part of its review of the water services function, the municipality decides to enter into a PPP arrangement for the treatment of selected water desalination plants. The recently established multi-jurisdictional service utility (MJSU) does not have the necessary equipment to conduct this function effectively therefore the municipalities issue a joint tender to conduct this service. After consideration, the municipalities enter into a PPP arrangement with a private sector party.	Non-exempt capital asset	Not applicable	PPP's are exempted from ATF Regs The PPP & SCM Regs apply
2	Prior to the finalization of the PPP agreement with the private sector party, it was agreed that an aspect of the water desalination process i.e. that of water analysis/inspection, would be better performed by another government entity that has the scientific equipment to conduct this function more effectively. The municipalities and the government entity enter into a separate arrangement to conduct this service. It is proposed that the desalination plant be transferred to the government entity.	Exempt capital asset	Applicable	Ch 3 will apply
3	In a separate transaction, the municipality enters into a PPP arrangement with a private sector party to build 200 houses on land owned by the municipality for the poor in terms of national housing policy. The PPP arrangement reflects the legislative requirements in terms of providing the housing to its targeted market of indigent residents but it is silent on the process of transfer. It is proposed that upon completion of the development, the municipality directly transfers the housing for the poor to such beneficiaries.	Non-exempt capital asset	Not applicable	Exempted to ATF Reg 4(3)(b) However, the SCM Regs will apply
4	The municipality also builds 200 separate houses itself to sell the houses directly to its target market of middle-income earners.	Non-exempt capital asset	Applicable	Ch 2 and SCM Regs apply
5	Another 200 houses were built by the municipality for the same purpose as in (4) above, however, since completion the Department of Housing issued national legislation which requires that such housing be transferred to the national government for distribution to certain poor and indigent persons in line with its national policy.	Exempt capital asset	Applicable	Ch 3 will apply Exempted from SCM Regs

**Summary**

Chapter 2 prescribes requirements for the transfer and disposal of a capital asset *not* exempted from sections 14 and 90 of the MFMA. This would include all transactions in which the transfer or disposal emanates from anything other than a transfer to an organ of state in the six circumstances described in regulation 20 (*regulation 21*). It will be applicable when the transfer or disposal is the result of an ordinary commercial transaction between a municipality or municipal entity and a private sector party or organ of state through a process of competitive bidding. All transactions with private sector parties are subject to this Chapter. This Chapter does *not* apply to PPPs (*regulation 4(3)(a)*), which are separately regulated or to housing on municipal land for the poor, when the municipality or entity wants to transfer that housing to those targeted to receive it (*regulation 4(3)(b)*).

Types of transactions impacted by this Chapter include for instance, the sale of a municipal truck no longer required by the municipality to a private company, or the sale of land by tender to a developer able to improve the use of that land, provided that in both instances the sale of the asset is done in accordance with the SCM Regulations. This Chapter is also applicable when a municipality or entity chooses to demolish or dismantle a capital asset such as an unused municipal building or obsolete electricity generator.

**CONSIDERATIONS PRIOR TO TRANSFER OR DISPOSAL OF A NON-EXEMPTED CAPITAL ASSET**

**4.1 Step 1 - DETERMINE THE NATURE OF THE TRANSFER OR DISPOSAL**

**4.1.1 Is the asset to be transferred a non-exempted capital asset?**

In general a transaction will be non-exempted and subject to Chapter 2 of the ATF Regulations (refer part 4 of the Guide) if it is **NOT** any of the following two types of transactions:

- If the transaction involves the transfer to an organ of state in the circumstances set-out in regulation 20, Chapter 3 of the ATF regulations will apply (Refer part 5 of the Guide); and
- If the transaction involves the granting of a right to use, manage or control municipal capital assets, Chapter 4 of the ATF regulations will apply (Refer part 6 of the Guide).

Once it has been determined that the asset to be transferred is a non-exempted capital asset and the transfer does not form part of the transfer of a municipal or commercial service (refer 3.1.2 below), the value of the asset must be determined as set out in step 2.

#### **4.1.2 Is the transfer part of the appointment of a service provider (*regulation 14*)?**

Once it has been determined that the asset to be transferred is a non-exempted capital asset, and the municipality or municipal entity assessed that the transfer forms part of the appointment of a service provider to perform a municipal or commercial service in terms of regulation 12(2), the value of the capital asset to be transferred must be determined as set out in step 2 below.

For example in terms of regulation 12(2)(a) - following a review of service delivery mechanisms under Chapter 8 of the MSA, when a private sector party is appointed (through a process of competitive bidding); or regulation 12(2)(b) - when a private sector party or organ of state is appointed by a municipality or entity (through a process of competitive bidding) to perform a commercial service. In these instances the municipality or entity may transfer the asset through a process of direct negotiation with the successful service provider (*regulation 12(3)*). Certain other conditions are imposed under these circumstances (*regulation 14*).

This assessment should be made early, and indeed it should be clear upon any initial investigation, whether the transaction is to involve the transfer of a municipal or commercial service or an individual asset. These determinations should be conducted in line with any MSA Chapter 8 service delivery reviews and dovetailed into the budget process commencing in August each year so that it can be merged into one process.

### **4.2 STEP 2 - DETERMINE IF THE ASSET IS CONSIDERED HIGH VALUE**

#### **4.2.1 Is an asset a ‘high value capital asset’?**

The disposal and transfer of assets require proper planning and a forward looking approach. The municipality or entity’s budget must reflect all the planned transfers and disposals for the year and as far as possible, over the MTREF-period. Once 4.1.1 and 4.1.2 has been determined, the municipality or municipal entity must consider whether the asset involved is a high value capital asset (*refer earlier discussion of “high value capital asset” in 3.2.1 above*).

If a number of capital assets are to be transferred or disposed of in a financial year, the municipality or entity must firstly determine whether the total value of all the assets to be transferred or disposed of is more than 5% of the total value of all the assets of the municipality or entity as shown in its last available audited annual financial statements (*regulation 5(2) and 8(2)*). If this is not the case, the municipality must determine if any individual capital asset to be transferred or disposed of is “high value” as defined in regulation 1. Whether a capital asset or group of assets is of high value or not will impact on the public consultation process required (*regulation 5(2) and 8(2)*).

This assessment should be made concurrently with any review of service delivery mechanisms each year or as a normal part of initial budget planning in August. Forward planning in this regard is important to avoid a situation where mid-year the 5% limit has been reached, but the municipality or entity finds itself unable to comply, since capital assets have already been transferred or disposed of without the public consultation processes having been conducted for those assets. Public consultation cannot be done after disposal or transfer and the National Treasury is unlikely to condone such transactions on the basis of poor planning.

If the transfer of the high value capital asset forms part of the appointment of a service provider to perform a municipal or commercial service in terms of regulation 12(2) (*refer 3.1.2 above*), the MFMA section 14(2) or 90(2) determinations and regulation 5(1) or 8(1) public participation process should be done as part of and concurrent with the processes envisaged in regulation 12(2).

To fast track the process, we would suggest that the public participation process for “high value” capital assets be combined with the annual budget consultation process. If this is done, assets should be identified per ward and also discussed during the consultation process with communities and specifically wards that are to be affected by such transfers or disposals.

#### **4.2.2 Public Participation if a high value asset**

If the asset is considered to be of high value, or if the total value of capital asset transactions for the financial year is more than the 5% threshold, then for all such asset transactions, the municipality or entity must conduct a more rigorous public participation process before it can even approve in-principle of the transfer or disposal (*regulations 5 and 8*).

## **Authorization of public participation**

The public participation process referred to may only be authorized by the council or the council of the parent municipality, although any party may make a request to the council that such a process be considered. The request must be submitted to the council with an information statement which shows the valuation of the asset, the method of valuation used to determine that value, the reasons for the proposal, and the benefits, proceeds and gain or loss that could be realized or incurred if the proposal went ahead. In the case of an entity, the information statement provided to the council of the parent municipality must first be approved by the board of directors of the entity. It must be remembered that the valuation method used must be in accordance with that described earlier i.e. in accordance with GRAP or otherwise one of the four methods described (*regulations 5(3), (4) and (5) and 8(3)(4) and (5)*).

Upon receiving the request, the council may choose to further consider the proposal by authorizing the public participation process or alternatively, reject the request in which case no further action will be required.

## **The public participation process**

Where council authorizes the public participation process to help facilitate its decision on whether to transfer or dispose of the asset, the accounting officer of the municipality (or the chief executive officer of the entity) must make public the proposal and the mandatory information statement, invite the community and other interested parties to submit their comments or representations and request the views and recommendations of the National Treasury and the relevant provincial treasury (*regulations 6 and 9*).

When the asset to be transferred or disposed of affects one or more communities, the information and notifications must also be made available to those communities through the ward committee/s representing those communities. This requires the municipality or entity to ensure that the documentation referred to is displayed in municipal and library offices and on the municipality's website and that notices be placed in local newspapers or on the radio advising of where such documentation can be obtained. Assistance to persons wishing to comment on the proposal must also be provided (*MSA section 21A*). This must be done at least 60 days before the council meeting in which the matter is to be discussed i.e. the meeting where the MFMA sections 14(2) or 90(2) decisions are to be considered by council. The extent and cost associated with this consultation process should be balanced against the

economic and community value of the asset and value to be derived from the sale or disposal of such assets.

The public participation process and related information requirements described in regulations 5, 6, 8 and 9, must be followed in addition to any reporting and disclosure requirements contained in the municipality's supply chain management policy and the SCM Regulations. Ideally, these requirements should be carried out concurrently.

As noted above, if the transfer of the high value capital asset forms part of the appointment of a service provider to perform a municipal or commercial service in terms of regulation 12(2) (*refer 3.1.2 above*), the MFMA section 14(2) or 90(2) determinations and regulation 5(1) or 8(1) public participation process described here should be done as part of and concurrent with the processes envisaged in regulation 12(2).

### **Public Meeting after the public participation process**

After the completion of the public participation process, the council may at this point make the section 14(2) or 90(2) determinations and, depending on the outcomes of these determinations, either resolve not to transfer or dispose of the asset or alternatively, *approve in-principle of the transfer or disposal* subject to the council considering factors described below in this Chapter (*regulation 5(1)(b) and 8(1)(b), MFMA section 14(2) and 90(2)*). It is important that the municipal administration prepare the supporting documentation for this public meeting, having regard to the regulations, since council will not be in a position to make a valid decision without having the mandatory information available for its consideration and discussion (regulation 7 and 10).

At the public meeting, council is required to decide whether the asset is not needed to provide a minimum level of basic municipal service and consider the fair market and economic and community value it would expect to receive for the asset. The information statement together with the mandatory information prepared by the administration should assist council in this determination – it will contain a valuation of the asset and will describe the methodology used to obtain that valuation; in addition to this, if the valuation used is not the fair market value, the information statement should also contain the fair market value to be anticipated from transfer or disposal.

It should be noted that the valuation used in the information statement at the public meeting is purely for the purposes of helping council make a reasonable

determination that the asset is in-principle available for transfer or disposal. This is only the first part of the process which is envisaged in section 14(2) of the MFMA.

Once that decision has been taken, the second part of the process which is envisaged in section 14(5) of the MFMA can take place. This requires any asset transfer to be fair, equitable, transparent, competitive and consistent with the supply chain management policy of the municipality. This will not apply where the capital asset forms part of the appointment of a service provider to perform a municipal or commercial service in terms of regulation 12(2), which is exempted from the SCM Regulations (*regulation 12(2)*).

Please note that SCM Regulation 40 provides that:

- (i) immovable property may be sold only at market related prices except when the public interest or plight of the poor demands otherwise; and
- (ii) movable assets may be sold either by way of written price quotations, a competitive bidding process, auction or at market related prices, whichever is the most advantageous to the municipality or entity; etc.

Hence, the valuation used to help council makes its section 14(2) or 90(2) determinations would not necessarily be a reasonable price or compensation for an asset transferred in terms of section 14(5) or 90(5), as this would not necessarily promote to their fullest extent the principle of competitiveness or consistency with the supply chain management policy.

Such consistency requires that the competitive process relies on the accounting officer and bid adjudication committee to make a decision based on bids which may be well in excess of fair market value or any other valuation method used by the municipality or entity. Compensation received should be at the most advantageous to the municipality or entity.

#### **4.2.3 If not considered a high value asset**

If the asset is not considered to be high value, and if the total value of asset transactions is not more than the 5% threshold value mentioned above, then the council must, at a meeting open to the public, and in terms of sections 14(2) or 90(2) of the MFMA:

- 1) reasonably decide (or confirm) that the asset is not needed to provide a minimum level of basic municipal service; and

- 2) consider the fair market and economic and community value to be received in exchange for the asset.

In the case of a municipal entity, these determinations must be made by the council of the parent municipality.

Such determinations are only necessary when the council wishes to consider the transfer or disposal of the asset. It may resolve not to go ahead with the transfer or disposal without the need for a meeting open to the public.

Should the council wish to consider the proposal, it must follow the process described above (section 14 and 90). Following the public meeting and the considerations described above, the council may at this point, resolve not to transfer or dispose of the asset or alternatively, *approve in-principle of the transfer or disposal* subject to the council considering a number of factors as required in terms of ATF regulation 7 and 10. The actual process to transfer or dispose of the asset will vary depending upon the conditions that council attaches to the in-principle transfer (refer ATF regulation 11).

If considered to be needed to provide a minimum level of basic municipal service, then that asset cannot be transferred (*regulations 5(1)(b) and 8(1)(b), MFMA sections 14(2) and 90(2)*).

If the transfer of the capital asset forms part of the appointment of a service provider to perform a municipal or commercial service in terms of regulation 12(2), the MFMA section 14(2) or 90(2) determinations should be done as part of and concurrent with those processes.

Table 3 over the page provides examples of capital assets to be transferred or disposed of, and shows calculations used to determine whether that asset is to be considered to be a high value capital asset.

**Table 3 – Determinations Regarding High Value Capital Assets**

	BACKGROUND	ASSET VALUE	HIGH VALUE	COMMENT
1	In 2007/08 a council has a total asset value of R200 mill as per its annual financial statements, and resolves to reduce the 1% regulation threshold for determining high value from R2 mill to R1 mill. The council intends to sell a fleet of 20 vehicles, each valued at R80 000 (combined value R1.6 mill) at fair market value through a process of competitive bidding.	R80 000 (combined value R1.6 mill)	No	Firstly the combined value of these assets does not exceed 5% of the total value of assets. Secondly, looking at the individual asset values, these assets are also not considered to be high value, since each individual value does not exceed the threshold adopted by council. The “high value” threshold is relevant to individual not combined asset value.
2	The following financial year in 2008/09, the council also intends to relocate its head office and library and will therefore aim to sell the existing municipal premises for R12 mill.	R12 mill	Yes	This asset is considered to be high value as it has a value in excess of the R1 mill council adopted threshold.
3	Assume council still has a total asset value of R200 mill as per its annual financial statements, hence 5% = R10 mill, in the same financial year (2008/09), the municipality plans to sell 40 municipal houses to middle-income residents at a price of R120 000 each but at less than market value as agreed by council as a matter of public interest.	R120 000 (combined value R16.8 mil (R4.8 mill + R12 mill))	Yes	Although these assets individually do not meet the threshold, the combined value of asset transfers for this financial year exceeds the 5% threshold of R10 mill (note earlier transfer of council buildings for R12 mill). If total asset transfers exceed 5% of the total value of assets all assets being transferred are considered high value (Reg 5(2) or 8(2)).

	BACKGROUND	ASSET VALUE	HIGH VALUE	COMMENT
4	In 2009/10 the council depot is damaged by a fire but salvageable parts are worth R2.5 mill to the municipality. It chooses to dispose of the facility and discard the material as scrap.	R2.5 mill	Yes	The asset individually meets the 1% threshold. This asset is still considered to be high value whether or not the council makes a decision to transfer or dispose of the asset – the council must therefore acknowledge the value still placed on the damaged asset and account for it accordingly.
5	One works shed complete with tools which survived the fire are to be sold for a total value of R500 000.	R500 000	No	These assets are not considered to be high value, as they do not exceed the R1 mill threshold.
6	Council seeks to dispose of its obsolete computer equipment which has a written down value of nil, providing it at no cost to any interested persons.	Nil	No	These assets are not considered to be high value, as they do not exceed the R1 mill threshold (SCM Reg 40). However, note the requirements of SCM Regulation 40, requiring the free disposal of computer equipment to first be offered to the provincial department of education.

#### 4.3 STEP 3 - UNDERTAKE MANDATORY CONSIDERATIONS WHEN TRANSFERRING A NON-EXEMPTED CAPITAL ASSET

##### 4.3.1 Mandatory considerations for in-principle transfers

During the public meeting, *before approving in-principle* to either retain or transfer or dispose of the asset, the council of the municipality (or parent municipality) must first consider the following factors (*regulation 5(1)(b), 8(1)(b), 7 and 10*). This is required irrespective of whether a high value capital asset or not is under consideration:

- whether it may need the asset at a later date;
- expected gain or loss on transfer or disposal;

- compensation for the asset and if it will result in a cost or benefit;
- management of any risk;
- impact on its credit rating and ability to raise further borrowings in the future;
- conditions attached to the asset;
- cost of the proposed transfer or disposal;
- transfer of any liabilities and reserves;
- stakeholder comments and recommendations; and
- the impact on its own strategic, legal and economic interests (*regulations 7 and 10, see also regulation 12(5)*).

These factors must be considered by council and documented in the council minutes, over-and-above the section 14 and 90 considerations relating to the fair market and economic and community value the municipality would expect to receive from the asset and whether the asset is needed to provide a minimum level of basic municipal services.

It is important to note that a municipality may wish to, where possible combine these processes and conditions in order to streamline the approval process required to authorize the asset transfer or disposal. This may be done by planning in advance so that all the information requirements are available to council during the public meeting, enabling council to make the necessary determinations over mandatory considerations and discretionary conditions and by dovetailing these requirements with those of the SCM Regulations. For this to happen, the required research into the proposal should be undertaken early in the process – this information should be made available to the council at the meeting to ensure that it is in a position to make its decisions based on all the available facts.

Upon the consideration of these impacts and the application of the discretionary conditions described below the council may make its final decision to transfer or dispose of the asset as requested.

#### **4.3.2 Mandatory Considerations - Stakeholder comments and representations**

Only in instances where an asset or all the assets to be transferred or disposed of are regarded as “high value”, will the public participation process envisaged in regulation 6 or 9 be required. It therefore follows that mostly only in “high value” cases will there be:

- comments or representations on the proposed transfer or disposal received from the local community and other interested persons; and

- written views and recommendations on the proposed transfer and disposal by the National Treasury and the relevant provincial treasury (regulation 7 and 10).

Although regulations 7 and 10 make it mandatory for council to consider any such comments received, regulation 7 and 10 should not be interpreted to mandate the municipality to solicit such comments other than where required.

It is important to note that there may be other instances where the local community, other interested persons, the National Treasury or provincial treasury provided input, where the assets are not “high value” (as part of the normal public consultation process even though not required). If such comments were received, it must also be considered in terms of ATF regulation 7 and 10, even if it was not solicited.

When soliciting the comments of the National Treasury and provincial treasury information addressing whether the municipality followed due processes in terms of public consultation, transparency, and compliance with the MFMA, Asset Transfer Regulations and the Municipal Supply Chain Management Regulations, etc. must be provided. It would also be useful to provide information arising out of any public consultation process pertaining to the specific asset.

#### **4.4 STEP 4 - APPLY DISCRETIONARY CONDITIONS TO THE TRANSFER OF A NON-EXEMPTED CAPITAL ASSET**

##### **4.4.1 Discretionary conditions on in-principle transfers**

When the council provides an in-principle decision that a non-exempted capital asset may be transferred or disposed of (irrespective of whether the transaction involves a high value capital asset or not), the council of the municipality (or parent municipality) *may impose* conditions on the transfer or disposal, including conditions to specify (regulation 11):

- how the asset is to be sold or disposed of (within the framework set by the SCM regulations);
- a floor price or minimum compensation;
- whether the asset can be transferred or disposed of for less than fair market value (subject to the council first considering the regulation 13(2) criteria); and
- a framework in which direct negotiations with another person may apply, if relevant (regulation 11(d)).

The administration, may also recommend such conditions to council. It is suggested that such be included in the supporting information containing the mandatory and other information required to facilitate council's decision making.

A council can also impose such conditions, where the transfer forms part of the appointment of a service provider to perform a municipal or commercial service in terms of regulation 12(2) (*refer 3.1.2 above*), in which case the conditions should be included as part of the bid specification processes envisaged in regulation 12(2).

The framework for direct negotiations with another person will be applicable in instances when, through a competitive process a municipality or entity appoints a private sector party to perform a municipal service, or a private sector party or organ of state to perform a commercial service (*regulation 12(3)*).

The framework may include a process of authorization and delegations in terms of the negotiating parties, an applicable timeframe for negotiations to be completed, the ambit of negotiations i.e. price and delivery conditions, requirements for additional reporting if any and any other matter provided such a framework is consistent with the principles of the MFMA (see especially section 110) and the SCM Regulations (see especially regulation 24).

It is recommended that the municipality early on determine general principles to guide the municipal administration of certain basic or standard conditions it wishes to impose on all asset transfers or disposals. It is also recommended that draft regulation 11 conditions concerning how the asset is to be transferred, minimum compensation and a direct negotiation framework be provided for consideration by the council when it makes its determinations in terms of sections 14(2) or 90(2), together with the information statement required by regulations 5(3)(b) and 8(3)(b) so that all issues can be resolved at one time where possible. This may require the provision of certain options for council to consider in terms of its established policy on method of sale, compensation and procurement. This will also expedite the process of transfer or disposal and could avert the need to have multiple council meetings to consider the issue.

It is important to note no conditions, contravening what is allowed in terms of the prevailing legal framework, can be imposed. For example conditions regarding the way in which the capital asset is to be sold or disposed of, is subject to the SCM Regulations. Hence, a condition that an asset is disposed of to Company X (that approached the municipality with an offer to buy/ develop an asset outside of a

competitive process) will be subject to the unsolicited bid framework contained in SCM Regulation 37.

## **PROCESS OF ACTUAL TRANSFER OR DISPOSAL OF A NON-EXEMPTED CAPITAL ASSET**

### **4.5 STEP 5 - TRANSFER OR DISPOSE OF THE ASSET**

#### **4.5.1 Transfer or disposal to be in accordance with disposal management system**

The MFMA requires the actual transfer or disposal to be fair equitable, transparent, competitive and consistent with the SCM Regulations. Council only has an oversight role in this process to ensure that council policy are implemented and no councillor of any municipality may be a member of a municipal bid committee or any other committee evaluating or approving tenders, quotations, contracts or other bids or attend any such meeting as an observer. (Refer MFMA section 117).

Once council has approved that a non-exempted capital asset can be transferred or disposed of as discussed above, the municipality or municipal entity may commence proceedings to transfer or dispose of that asset – which irrespective of the value of the asset or whether the asset is to be transferred to a private sector party or organ of state, can only be done in accordance with its disposal management system – this in effect is the supply chain management policy of the municipality (*regulation 12(1) and SCM regulation 40*).

#### **4.5.2 Circumstances when direct negotiations with selected bidders are allowed**

There are two *exceptions* to the requirement that the actual transfer or disposal of non-exempted capital assets be done in terms of a competitive process (refer regulation 12):

- 1) when a municipality or entity undertakes a review of service delivery mechanisms in terms of Chapter 8 of the MSA and a private sector party is selected; and
- 2) when a municipality or entity appoints a private sector party or organ of state to perform a commercial service (*regulation 12(2)*).

In these cases, provided that a competitive bidding process is used to appoint the service provider, a municipality or entity may transfer the asset as part of the appointment of the service provider and negotiate directly with the selected bidder (*regulation 12(3)*).

#### **4.5.3 Compensation under the disposal management system**

Included in the requirements of the disposal management system is that:

- 1) immovable property must be sold only at fair market value unless in the public interest or when the plight of the poor demands otherwise; and
- 2) that movable assets must be sold either by way of written quotations, a competitive bidding process, auction or at fair market value, whichever is most advantageous to the municipality or entity. In the case of trade-ins, the highest possible trade-in price must be negotiated (*SCM Regulations - regulation 40(2)*).

For example, a municipality seeking to sell an abattoir that is no longer needed on the open market must do so in accordance with the MFMA, these regulations and the SCM Regulations. The abattoir must be sold at fair market value unless it is in the public interest or due to the plight of the poor to sell it for less.

Regarding trade-ins where assets are traded-in when assets are being procured, negotiations for such trade-ins should only take place with the successful bidder after the competitive bidding process so that the trade-in price does not manipulate the tendering system.

In applying the process of transfer or disposal, and when negotiating appropriate compensation with selected bidders, the municipality or entity must also consider the loss or gain that will result from the transaction and what will be recorded in the municipality's or entity's records (*regulation 12(5)*).

#### **4.5.4 Special conditions on asset transfers when transferred as part of a service**

When the performance of a municipal or commercial service is transferred in terms of regulation 12(2), all assets needed to provide that service must be properly identified (or ring-fenced) (*regulation 14(a)*). For capital assets, the considerations involved in the original in-principle decision must be taken into account in appointing a service provider (*regulation 14(b)*). Documents prepared for those decisions must be considered in any feasibility study conducted to determine the implications of appointing that service provider (*regulation 14(c)*).

All capital and subsidiary assets that are essential to the performance of the service (provided they are not needed to provide a minimum level of basic municipal service) may be transferred to the service provider subject to the agreement of both parties (*regulation 15(1)*). In addition to all movable and immovable assets, other assets to

be transferred may include intangible assets, receivables, investments and cash and reserves associated with the performance of that service (*regulation 15(2)*)).

For example, in the case of a municipality that has appointed a private sector party to undertake its sewage disposal function, the municipality may with the agreement of the other party, transfer all of the assets associated with that service to the private sector party. In order to do this accurately, the municipality must first separately identify or ring-fence those assets and ensure that appropriate values are attached to each asset. Any assets required to provide the minimum level of basic municipal service should be excluded from the transfer. This process must be completed before the appointment of the service provider is considered, and council should have agreed to the transfer at least in-principle at this point. Once agreement has been reached over what capital and subsidiary assets will be transferred, both parties will then be at a stage to undertake final negotiations toward determining the appropriate compensation payable to the municipality.

It should be remembered that before a decision is made to appoint the service provider, the municipality must have reviewed all of the earlier documentation prepared in the considerations involving the asset transfer, and apply that to the decision to appoint the service provider. Research into whether the asset transfer should proceed should therefore have been undertaken well before any considerations to appoint a service provider. This will provide council with enough background information to be able to determine the appropriate compensation for all assets transferred prior to final appointment of the service provider.

## **4.6 STEP 6 – NEGOTIATE THE COMPENSATION PAYABLE**

### **4.6.1 Compensation to be paid**

Compensation payable to a municipality or municipal entity for a capital asset in terms of Chapter 2 of these regulations must always be in line with the disposal management system described above.

If the transfer is the result of the transfer of a commercial service or the sale of immovable property such as land or buildings then compensation must reflect fair market value (*regulation 13(1), SCM Regulations - regulation 40(2)*)).

If movable assets such as plant or equipment are sold, they must be sold at a price most advantageous to the municipality or entity by way of written quotes, competitive bidding or auction or at market related prices (*SCM Regulations - regulation 40(2)*)).

If a municipality or entity decides that in the public interest for instance, on account of the plight of the poor, it wants to transfer an asset for less than its fair market value, the municipality or entity must take into account a number of other factors, including the interests of the state (generally meaning the interests of the national or provincial government or the local area) and the local community, strategic and economic interests of the municipality or entity and the constitutional and legal rights of all parties concerned. It must then weigh up all these interests before making a decision (regulation 13(2)). The National Treasury's approval to transfer the asset below market value is not required, since the decision to transfer or dispose of the asset below fair market value remains the prerogative of the municipality subject to it having considered the factors mentioned in regulation 13. The consideration by council of these factors must, however, be documented in the minutes of the public meeting during which council considered such as part of approving-in-principle the transfer.

Transfers below fair market value, like any other transfer, must be done in terms of a process that is fair, equitable, transparent, competitive and cost-effective and in accordance with the SCM Regulations. In this instance, when council, in a meeting open to the public, considers whether the asset is not needed to provide the minimum level of basic municipal services and the fair market value of the land and the economic and community value to be received in exchange for the land, it should as part of the MFMA section 14 process apply the principles set-out in our regulation 13 in considering what is best in terms of the public interest factor and document such when making a decision on the value the asset to be transferred. Council in its decision should also make its policy clear regarding the criteria for awards to the public of the asset below market value e.g. number of indigents to benefit from the award/purpose for which asset are to be used, etc.

In view of the National Housing policy also providing support for the same target group in some instances, the municipality should consult with the Housing department to ensure alignment in policy and prevent a duplication of support to the same beneficiaries.

The primary determinant of compensation for these transfers is the SCM Regulations – regulation 40(2), which determines requirements of the municipality's supply chain management policy.

The issue of compensation must be considered by the municipality or entity, but that does not preclude a municipality or entity from transferring an asset below market prices provided that it is done so in accordance with these regulations

#### **4.6.2 Discharge of borrowings on assets transferred or disposed of**

Once compensation has been received by the municipality or entity, the proceeds must be used to discharge any borrowings against the asset at its redemption date or at another date agreed between the municipality or entity and the lender (*regulation 16*).

Alternatively, the municipality or entity may seek to negotiate with the private sector party or organ of state to which the asset is to be transferred, to take over any borrowings made against the asset as part of the compensation payable, subject to the agreement of the lender.

This effectively means that any liability for borrowings taken out for an asset is removed once the municipality or entity no longer has ownership of the asset. This precludes a municipality or entity from having to service a debt for an asset it no longer owns.

If a municipality as in the previous example decided to sell its administration building for R12 million, it must consider that the proceeds from the sale would need to be used to pay back the loan taken out for this building some years ago, either directly or by way of negotiation with the purchaser which would lead to reduced compensation. If the net cost to discharge the loan was R8 million, then the net proceeds from the sale would equate to just R4 million.

This should be considered when the municipality first develops its proposal for council to consider the in-principle transfer at the start of the transfer process. Such a determination should form a part of any feasibility study undertaken to consider the proposal.

Table 4 over the page provides a determination of how the process of compensation should be addressed for the various capital asset transfers or disposals made in terms of Chapter 2 of these regulations

**Table 4 – Determinations of Compensation Payable for Capital Assets in terms of Chapter 2**

<b>BACKGROUND</b>		<b>COMMENT</b>
1	The council intends to sell a fleet of 20 vehicles, each valued at R80 000 at fair market value through a process of competitive bidding.	These assets must be sold at a price considered to be most advantageous to the municipality by way of written quotes, competitive bidding or auction or at market related prices. Note: if the vehicles are to be traded-in, the municipality must negotiate the highest possible trade-in price.
2	The following financial year in 2008/09, the council also intends to relocate its head office and library and will therefore look to sell the existing municipal premises for R12 mill.	This asset may only be sold at market related prices. The method of sale is not specified however, it must be done in a manner that is fair, equitable, transparent, competitive and consistent with the SCM regulations. This is normally achieved through a process of competitive bidding or by way of public auction.
3	In the same financial year, the municipality plans to sell 40 municipal houses to poor and indigent residents at a price of R50,000 each which is less than market value as approved by council as a matter of public interest.	These assets may be sold at less than market related prices if it is considered that public interest or the plight of the poor necessitates this. However, a competitive process must still apply to their transfer or disposal. This may or may not preclude the houses being offered to certain residents listed on a “short list”, but sale may be achieved through other means such as by written quote, competitive bidding, public auction or any other means provided that it is fair, equitable, transparent and competitive and forms part of the municipality’s SCM policy.
4	In 2009/10 the council depot is damaged by a fire but salvageable parts are worth R2.5 mill to the municipality. It chooses to dispose of the facility and discard the material as scrap.	The municipality’s SCM policy must determine the way it must dispose of an unserviceable, redundant or obsolete asset. If transferred in terms of Chapter 2 it must again be done through a competitive process at a price most advantageous to the municipality.
5	One works shed complete with tools which survived the fire are to be sold off for a total value of R500 000.	These assets must be sold at a price considered to be most advantageous to the municipality by way of written quotes, competitive bidding or auction or at market related prices.

BACKGROUND		COMMENT
6	Council seeks to dispose of its obsolete computer equipment which has a written down value of nil, providing it free of charge to Sunshine Children (a private orphanage).	<p>This cannot be done – SCM regulation 40 requires that the provincial department of education must first be approached in the case of the free disposal of computer equipment.</p> <p>If the department is not interested, the municipality must consider the factors in regulation 13 to assess whether it is in the public interest or the plight of the poor to transfer the equipment below market value. The actual disposal must be done in terms of a competitive process in accordance with its SCM policy. The equipment cannot only be offered to Sunshine Children and must be offered in a competitive process clearly indicating the criteria for awards to the public of the asset below market value e.g. number of indigents/children to benefit from the award/purpose for which asset are to be used, etc.</p> <p>If transferred in terms of Chapter 3 to another organ of state it may donate the asset free of charge, if the department of education is not interested.</p>

## FORMALISING THE ASSET TRANSFER

### 4.7 STEP 7 – FINALISE ASSET TRANSFER AGREEMENT

#### 4.7.1 Detail of transfer agreements

All asset transfers in Chapter 2 may only take place by way of a written transfer agreement (*regulation 17(1)*). This agreement must include:

- the terms and conditions of the transfer;
- details of the capital and subsidiary assets and liabilities to be transferred;
- compensation to be paid and the terms and conditions for payment; and
- the effective date in which risk and accountability for the assets are to be transferred (*regulation 17(2)*).

It is advisable that details of any existing encumbrances, rights and servitudes also be clearly recorded in the transfer agreement (*regulation 48*).

#### **4.7.2 Transfer agreements for services**

A transfer agreement relating to assets transferred in terms of a municipal or commercial service must include provision for contract termination, dispute resolution and periodic review (at least once every three years if the contract is for longer than three years). Such conditions may be incorporated into the service delivery agreement or procurement contract agreed between the parties (*regulation 17(3)*).

Any transfer agreement must be made available in its entirety to the council and also be made publicly available unless legislation requires that it should be withheld from public scrutiny (*regulation 18*).

Attachment 6 provides a decision tree illustrating the process required to transfer or dispose of capital assets which are not exempted from sections 14 or 90 of the MFMA, where Chapter 2 of the regulations apply.

### **4.8 COUNCIL MAY DELEGATE CERTAIN AUTHORITY**

#### **4.8.1 Permitted and not permitted delegations**

Attachment 6 illustrates the process of transfer or disposal of a capital asset in terms of Chapter 2 of the regulations. The areas bordered in red signify those decisions that may be formally delegated by the council in terms of the regulations.

For certain movable assets below a value determined by the council, a council may delegate the authority to decide if an asset is not needed to provide a minimum level of basic municipal service and consider the fair market and economic and community value of that asset, to the municipal manager. It may also delegate to the municipal manager the power to approve *in-principle* that the asset may be transferred or disposed of (*regulation 5(6)*). In the case of a municipal entity, the council of the parent municipality may delegate these tasks to the chief executive officer of the entity (*regulation 8(6)*). When council made such a delegation, the accounting officer will have to make the required regulation 7 or 10 considerations before he/ she will be able to make an in-principle decision. Regulation 5(6) and 8(6) do not allow the accounting officer to further sub-delegate such a delegation.

It should be noted however that only the municipal council may authorize the public participation process referred to in regulations 5(1)(a) and 8(1)(a) (*regulations 5(3)(a) and 8(3)(a)*). This cannot be delegated, even for movable capital assets.

#### **4.8.2 Delegations under sections 79 and 106 of the MFMA**

The responsibilities of the accounting officer described in these regulations, meaning the municipal manager of a municipality or the chief executive officer of a municipal entity, may be delegated in terms of sections 79 and 106 of the MFMA to top management in the case of a municipality, or to an official in the case of an entity.

#### **4.8.3 Review of delegations recommended**

In other instances in this Chapter, the regulations require that the municipality or entity undertake all the legislated responsibilities and actions required to transfer or dispose of a non-exempted capital asset. Individual municipalities should determine the extent of their own delegations in this regard, after closely examining the decision-making process referred to above. In considering such delegations, municipalities must be mindful of their own responsibilities in terms of the principles of the MFMA whilst acknowledging the need to streamline administrative processes and improve service delivery (*MSA - part 3, section 59*) and ensure public accountability for the disposal or transfer of public assets funded from public resources is uppermost when taking such decisions.

### **4.9 RESPONSIBILITIES OF MUNICIPAL ENTITIES**

#### **4.9.1 Council, the parent municipality and the municipal entity**

A very similar process and similar conditions are placed on a municipal entity in terms of the responsibilities of a board of directors and chief executive officer when first considering the transfer or disposal of an asset, the process to affect such transfer or disposal, compensation and the formalization of the transfer (*regulations 8 to 10 and 11 to 18*).

It is important to note however, that the determinations required in terms of section 90(2)(a) and (b) of the MFMA must be made by the parent municipality of the entity. This means that the parent municipality must decide on reasonable grounds that the capital asset is not needed to provide a minimum level of basic municipal service and must consider the fair market value and the economic and community value to be received in exchange for the asset (*regulation 8(1)(b)*). Delegations to the chief executive officer of the entity in terms of these determinations may only be authorized by the parent municipality with respect to movable capital assets up to a certain value to be determined by the parent municipality (*regulation 8(6)*). When council made such a delegation, the accounting officer will have to make the required regulation 10

considerations before he/ she will be able to make an in-principle decision. Regulation 8(6) does not allow the accounting officer to further sub-delegate such a delegation.

Furthermore, only the council of the parent municipality may authorize the public participation process referred to in regulation 8(1)(a) (*regulation 8(3)(a)*).

In considering such delegations, boards of entities and municipal councils must be mindful of their own responsibilities in terms of the principles of the MFMA whilst acknowledging the need to streamline administrative processes and improve service delivery and ensure public accountability for disposal or transfer of public assets funded from public resources is uppermost when taking such decisions.

## **4.10 TIMING CONSIDERATIONS IN HIGH VALUE ASSET TRANSFERS**

### **4.10.1 Strategic considerations in asset transfers and disposals**

It is important that a municipality and municipal entity appropriately reflect in its long term planning processes, its plans for possible usage, transfer and disposal of capital assets.

High value asset transfers in particular should be budgeted for as they form a significant source of income to the transferring or disposing municipality or entity. Therefore, such transfers or disposals require careful planning, which should commence in line with other budget planning processes in August each year at the same time the council's budget and IDP time schedule for consultation is tabled in council.

This will also be the time that the council commences a process to review its IDP and service delivery mechanisms to gauge the impact of new or existing service delivery agreements and long-term contracts on the coming budget. It is also a time where strategic objectives for service delivery and development including backlogs are reviewed and a retrospective analysis is conducted on the previous year's budget performance.

Municipalities should at this time, be in a position to provide to council a schedule of proposed high value capital asset transfers and disposals, with a timeline showing when each process for the transfer or disposal will occur. This will be necessary in order to predict cash flow levels during the course of the new financial year and to determine utilization requirements across all departments to improve service delivery.

Council may then resolve that it undertake all in-principle decisions on transfers and disposals of its high value capital assets before December each year so that all determining factors may be resolved and decided upon before 1 July of the next financial year, allowing the actual process of transfer or disposal to commence early in the next financial year, or at any other time most beneficial to the municipality.

For example, in early November, a municipality resolves that it consider the transfer of all assets associated with its meter reading service and authorizes a public participation process to examine the proposal. This is a result of a decision taken in August (as part of a broader MSA Chapter 8 review of its service delivery mechanisms) to use an external service provider to undertake the meter reading function throughout the municipality.

Council meets again in late January at a meeting open to the public to discuss the proposal. At this meeting, council has been furnished with an information statement which provides all the information required to make an in-principle decision as to whether the assets should be sold. Previously, the municipal manager had initiated the MSA section 21 requirements to make the proposal public and has since received several comments and representations which are also summarized with the information statement. Additional information is provided to enable discussion over the range of discretionary (regulation 11) and mandatory (regulation 7) considerations that council wishes to address (agreed through council policy).

At this meeting council resolves to approve the transfer in-principle. Following debate and after discussion of all the matters contained in the information statement and in other documentation, council then resolves to formalize the asset transfer and instructs the municipal manager to make the required appropriations in the forthcoming budget and progress the transfer as an urgent priority.

The municipal manager then ensures that provision for the proceeds from the impending sale are incorporated into the budget for tabling in March and approval in June.

The municipal manager then initiates a process of public advertising to sell the assets through a competitive bidding process by early July.

## 4.11 BUDGET CONSIDERATIONS FOR GAINS OR LOSSES NOT BUDGETED FOR

### 4.11.1 Financial considerations in asset transfers and disposals

A gain or loss from a transfer or disposal of an asset must be provided for in the budget of the municipality or municipal entity. If the gain or loss was not anticipated or if the proceeds from the transfer were for any reason not budgeted for, it must be recognized in the next adjustments budget of the municipality or entity (*regulation 47*).

A municipality or entity should plan to incorporate all asset transfers into its budget by dovetailing the deadlines associated with the transfer process into those established for the three-year budget – failure by a municipality or entity to recognize this could have serious implications on the cash flow of the municipality or entity and on other management decisions.

A municipality and entity will also not be able to determine whether the 5% threshold of regulation 5(2) or 8(2) impacts on the public consultation required for its transfers and disposals in a particular year, if its capital asset transfers and disposals are not pre-planned and included in its budget. This may result in non-compliance with the MFMA and regulations, if assets are sold only to mid-year discover that in terms of regulation 5(2) or 8(2) all transfers and disposals in that year were to have been regarded as “high value” due to the combined value of asset transfers and disposals having exceeded five per cent of the total value of its assets.

Case study 1 over the page provides an example of the processes required for a municipality to sell its main administrative building in order to upgrade to a new facility.

Case Study 2 provides the example where the same municipality, as part of its plans to refurbish its office equipment for the new facility, must sell its existing office equipment.

## Case Study 1 – Pleasant View Administration Building

### Background

As a result of recent expansion and a need to upgrade its main administrative building, the Pleasant View metropolitan municipality resolves to relocate its head office and library. The municipality will need to sell its existing administrative building and use the proceeds from that sale less outstanding borrowings to fund the project. It plans to sell the old building for R12 mill, pay out or transfer outstanding debt of R4 mill and use the balance with further borrowings to pay for the new building. The municipality has been approached by Pleasant View Mining Corporation to purchase the building outright for R11.5 million.

### Determine circumstances of transfer

Pleasant View municipality must first determine whether the circumstances of the proposal i.e. to sell the administration building to a private sector party, will exempt the transaction from section 14.

Clearly, given that the offer has come from a private sector party and not an organ of state, the asset will be regarded as a non-exempted capital asset, and therefore MFMA section 14, the ATF regulations and SCM regulations will apply.

The municipality owns capital assets totalling R500 million, and the fair market value of the administrative building has been assessed at R11 million, meaning that the building will be considered to be a high value capital asset – its value represents 2.2% of the value of all assets, beyond the 1% threshold.

Having established that the circumstances of the transaction will result in the asset to be transferred to be regarded as a high value non-exempted asset, the municipality acknowledges that it cannot sell the building to Pleasant View Mining without going through the processes required by Chapter 2 of the regulations.

### Public participation

Before it can consider any proposal, the council must first receive a formal request for it to authorise a public participation process to help facilitate its decision. This request must be accompanied by a statement to provide council with certain information to help it make that decision.

If this proposal is authorised, then the public participation process may commence. Such a process requires that adequate notice be provided to the public, seeking its comments or representations on the proposal. The municipality must ensure all documentation is published in the municipal offices and in other outlets.

At a public meeting, council must then consider whether the administrative building is required to provide a minimum level of basic municipal service, and consider its fair market, economic and community value.

### Mandatory Considerations and Discretionary Conditions

During the meeting, the council must also take into account certain mandatory considerations (regulation 7) and decide whether the transfer should be made subject to any other conditions (regulation 11). Only once this process is completed, and if the council has resolved that the building is not required to provide a minimum level of basic municipal service, may the council decide to approve in principle of the sale of the building.

### Process of disposal

Once this is done and council has made the in-principle-decision, the municipal administration may then progress the sale of the administrative building, which must be done in accordance with the municipality's disposal management system.

As an immovable asset, unless the public interest or the plight of the poor demands otherwise, the administrative building must be sold at least at market value.

In this particular case, the council agrees that the building should in fact be sold at market value, through a process of competitive bidding.

### Fair market value

As the transfer does not relate to the transfer of a municipal or commercial service, the Pleasant View municipality may not negotiate directly with Pleasant View Mining at this point. The municipality must commence a process of competitive bidding and ensure the transfer is fair, equitable, transparent, competitive and consistent with the municipality's SCM policy. If it wants to accept the unsolicited bid of Pleasant View Mining it will have to follow the unsolicited bid process, subject to the conditions provided for in SCM regulation 37.

### Discharge of existing loan

It is important to point out that in this situation, Pleasant View municipality is required upon transfer to pay out the remaining loan of R4 mill or alternatively negotiate with the preferred bidder to take over liability for the borrowing subject to the agreement of the lender.

### Application of remaining funds

Only once this amount has been paid out or transferred, may the municipality apply the remaining funds for future purchases, in this case to pay in part for a new administrative building, where a separate loan may be considered to subsidise funding.

### Transfer Agreement

The transfer must be concluded through a written transfer agreement which is to be signed by both parties around the time of the contract of sale being signed. It must include the minimum term and conditions as provided for in ATF regulation 17.

## Case Study 2 – Pleasant View Office Equipment

### Background

As part of its refurbishment programme for the new administrative building, Pleasant View municipality has identified obsolete office equipment such as old desks, chairs, cupboards and photocopiers, which has a written down value of nil in its accounting records. It seeks to sell this equipment to anyone providing the best offer provided that there are no costs associated with its transfer. The municipality has had a request from Pleasant View mining to sell the equipment to them. It has also received several requests from councillors and staff to purchase the equipment at a fair or discounted price without going to sale by tender.

### Determine circumstances of transfer

Learning from the previous transaction concerning the sale of its administration building, the Pleasant View municipality quickly determines that this transaction is not exempted from the regulations, even though the equipment concerned is not considered to be high value.

### Delegation of certain decisions

The assets to be sold are considered movable assets and market value for each item is considered to be below the R5 000 threshold for delegation to the municipal manager, which was determined by the council in terms of its delegation policy. The municipal manager decides to determine whether the office equipment in question is needed to provide a minimum level of basic municipal service, and also considers the fair market value, and economic and community value of the assets in order to decide whether the office equipment should be transferred in principle.

### Discretionary Conditions and Mandatory Considerations

Before the municipal manager can approve the transfer in-principle, he must also take into account certain mandatory considerations (regulation 7) and decide whether the transfer should be made subject to any other conditions (regulation 11). Only once this process is completed, and if the municipal manager has resolved that the equipment is surplus to requirements and not required to provide a minimum level of basic municipal service, may he approve that the equipment be sold.

### Process of disposal

As a movable asset, the municipal manager instructs those duly delegated staff to commence the process to sell all equipment in this case by public auction with a view to getting the most advantageous price for the municipality. It will be a condition of auction that all bidders at the auction disclose whether he/ she is a person "in the service of the state" as defined in the SCM regulations, since awards to "persons in the service of the state", including municipal officials and councillors, are prohibited in terms of SCM regulation 44.

### Reasons for the decision

The municipal manager explains to Pleasant View Mining that any decision to sell the office equipment directly to them without going through a process of competitive bidding would be unfair and inequitable to those not being given an opportunity to bid and would furthermore contravene the municipality's SCM policy. Their offer also does not meet the conditions required to follow and unsolicited bid process as envisaged in SCM regulation 37.

### Transfer Agreement

Once the auction has been concluded and items sold, municipal staff commence the process of finalising written transfer agreements (complying with ATF regulation 17) with each of the purchasers which is signed by both parties and made available to the council and the general public. This ensures full accountability and transparency of the part of the council should anyone wish to query how the assets were sold and if they were sold off in a competitive manner consistent with the SCM regulations.

## PART 5 TRANSFER OF EXEMPTED CAPITAL ASSETS

### Summary

Chapter 3 prescribes requirements for the transfer of a capital asset to an organ of state such as another municipality, municipal entity or national or provincial organ of state in terms of the exemptions contained in sections 14(6) and 90(6) of the MFMA. Competitive bidding is not relevant in these circumstances, where the transfer is generally driven or guided by the MFMA or legislation such as the MSA or Municipal Structures Act. Transfers in these circumstances must emanate from any one of the six circumstances described in Part 1 of this Guide which includes certain restructuring under the MSA, the transfer of services, powers or functions under the Municipal Structures Act, the adjustment of municipal boundaries or the result of certain national or provincial housing policy or national legislation. This Chapter also includes the sale of surplus assets to another organ of state at market value or less provided that the municipality takes into account certain regulatory requirements. In this Chapter, capital assets needed for a minimum level of basic municipal service are generally not excluded (*regulations 19 and 20*).

The transfer and disposal of all capital assets, including transfers to other organs of state, require proper planning and a forward looking approach. The municipality or entity's budget must reflect all the planned transfers for the year and as far as possible, over the MTREF-period

Examples of this type of transaction include the transfer of water assets by a municipality to a municipal service utility, or the sale of surplus equipment to another municipality at market value or below.

### CONSIDERATIONS PRIOR TO TRANSFER OF AN EXEMPTED ASSET

#### 5.1 STEP 1 – IDENTIFY THE CIRCUMSTANCES OF THE TRANSFER

##### 5.1.1 Understand the nature of the transfer

The municipality or municipal entity must identify the nature of the proposed transfer, firstly to make sure that the transfer does necessitate an exemption in terms of sections 14(6) or 90(6), and secondly because the nature of the transfer will determine the process that needs to be followed in terms of Chapter 3. This process and the conditions to be attached to the transfer will vary greatly depending upon the circumstances behind the transfer. As stated earlier, for the transfer to another organ

of state to be exempted, the circumstances behind the transfer must be the result of any one of the following:

- when a municipality reviews its service delivery mechanisms in terms of Chapter 8 of the MSA, and appoints another organ of state to undertake the service;
- when there is a reorganisation of powers and functions between a municipality and its municipal entity;
- when a municipality's powers or functions are assigned to another organ of state as a result of national legislation or a power contained in national legislation;
- when municipal housing or land is transferred to a national or provincial organ of state for the poor in terms of national or provincial housing policy;
- when the transfer to the organ of state is required or permitted by national legislation that determines the conditions of the transfer; or
- any other circumstance not provided above, on condition that the asset to be transferred to the organ of state is considered by council to be not needed to provide a minimum level of basic municipal service and is surplus to the requirements of the municipality and entity (*regulation 20*).

Determine the nature of the transfer or disposal in terms of Chapter 2		
	BACKGROUND	COMMENT
1	The Municipality intends to sell land by private treaty to employees, since these assets are surplus to Municipal requirements and the Municipality is desirous of selling them to the current tenants (municipal employees). The Municipal Manager requested advice on whether Chapter 2 of the regulations can be used to transfer the land to these employees.	<p>Chapter 2 of the ATF Regulations will only apply to transfers to "another organ of state" and only in the circumstances set-out in ATF regulation 20. "Organ of state" is defined in ATF regulation 1, and does not include municipal officials. Chapter 2 cannot be used to transfer land to municipal officials.</p> <p>The Municipal Manager is advised that the ATF regulations, Chapter 2, in conjunction with the Municipal Supply Chain Management Regulations apply to these transactions. It is important to note that SCM Regulation 44 prohibits any awards, including disposal of surplus assets to "persons in the service of the state". "Persons in the service of the state" is defined in the SCM regulations and include municipal officials.</p>

## 5.2 STEP 2 - IDENTIFY ASSETS TO BE TRANSFERRED

### 5.2.1 All related assets, staff and borrowings to be considered

Once the exact nature of the transfer has been identified, the municipality or municipal entity must then properly identify and distinguish any asset it intends to transfer, and staff and borrowings associated with that asset, from the other assets and staff of the municipality or entity (*regulations 23 and 26(1)*).

When the transfer involves the transfer of a service, power or function or is the result of national or provincial housing policy or certain national legislation, all other assets directly needed or related to that asset must also be identified.

This facilitates the process in which a municipality or entity will ring-fence its assets, which will be necessary for valuation purposes and to evaluate the impact the transfer will have on the remaining powers, functions and services of the municipality or entity. This will bring into the analysis, all subsidiary assets, staff and borrowings associated with the capital assets to be transferred.

It is critical that these assets, staff and borrowings are identified and recognized in any feasibility study or risk analysis that is to be undertaken before consideration of the proposed transfer, and therefore it is strongly recommended that identification and cost attribution associated with the proposal be conducted early in the transfer process.

For instance, if a municipality decides as a result of a review of service delivery mechanisms, to transfer all assets associated with its water services function to a newly created services utility under the control of the municipality, it must first identify all of the assets associated with that service, including the existing staff involved in the service, any subsidiary assets required for the functioning of the service and any associated borrowings attached to the service. The costs and impacts of transferring all aspects of the water service must then be closely examined in the MSA section 78 feasibility study and in any other risk assessment well before actual transfer is affected.

### **5.3 STEP 3 – DETERMINE IF THE ASSET IS REQUIRED TO PROVIDE A MINIMUM LEVEL OF BASIC MUNICIPAL SERVICE**

#### **5.3.1 Assurances required protecting certain assets**

The MFMA prohibits the transfer and disposal of municipal capital assets needed to provide a minimum level of basic municipal services. The only exception on this prohibition is where such assets are transferred to an organ of state and in the circumstances provided for in regulation 20.

Unless emanating from an adjustment of powers and functions or boundaries as a result of national legislation (regulation 20(1)(c)), or the transfer of municipal housing or land to a national or provincial organ of state for the poor in terms of national or provincial housing policy (regulation 20(1)(d)), if the assets to be transferred are required to provide a minimum level of basic municipal service, then the municipality or municipal entity must before transferring the asset satisfy itself that the organ of state receiving the asset (the transferee) is able to demonstrate that it can adequately maintain and safeguard the asset (regulation 24(2)).

The municipality or entity will in each instance have to decide what investigations or information or assurances from the organ of state are required to satisfy it that the organ of state can adequately maintain and safeguard the asset. Any such process should include a review of the last three years audited annual financial statements, audit reports and annual reports of that organ of state. The municipal administration or entity will have to prepare adequate information supporting the organ of state's ability or inability to enable council to make an informed decision regarding the transfer. These considerations will also need to be documented in the council minutes.

Table 5 over the page provides examples of different types of transfers, highlighting when the regulation 24(2) assurances i.e. those relating to maintenance and safeguarding of an asset, are needed.

### 5.3.2 Mandatory conditions on transfer

**Table 5 – Transfers Necessitating Regulation 24(2) Asset Protection Assurances (Maintenance & Safeguarding)**

	BACKGROUND	REG 24(2) ASSUR REQD	COMMENT
1	The council resolves to investigate a proposal to transfer the assets associated with its water service to a multi-jurisdictional service utility.	Yes	Council must receive the appropriate assurances from the water utility before it transfers any asset, that the utility will be in a position to adequately maintain and safeguard the transferred assets.
2	The Demarcation Board initiates a change in the boundaries of a municipality in which a township on the municipality's border is relocated to another neighbouring municipality. The demarcation notice carries with it a requirement for the municipality to transfer services associated with that township to the neighbouring municipality.	No	Regulation 24 does not apply to transfers envisaged in regulation 20(1)(c). - As the transfer was initiated by a party other than the municipality, the party responsible for the transfer must stipulate conditions relating to asset custodianship. In this case, the transferee should take responsibility for maintenance and safeguarding. The transferor is no longer in a position to demand such assurances as ownership has passed to another municipality along with the risk attached to the asset.
3	In response to provincial housing policy, a municipality is required to transfer housing and land it has developed for the poor and indigent to the province, to allow the province to administer occupation and ownership of the housing in line with its provincial housing policy.	No	Regulation 24 does not apply to transfers envisaged in regulation 20(1)(d). - As with the previous example, it would be expected that the province would take on maintenance and safeguarding of the housing assets until such time as the houses are transferred – this would also depend on the provincial housing policy in place.
4	Following replacement of its entire truck fleet, a municipality resolves to investigate a proposal to sell its surplus trucks to the neighbouring municipality.	No	Whilst the municipality has initiated this transaction, the fact that the trucks are now surplus to requirements suggests that they are no longer required to provide a minimum level of basic municipal service, therefore the provisions of Regulation 24(2) would not be applicable in this instance – that being the case it would be highly unlikely that the municipality would again require these trucks to perform any essential service and it would then be incumbent on the municipality taking possession of the asset to take responsibility for its own maintenance and safeguarding requirements in accordance with its own policies.

As stated above, municipal capital assets needed to provide a minimum level of basic municipal services can only be transferred to an organ of state and in the circumstances provided for in regulation 20, subject thereto that the transferee (organ of state) demonstrated its ability to adequately maintain and safeguard the asset.

Under these circumstances, the municipality or entity must impose certain mandatory legislated conditions on the transfer and ensure that the transfer documentation contains these conditions. Conditions that must be included are:

- that ownership of the asset must immediately revert back to the municipality or entity if the organ of state receiving the asset (the transferee) ceases or is unable to render the service; and
- that the transferee cannot without the written approval of the municipality or parent municipality of the entity, transfer, dispose, grant a right of use or encumber that asset in any way.

These conditions must also apply to any replacement, upgrade or improvements to the original asset (*regulation 24(1), (3) and (4)*).

It is recommended that the contracting parties consider and include terms and conditions to address the event of an asset reverting back, including conditions relating to (a) compensation for upgrades or improvements to an asset and also (b) that any significant or substantial replacements, upgrades or improvements only be done after consulting the municipality, if the municipality will be liable for compensation later on.

Table 6 below highlights the same transfer conditions as described above, and demonstrates how the regulation 24(1) mandatory conditions relating to third party use or ownership will be affected.

**Table 6 – Transfers Necessitating Regulation 24(1) Third Party Conditions (Use & Ownership)**

	BACKGROUND	REG 24(1) CNDTNS REQD	COMMENT
1	The council resolves to investigate a proposal to transfer the assets associated with its water service to a multi-jurisdictional service utility.	Yes	<p>The utility to receive the asset may not transfer or dispose, or grant another party the right to use the asset without the express permission of the transferring municipality.</p> <p>If the utility, a partly-controlled municipal entity of the municipality, is unable for whatever reason to carry out the service it was established to perform, then ownership of all transferred assets must revert back to the municipality to enable it to carry out the service itself.</p> <p>The utility should not replace, upgrade or make any improvements to the transferred asset without the express permission of the transferring municipality.</p>
2	The Demarcation Board initiates a change in the boundaries of a municipality in which a township on the municipality's border is relocated to another neighbouring municipality. The demarcation notice carries with it a requirement for the municipality to transfer services associated with that township to the neighbouring municipality.	No	<p>Regulation 24 does not apply to transfers envisaged in regulation 20(1)(c). - The mandatory conditions relating to asset use and ownership after transfer do not apply – upon transfer the neighbouring municipality will be required to make its own policy decisions relating to use and ownership of the asset subject to these regulations.</p>
3	In response to provincial housing policy, a municipality is required to transfer housing and land it has developed for the poor and indigent to the province, to allow the province to administer occupation and ownership of the housing in line with its own provincial housing policy.	No	<p>Regulation 24 does not apply to transfers envisaged in regulation 20(1)(d). - The mandatory conditions relating to asset use and ownership after transfer do not apply – upon transfer the provincial government will make its own decisions relating to asset use and ownership in line with its own provincial housing policy.</p>
4	Following replacement of its trucks, a municipality resolves to investigate a proposal to sell its now surplus trucks to the neighbouring municipality.	No	<p>If the trucks are not considered to be “assets needed to provide a minimum level of basic municipal services”, the mandatory conditions relating to asset use and ownership after transfer do not apply – upon transfer the neighbouring municipality taking possession of the asset will be required to make its own policy decisions relating to use and ownership of the asset subject to these regulations.</p>

## PROCESS OF ACTUAL TRANSFER OF AN EXEMPTED CAPITAL ASSET

### 5.4 STEP 4 - BASED ON THE CIRCUMSTANCES OF THE TRANSFER APPLY THE APPROPRIATE CONDITIONS

#### 5.4.1 Transfers arising from a review of service delivery mechanisms by a municipality

##### **Risk management, continuity of service and preservation of the asset**

Any transfer that results from a municipality's review of its service delivery mechanisms done in terms of Chapter 8 of the MSA, when another organ of state is appointed to undertake the municipal service, must be done subject to certain conditions and in accordance with a process designed to ensure that the municipality or municipal entity is not prejudiced by the transfer, that service is continued without interruption and that the assets being transferred are preserved in an appropriate condition.

If the asset is needed to provide a minimum level of basic municipal service, the municipality or entity must ensure it receives the required assurances and imposes the necessary conditions outlined in step 3 to ensure that the asset will be adequately maintained and appropriately safeguarded (*regulation 24*).

As this type of transfer is an initiative of the municipality itself, and whether related to the transfer of assets required to provide a minimum level of basic municipal service or not, the regulations put the onus on the municipality to ensure that the transfer will result in the continuation of the service to at least the same or better level than would otherwise have been provided by the municipality had it not transferred the asset (*regulation 22(3)*).

##### **Capital and subsidiary assets, borrowings and staff transfers**

The municipality or entity may agree with the organ of state to transfer all capital and subsidiary assets that are essential to the performance of that service which in addition to all movable and immovable assets include intangible assets, receivables, investments and cash equal to the difference between the assets and liabilities of that particular service as well as any reserve funds (*regulation 25*).

Borrowings or other amounts owing by the municipality or entity associated with the service must also be transferred (*regulation 26(2)*).

If the transfer gives rise to the transfer of staff associated with that service, the staff transfer must be done in accordance with applicable labour legislation and legislation

regulating the transfer of liabilities associated with such staff if applicable – such liabilities may include leave entitlements, medical, post-retirement liabilities and other staff liabilities (*regulation 27*).

### **Asset transfer to be an integral part of decision-making**

All of the considerations involved in deciding whether the asset is to be transferred must be taken into account in selecting a service provider. Documents prepared for any public participation process must include details of the proposed transfer. The transfer proposal must be taken into account in any feasibility study conducted to determine the implications of selecting the service provider (*regulation 22(1)*). It is recommended that this information be provided and relate to the feasibility study described in section 78(3)(b) of the MSA, to ensure all the necessary information is provided to the council up front, to better inform good decision making and to combine processes and reduce the time taken to make an informed decision.

If the above feasibility study indicates that there will be a significant increase in costs to the municipality or entity as a result of the transfer, the municipality or parent municipality of the entity must then demonstrate how these costs can be minimized by cost-sharing between the parties, how much revenue can be generated by the organ of state which can be used to offset these costs, and how the municipality or entity can rationalize its own costs after the transfer takes place (*regulation 22(2)*). A municipality or entity must consider the effect the transfer will have on the credit rating, and financial position and cash flow of the municipality or entity (*regulation 31*).

Case Study 3 over the page provides an illustration of the processes involved to affect an asset transfer arising from a review of service delivery mechanisms by a municipality. It also highlights how the various legislative requirements for a feasibility study and municipal assessment can be dovetailed or held concurrently to reduce the time taken to make a decision and ensure all information relevant to stakeholders is provided in a timely and effective manner. In this example a checklist is used to determine the appropriate process.

## Case Study 3 – Hilltown Water Services Facility

### Background

Following a review of its service delivery mechanisms in terms of Chapter 8 of the Municipal Systems Act, the Hilltown local municipality recently decided to consider the transfer of its water services function to a newly formed multi-jurisdictional service utility. Called the Pleasant View and Valleydale Water Corporation or PVWC, this multi-jurisdictional service utility was created by the Pleasant View metropolitan municipality and the neighbouring Valleydale local municipality to carry out all of the municipal water services functions in the local area.

This is a transfer to an organ of state within the ambit of regulation 20(1)(a). Chapter 3 of the regulations apply. The actual transfer in these circumstances is exempt from the SCM regulations.

### MSA Section 78 Assessments (1)

As part of its review of the integrated development plan, the Hilltown municipality undertakes a thorough organisational and benchmarking review and an in-house review of service delivery requirements to assess how it can best deliver its water services responsibilities to the community. Having resolved not to conduct the service using an internal service delivery mechanism the municipality gives notice to its community that it intends to explore an external mechanism to conduct the service. It undertakes an assessment in terms of section 78(3)(b) of the Municipal Systems Act to examine the different options available. The municipal assessment takes into account:

- the direct and indirect costs and benefits associated with the project, including the expected effect of any service delivery mechanism on the environment and on human health, safety and well-being;
- the current and future capacity of prospective service providers to provide the appropriate skills, expertise and resources;
- the views of the local community;
- the likely impact on local development and employment; and
- the views of the unions involved.

In addition, a section 78(3)(c) feasibility study is conducted by the municipality to include:

- an indication of the service which is to be considered;
- an indication of the term which is to be considered;
- projected outputs to be expected from the proposal;
- an assessment of how the proposal will provide value for money, address the needs of the poor, be affordable and transfer risk; and
- an assessment of impact on the municipality's assets and liabilities.

### First Concurrent Asset Transfer Assessment

Mindful of the requirements of the Municipal Asset Transfer Regulations, the municipal manager incorporates into this assessment and feasibility study:

- an explanation of the nature of the proposal – and the nature of the transfer;
- a description of what assets may need to be transferred as a result of a change in the service provider;
- whether any subsidiary assets, staff or borrowings would also need to be transferred;
- whether the assets in question would be needed to provide a minimum level of basic municipal service;
- assurances necessary to protect the asset;
- third party conditions;
- considerations relating to risk management, continuity of service and asset preservation;
- financial information relating to anticipated costs and benefits, gain or loss and efficiencies or otherwise; and

- documentation requirements and other information necessary to make the appropriate decision.

### MFMA Section 84 Assessment (2)

Following an evaluation of all assessments, and after satisfying all the required conditions precedent contained in the Municipal Systems Act, the municipality resolves to conduct the service using an external service mechanism. The municipality then undertakes further research into the various external service delivery options available: it concludes that participation in the newly established multi-jurisdictional service utility, the PVWC, would easily provide the best overall value and service for the municipality. It then undertakes an assessment in terms of section 84(1)(b) of the MFMA to examine the impact of the shifting of that function on staff, assets and liabilities. This second assessment takes into account:

- staff transfers, redundancies and retrenchments; and
- all asset transfers, liabilities and debt.

### Second Concurrent Asset Transfer Assessment

Having the basis of the required information ready for this assessment from the s78 feasibility study, an updated information statement is developed taking into account the s84 MFMA requirements.

The service delivery assessment is being run concurrently with the budget and IDP process, to help the municipality to evaluate its assessments in line with emerging strategic priorities of the municipality using the latest available financial information from the audited annual financial statements.

### Public Meeting

Having considered all of the required information needed to make a valid assessment of the proposal, the municipality gives notice of a public meeting to discuss the proposal in terms of section 84(2)(a) of the MFMA. It resolves that any asset transfers to be considered as part of this decision should be listed on this agenda.

Following consideration of comments and representations on the proposal, the council decides to participate in the entity as originally proposed. It also agrees that all associated assets should be transferred to the entity subject to various conditions.

### Other Considerations

Following various other processes to affect the proposal the municipality reaches a point to negotiate the service delivery agreement with the PVWC. It further resolves to incorporate the asset transfer agreement into the service delivery agreement.

### The Service Delivery and Transfer Agreements

Once both agreements are suitably negotiated and finalised, both parties sign off the agreements to commence service delivery and the transfer of all assets necessary to the performance of the water service.

## Case Study 3 – Hilltown Water Services Facility (continued)

### Checklist of determinations required for asset transfer assessment

(To form part of broader assessment of external service delivery required in terms of section 78(3)(b) of the MSA and section 84 of the MFMA)

In developing the initial concurrent asset transfer assessment, the municipal manager adopts a checklist approach to ensure all considerations required by the Asset Transfer Regulations are properly completed. The approach also helps the municipal manager to bring in certain information which may be required for other municipal assessments such as those contained in the Municipal Systems Act and in section 84 of the municipal Finance Management Act:

#### **CHECKLIST OF DETERMINATIONS FOR ASSET TRANSFER ASSESSMENT**

The checklist is based on the decision trees contained in this Guide (see attachments 5, 6, 7 and 8).

##### **Q1 – Identify the nature of the proposal:**

It is clear that that transfer of any capital assets as a result of this proposal will be the result of an MSA Chapter 8 review of service delivery mechanisms where an organ of state is preferred. This means that the transfer will be in terms of regulation 20(1)(a), and assets will be considered to be exempted – so Chapter 3 of the regulations will apply.

##### **Q2 – Identify the assets to be transferred:**

As the transfer involves the transfer of a municipal service, all other assets and staff directly needed or related to that asset must also be identified. Borrowings associated with the asset must also be identified in this process. This will assist the municipality in assessing all the values and costs associated with the service (regulations 25(1), 26 and 27).

##### **Q3 – Identify whether the assets to be transferred are needed to provide a minimum level of basic municipal service:**

As water and sanitation services are considered a local government matter in schedule 4B of the Constitution, it could be interpreted that these assets will be required to provide a minimum level of basic municipal service. This being the case, the municipality will need to impose certain conditions on any asset transfer such as those relating to continuity of service.

##### **Q4 – Determine what assurances will be relevant:**

As the transfer involves the transfer of a service, the asset protection assurances relating to asset maintenance and safeguarding will be applicable in this instance. The municipal manager must ensure that these assurances are provided by the organ of state receiving the asset before transfer takes place (regulation 24(2)).

##### **Q5 – Determine what third party conditions will be relevant:**

As the transfer involves the transfer of a service, the third party conditions relating to asset use and ownership will also be applicable. These conditions will need to be incorporated into the transfer agreement between the parties (regulation 24(1)).

##### **Q6 – Determine whether risk management, continuity of service and asset preservation considerations must be included:**

As the transfer is an initiative of the municipality itself, the municipality must ensure that the transfer will result in the same or better service. This should be included as a specific condition in the transfer documentation (regulation 22(3)).

##### **Q7 – Determine if additional financial information is required:**

As an initiative of the municipality, the municipality must mitigate against any cost increases – and therefore must have available additional financial information required to facilitate this, including cost and revenue forecasts, details of cash flow and financial position and available credit rating (regulations 22(2) and 31).

The municipal manager should have at this point initiated calculations surrounding the profitability or otherwise of the proposal including financial information that would have a bearing on transfers of assets. This information should be analysed against impending costs or losses, and any impact on credit rating and borrowings

##### **Q8 – Determine other information requirements:**

As an initiative of the municipality, the asset transfer is to be an integral part of decision making involving the appointment of a service provider chosen to perform the service (regulation 22(1)).

In this case all of the additional information required for the public participation process must also be taken into account in any decision to appoint PVWC to manage the municipality's water service.

##### **Q9 – Provide information relating to compensation payable:**

In this instance, compensation payable is as agreed between the parties. The Hilltown municipality and PVWC must negotiate appropriate compensation based on the valuation of assets and liabilities as determined in the accounts of the municipality (regulation 29).

At this point, the assessment is based on estimates and proposals; it is recommended that the municipal manager ensure that all the necessary information is collated to allow council to negotiate mindful of all the facts available.

It would be anticipated that various options of financial viability and service delivery would be explored at this point, through financial modelling and by initiating strategic planning discussions as necessary.

##### **Q10 – Provide information relating to transfer agreement:**

The municipal manager should have developed standard terms and conditions from which council can develop a basis for the asset transfer agreement. These terms and conditions may include arrangements for optimal participation by the entity in planning and policy processes, tariff determination, performance targets and the required assurances and considerations relating to the transfer.

## PROCESS OF ACTUAL TRANSFER OF AN EXEMPTED CAPITAL ASSET

### 5.4.2 Transfers arising from a reorganisation of powers and functions between a municipality and its municipal entity

#### **Risk management, continuity of service and preservation of the asset**

Asset transfers resulting from a reorganisation of powers and functions between a municipality and its municipal entity are treated in a similar manner to those transfers resulting from a municipality's full review of service delivery mechanisms in terms of Chapter 8 of the MSA.

Whilst a full review in terms of Chapter 8 could result in the appointment of a service provider that is outside of the ownership control of the municipality, or indeed the creation of a new entity; transfers resulting from a reorganisation of powers and functions between a municipality and its entity, will generally be regarded as being limited to asset transfers to parties owned by the municipality in a closed system of control.

Mindful of this difference, some of the conditions applicable to asset transfers emanating from a service delivery review are redundant to transfers within and between a municipality and its own entity.

The provisions relating to assets needed to provide a minimum level of basic municipal service i.e. those relating to assurances and conditions to ensure maintenance and safeguarding of the asset, remain applicable to any asset transfer in terms of Chapter 3, and so will be applicable in this instance (*regulation 24*).

Regulation 22(3) relating to continuity of service is not relevant in this instance, as this is implicit in the conduct of all powers, functions and services within the municipality.

#### **Capital and subsidiary assets, borrowings and staff transfers**

Regulations 25 and 26(2), relating to the transfer of subsidiary assets and borrowings are not applicable to these transfers – the municipality must manage this process in its own manner provided that it adheres to the principles in the regulations and other relevant legislation. Regulation 27 concerning staff transfers and liabilities associated with such staff remain relevant.

#### **Asset transfer to be an integral part of decision-making**

As in the case of transfers emanating from a review of service delivery mechanisms, all of the considerations involved in deciding whether the asset is to be transferred

must be taken into account in selecting a service provider. Documents prepared for any public participation process must include details of the proposed transfer. The transfer proposal must be taken into account in any feasibility study conducted to determine the implications of selecting the service provider, although the MSA section 78(3)(c) feasibility study or assessments required by section 84 of the MFMA will not necessarily be required for this type of transaction (*regulation 22(1)*).

Consistent with these principles, if the feasibility study indicates that there will be a significant increase in costs as a result of the transfer, the parent municipality must then demonstrate how these costs can be minimized by cost sharing, how much revenue can be generated which can be used to offset these costs, and how the parties can rationalize its own costs after the transfer (*regulation 22(2)*). The parties must consider the effect the transfer will have on the credit rating, financial position and cash flow of the municipality or entity (*regulation 31*).

#### **5.4.3 Transfers arising from the assignment of a municipality's powers or functions to another organ of state**

##### **Risk Management, continuity of service and preservation of the asset**

Asset transfers emanating from the assignment of certain municipal powers or functions to another organ of state, as a result of national legislation or in terms of a power contained in national legislation, are treated quite differently from the previous two scenarios.

Such transfers include situations such as the re-alignment of municipal boundaries or adding or taking away certain powers and functions of a municipality. This is normally done through national legislation such as the Municipal Structures Act or Municipal Demarcation Act and supported by certain provincial legislation.

Even if the transfer involves assets required to provide a minimum level of basic municipal service, the regulation 24 conditions and assurances relating to asset use, ownership and asset protection are not relevant here, as the asset transfer is initiated by the national government through legislation to effect a national policy – it is anticipated that issues of asset use and ownership have in effect, already been considered by the national department and protection of the asset will become the responsibility of the organ of state that is to receive the service (the transferee). Regulation 22(3) relating to continuity of service is also not relevant in this instance, as this requirement will also become the responsibility of the transferee.

### **Capital and subsidiary assets, borrowings and staff transfers**

Regulations 25, 26(2) and 27, relating to subsidiary assets, borrowings and staff are applicable to these transfers – this is because they relate to the transfer of a power or function and therefore the capital and subsidiary assets involved in the power or function to be transferred may all be considered.

Therefore if a power or function of a municipality was subsequently transferred from the municipality to provincial government, where the legislation did not stipulate the asset transfer process, then the municipality and provincial government would negotiate whether the subsidiary assets essential to the performance of that service would be transferred. Borrowings and staff associated with the transfer of the service, however, must also be transferred with the service.

All of the conditions associated with the transfer of these subsidiary assets, borrowings and staff are also applicable here.

### **Asset transfer is an initiative of national government**

In this transfer scenario, the asset transfer is the result of national legislation or a power contained in national legislation and therefore it is considered an initiative of national government. In these instances, a public participation process, transfer documentation leading up to the transfer and feasibility study would not necessarily have been contemplated by the municipality. Therefore, the provisions of regulations 22(1) are not relevant here.

Similarly the impact of the transfer on the credit rating and the financial position of the municipality would also not need to be considered by the municipality in terms of regulations 22(2) and 31.

#### **5.4.4 Transfers of municipal land or housing for the poor in terms of national or provincial policy**

##### **Asset transfer is limited to individual capital assets only**

If a national or provincial policy on housing necessitates the transfer of municipal housing or land to a national or provincial organ of state for the poor, the provisions of regulations 22, 24, 25, 27 and 31 do not apply. As the transfer is limited to specific capital assets i.e. municipal housing and land, regulations that are pertinent to the transfer of a municipal service, power or function are no longer relevant.

As an initiative of national or provincial government, regulation 24 conditions and assurances relating to asset use and ownership and asset protection for assets required to provide a minimum level of basic municipal service, are no longer relevant.

For the same reasons, regulations 22 and 31 become redundant.

As the transfer involves specific capital assets only, and not assets involved in the provision of a service, power or function, regulation 25 relating to subsidiary assets is also irrelevant to these transfers. Regulation 27 concerning staff transfers and liabilities associated with such staff also lose relevance.

In accordance with regulation 26(1), and subject to the limitations of this regulation, the transfer of borrowings associated with the municipal housing or land to be transferred will still apply to these transfers, meaning that any loan taken out by the municipality or entity with regard to the housing or land which is to be transferred to the organ of state must also be transferred with that housing or land.

#### **5.4.5 Transfers required or permitted by national legislation**

##### **Asset transfer is to be governed by national legislation**

Certain transfers will be the result of national legislation that specifies the conditions of the transfer. These are unlike transfers which arise from the assignment of powers and functions to another organ of state where transfer conditions are not stipulated.

In these circumstances, the very same conditions attached to the transfer of municipal land and housing for the poor as referred to in section 5.4.4 of this Guide will be applicable.

It is anticipated that the national legislation that guides the transfer will provide the terms and conditions of the transfer, and therefore additional conditions other than those requiring the transfer of any borrowings associated with that asset are considered redundant.

It is important here to make the distinction between assets transfers that are initiated as a result of the assignment of powers and functions to another organ of state and those determined by national legislation when that legislation specifies the transfer conditions.

A transfer emanating from a re-demarcation of municipal boundaries in terms of the Municipal Structures Act would be considered to be a transfer covered by section 5.4.3 of this Guide (regulation 20(1)(c)(iii)), as this legislation does not itself specify the conditions of the transfer.

Even if the notice required in terms of section 12 of the Municipal Structures Act made such conditions, the regulations require that the actual legislation which determines the transfer stipulate conditions for this section of the regulations and Guide to be relevant. In the absence of specific transfer conditions in the legislation determining the transfer, the processes and requirements set-out in the ATF regulations will apply to such a transfer. At time of publication of this Guide, we are not aware of any legislation that caters for this type of transfer.

Case Study 4 below provides an illustration of the processes involved to affect the transfer of municipal clinics.

## Case Study 4 – Valleydale Infant Health Clinics

### Background

The Valleydale local municipality is required to transfer its 20 infant health clinics to the National Department of Health, as required by new National legislation that stipulates the conditions of transfer, including the method to be used to evaluate all assets to be transferred. The cost of each clinic was R70 000 and land was valued at R50 000, a total municipal investment of R120 000 per clinic – a total of R2.4 million.

### Identification of all assets

The municipality identifies that the circumstance of the transfer is in terms of regulation 20(1)(e) of the regulations. In response to the legislation, and following a request from the National Department of Health for the municipality to engage in the transfer of its 20 clinics, the Valleydale municipality immediately commences the process of identifying all assets needed for or directly related to the clinics. It also identifies the municipal land on which the clinics were built as related assets for the purpose of the transfer.

### Conditions attached to the transfer proposal

Whilst the assets were needed to provide a minimum level of basic municipal service, the municipality and the National department recognise that the transfer does not necessitate the regulation 24 asset protection conditions and third party considerations. Further the circumstances of the transfer means that the risk management, continuity of service and asset preservation considerations required in terms of regulations 22 and 31 are also not applicable.

Both parties do recognise the requirement that the municipality must transfer the borrowings associated with the construction of the asset as required by regulation 26(1).

### Negotiation of compensation payable

As no additional consideration or conditions were required the Valleydale municipality and National government department initiate negotiations to address appropriate compensation payable to the municipality such that no party should be disadvantaged by the proposal.

Following a due diligence review being undertaken by the National government department to examine all issues relating to the transfer, the department agrees to pay the Valleydale municipality R400 000 plus interest and all transfer costs as compensation. Given that this transaction arises from a national policy, the municipality may decide to forego any financial compensation, after debating the matter in Council.

### Transfer Agreement

The transfer agreement is concluded by the parties containing the required terms and conditions and signed.

## 5.4.6 Other transfers to organs of state

### Assets not required to provide a minimum level of basic municipal service

A municipality or entity may transfer a capital asset to another organ of state in any other circumstance not referred to above provided that the council of the municipality or council of the parent municipality of the entity determines that the asset is not needed to provide a minimum level of basic municipal service and is surplus to the requirements of the municipality and entity. Such determinations must be made by a resolution of the council of the municipality.

An example of this type of asset transfer may be a municipality seeking to sell its redundant trucks and equipment to a neighbouring municipality following the purchase of several new trucks, rendering the old fleet of trucks and equipment redundant and surplus to requirements and therefore no longer required to provide a minimum level of basic municipal service.

In this instance, as the assets to be transferred are considered to be exempted, they may be transferred without reference to the SCM Regulations.

In this situation, due to the nature of the transfer, regulations 22, 24, 25, 27 and 31 will not apply. As the transfer does not include those assets required to provide a minimum level of basic municipal service, regulation 24 becomes redundant. As the transfer involves specific capital assets only, and not assets involved in the provision of a service, power or function, regulations 22, 25 and 27 relating to subsidiary assets and staff are also irrelevant. If the assets are surplus to the requirements of the municipality and entity, the impact of the transfer on the credit rating and the financial position of the municipality would also not need to be considered by the municipality or entity in terms of regulations 22(2) and 31. Only the requirements of regulation 26(1) relating to borrowings associated with the capital asset are relevant. In these situations, the municipality or entity may directly negotiate the compensation to be paid with the neighbouring municipality.

The municipality must still properly identify and distinguish the assets (and staff if relevant) proposed to be transferred from other assets (and staff) of the municipality as required by regulation 23.

Whilst a transfer of this nature will generally not include staff of the municipality or entity as it does not envisage the transfer of a service or power or function, it is advisable that the municipality still review the transaction to identify the impact the loss of the asset will have on existing staff which may be attached to the operation of the asset being transferred for instance, in the case of vehicles, plant mechanics and fleet personnel; or in the case of council buildings, maintenance staff such as carpenters, painters, plumbers or landscape gardeners.

Case Study 5 below provides an illustration of the processes to consider in the transfer of surplus municipal assets to another organ of state.

## Case Study 5 – Hilltown Surplus Truck Fleet

### Background

The Hilltown municipality has recently replaced its entire truck fleet and now wishes to investigate the possibility of selling its surplus trucks to the neighbouring Valleydale municipality, whose fleet of trucks is insufficient to cater for its growing needs. Hilltown have ten trucks that are surplus to their requirements each with a fair market value of R200 000, although the value in the accounts of the municipality has been written down to nil. The depreciated replacement cost of the asset has been calculated at R180 000 each truck although recent sales evidence of trucks of a similar type and condition reveal a realisable value of R220 000 per truck.

### Identification of all assets

The municipality confirms that the nature of the transfer is based on regulation 20(1)(f), and commences a process to identify all other assets including staff needed for or directly related to the truck fleet. It acknowledges that all other assets and staff are now redeployed to work in connection with the new fleet of trucks.

### Conditions attached to the transfer or disposal

The municipality reviews and confirms by council resolution that the asset is no longer needed to provide a minimum level of basic municipal service, given the purchase of the new fleet, and is therefore surplus to the requirements of the municipality and its entities. This means that the regulation 24 asset protection conditions and third party considerations do not apply here. Similarly, the nature of the transfer means that the risk management, continuity of service and asset preservations considerations required in terms of regulations 22 and 31 are also not applicable. Hilltown municipality confirms that there are no longer any outstanding loans on the fleet.

### Negotiation of compensation payable

It then commences a process to consider the appropriate compensation to be paid for the asset. As GRAP was still being phased-in Hilltown was not using the new standards, it needed to apply any one of the four methods stipulated in regulation 29(2). It calculated each option as follows:

Historical cost, less depreciation and impairment:	R NIL
Fair market value:	R200 000
Depreciated replacement cost:	R180 000
Realisable value:	R220 000

Although Hilltown acknowledges Valleydale municipality's difficult financial situation, and therefore wishes to provide the municipality with a discounted market price, it realises it cannot provide the trucks for less than fair market value (unless in the public interest or a result of the plight of the poor (refer regulation 20(1)(f)(ii)) – which it didn't want to pursue).

### Transfer Agreement

It was agreed that the trucks should be sold at the fair market value of R200 000 per truck, a total cost of R2 mill – the proposal was put to the Valleydale municipality for consideration.

## 5.5 STEP 5 – NEGOTIATE THE COMPENSATION PAYABLE

### 5.5.1 Compensation to be paid

The municipality or municipal entity and the organ of state receiving the asset (the transferee) must agree on any compensation to be paid for the asset being transferred. Although it is not necessarily a requirement that compensation actually be paid, council should decide what is in the best interest of the municipality in the particular circumstances also taking into account the value the asset has for the municipality, any liabilities attached to it, etc. For the purposes of calculating compensation, asset and liability values must be determined in accordance with the methods described earlier (*regulations 28 and 29*).

As the disposal management system of the municipality is not applicable to exempted transfers to organs of state, a municipality or entity may choose to negotiate with the transferee the amount of compensation payable, subject to certain limitations on transfers for less than fair market value contemplated in regulation 20(1)(f). The

amount of compensation payable and the terms and conditions for payment must be set out in the transfer agreement (regulation 30).

### **5.5.2 Special considerations on assets if transferred for less than market value**

#### **Assets surplus to requirements and not required to provide a minimum level of basic municipal service**

If the transfer is the result of any other transfer not contemplated in regulation 20(1)(a) to (e), for instance when a municipality or entity chooses to sell or donate an exempted capital asset which is not required to provide a minimum level of basic municipal service and is surplus to requirements, to another organ of state for less than fair market value, it may only do so if the municipality takes into account the following matters:

- whether the asset may be required at a later date;
- the loss or gain expected from the transfer;
- the extent to which any compensation will result in a significant economic or financial cost or benefit to the municipality;
- the risks and rewards associated with the operation or control of the asset in relation to the interests of the municipality or entity;
- the effect the transfer will have on the ability of the municipality or entity to raise borrowings in the future;
- the limitations and conditions attached to the asset, and the consequences of any potential non-compliance with these conditions;
- the estimated cost of the transfer
- the transfer of any reserve funds associated with the asset;
- the interests of any other affected organ of state and the municipality's own strategic, legal and economic interests and the interests of the community; and
- compliance with all legislation impacting on the transfer (*regulation 20(1)(f)(ii)*).

### **5.5.3 Special considerations on borrowing on all assets transferred**

#### **Borrowings to be transferred on all asset transfers**

All asset transfers to another organ of state must include the transfer of borrowings associated with the acquisition, operation or maintenance of that asset. A municipality or entity cannot transfer an exempted capital asset without also transferring all borrowings associated with the asset (*regulation 26(1)*).

If the transfer is the result of a municipality's review of its service delivery mechanisms in terms of Chapter 8 of the MSA, when another organ of state is appointed, or when the result of an assignment of powers or functions to another organ of state through national legislation, all borrowings or other amounts owing by the municipality or entity that is specifically associated with the service, power or function must also be transferred (*regulation 26(2)*).

### **Allocation of general borrowings to assets**

Transfers of borrowings must be done on a reasonable basis. In a case where a municipality or entity has borrowed money as a 'general borrowing' for capital expenditure, the portion of the outstanding balance of the general borrowing which is specifically associated with the asset, service, power or function to be transferred, must also be transferred. The value of the general borrowing to be allocated against the asset, service, power or function is based on a ratio of the total value of capital assets to be transferred, to the total value of all capital assets owned by the municipality or entity multiplied by the borrowings on those assets.

For example:

- the total value of capital assets to be transferred is R10 million, of all capital assets owned by the municipality of R100 million – a ratio of 1 to 10 or 10% of the total.
- general borrowings against all capital assets total R25 million – the borrowings have been undertaken for various reasons including asset acquisition.
- the amount of borrowings to be transferred therefore is R2.5 million (or 10% of the total borrowing amount of R25 million) (*regulation 26(3) and (7)*).

### **Liability for borrowings transferred**

Once transfer takes place, the organ of state becomes fully and legally liable for the amount owing (*regulation 26(5)*). If for any reason borrowing cannot be transferred, for instance if the original lender does not allow the transfer of the debt or for any other legal reason, then both parties (the transferor and transferee) must come to an agreement whereby the organ of state compensates the municipality or entity for repayments due (*regulation 26(4) and (6)*), as they may agree.

## FORMALISING THE ASSET TRANSFER

### 5.6 STEP 6 – UNDERTAKE DUE DILIGENCE

#### 5.6.1 Due diligence to be undertaken and documented

Due diligence is the performance of an investigation into a business concern or entity. Depending on the nature of the entity to be reviewed, the due diligence may involve an investigation into the financial, legal, labour, taxation, environmental and market or commercial situation of the entity. Other areas may also include a review of real and personal property, insurance and liability coverage, debt instruments, employee benefits and labour matters and any other area that may be of concern to the purchasing party or transferee.

Before entering into the transfer agreement, the organ of state to whom the asset will be transferred must undertake and document an exercise in due diligence on the assets and liabilities to be transferred. The results of the due diligence must be taken into account in any transfer decision to be made by the organ of state (*regulation 32*). It is anticipated that responsibility for the costs associated with the exercise of due diligence will be as agreed between the parties taking into consideration the particular circumstances of each transfer.

### 5.7 STEP 7 – FINALISE ASSET TRANSFER AGREEMENTS

#### 5.7.1 Detail of transfer agreements

As in the case of Chapter 2 transfers, all asset (and debt) transfers in this Chapter may only take place by way of a written transfer agreement signed by both parties. The agreement must include:

- the terms and conditions of the transfer;
- details of the capital and subsidiary assets and liabilities to be transferred (including valuation details and evidence to support the valuation, encumbrances, servitudes and rights of access requirements);
- compensation to be paid (if any) and the terms and conditions for payment;
- the effective date in which risk and accountability are to be transferred; and
- details of any staff affected by the transfer – including details of staff that may be available to the organ of state on a temporary or defined basis, together with the compensation payable for such staff and any financial risk exposure to the municipality or entity;

- if billing, information technology or other administrative systems are to be shared between the parties, the basis of that shared arrangement and any financial risk exposure to the municipality or entity must also be defined and recorded;
- where an asset is to be used by both the municipality or municipal entity and the organ of state, the basis of how the asset is to be shared as well as how the costs and benefits of the shared asset will be apportioned between the parties.

The transfer agreement must contain a separate clause that states that the transfer was affected on the basis of Chapter 3 of the regulations, and that those provisions form part of the agreement (*regulation 30(1) and (2)*).

### **5.7.2 Transfer agreements for services**

In the case of a transfer that emanates from a review of service delivery mechanisms when an organ of state is preferred, the transfer agreement must include provision for contract termination in case of non- or underperformance (which must be linked to termination of the service delivery agreement entered into between the parties); dispute resolution and periodic review (which must be linked to the review of the service delivery agreement entered into between the parties – but at least once every three years if the contract is for longer than three years). It must also provide assurances that the organ of state is able to maintain and safeguard the asset.

The agreement may contain conditions imposed by the municipality or entity that limit or restrict the use or subsequent transfer of the asset, and the extent that the asset may be used to provide security over any borrowings taken out by the organ of state. Such conditions may also be incorporated into the service delivery agreement (*regulation 30(3)*).

Whilst not a requirement of the regulations, it is good practice for a municipality to consider inclusion of the following additional matters in the transfer agreement:

- the manner in which the organ of state will participate in the integrated development planning processes of the municipality;
- how it will achieve minimum service standards and eliminate service backlogs;
- how it is to coordinate and implement its budget;
- how it will comply with tariff, indigent and credit policies, how those policies will be reviewed and the process by which the organ of state will participate in policy reviews;

- how it is to provide for the indigent support and free basic services it must provide and the basis of compensation for this support and service;
- the process by which limitations on tariffs will be set;
- appropriate condition to prevent any potential for 'asset stripping' of the concern and
- applicable performance measures and targets to be used.

Attachment 7 provides an illustration of the process required to transfer those capital assets that are exempted from sections 14 or 90 of the MFMA, where Chapter 3 of the regulations apply.

## 5.8 COUNCIL MAY DELEGATE CERTAIN AUTHORITY

### 5.8.1 Permitted and not permitted delegations

There are no prohibitions on delegations, and no specified delegations, contained in Chapter 3. All provisions require either the municipality or in the case of a municipal entity, the parent municipality of the entity or the entity itself to undertake all requirements contained in this Chapter, subject to authorised delegations in line with Part 3, section 59 of the MSA.

## 5.9 RESPONSIBILITIES OF MUNICIPAL ENTITIES

### 5.9.1 Council, the parent municipality and the municipal entity

The process to transfer exempted capital assets in terms of this Chapter are similar for both a municipality and a municipal entity. An exception to this is the regulation 20(1)(f)(i) requirement that only the council of the municipality may make a determination as to whether a capital asset is not needed to provide a minimum level of basic municipal service, and if it is considered surplus to the requirements of the municipality or entity.

In any feasibility study undertaken to determine the financial and other implications of selecting a service provider for the performance of a municipal service or of the reorganisation of powers or functions, if it is indicated that there will be a significant increase in costs to the municipality or entity following the transfer of the asset, the municipality or parent municipality in the case of a entity are required to investigate how to minimise costs (*regulation 22(2)*).

If a municipality or entity transfers to an organ of state an asset needed to provide a minimum level of basic municipal service, only the municipality or parent municipality of the entity can provide the necessary written authorisation to allow that organ of state to transfer, dispose of or grant a right to use the asset or encumber the asset in any way.

## **5.10 BUDGET AND TIMING CONSIDERATIONS**

### **5.10.1 Strategic and financial considerations in asset transfers and disposals**

Chapter 3 transfers of exempted capital assets do not differentiate between high value capital assets and other capital assets, nor do they require a separate process of public consultation. Depending on the nature and complexity of the transfer, the time taken to affect an exempted capital asset transfer can be considerably reduced if the municipality is able to plan ahead.

As is the case with Chapter 2 transfers or disposals, the municipality and municipal entity should commence its process to transfer these assets at the time of other budget planning processes so that all proposed transfers can be reflected in the following financial year's three-year budget.

Any gain or loss from a transfer of this nature must be provided for in the municipality's or entity's budget or alternatively in the next adjustments budget of the municipality or entity (*regulation 47*).

## PART 6 GRANTING OF RIGHTS TO USE, CONTROL OR MANAGE CAPITAL ASSETS

### Summary

Chapter 4 prescribes requirements for circumstances in which a municipality or municipal entity grants a right to use, control or manage its capital assets, without actually transferring or disposing of the ownership of the asset to the other party. Sections 14 and 90 do not apply to the granting of such temporary rights (a competitive bidding process is generally required for this type of transaction). Chapters 2 and 3 will however apply to the granting of such rights when the transfer of such a right is for an indefinite or undetermined period of time, when the period of the transfer exceeds the useful life or economic usefulness of the asset, when there is an option to buy the asset at a future point in time or when a person becomes the beneficial (not necessarily legal) owner of the asset (*regulation 33*).

Transactions covered under Chapter 4 generally include all letting and hiring out arrangements of municipal capital assets, for instance municipal land or buildings such as a recreational facility to a sporting club for a number of years. It also includes a short term rental or lease arrangement such as the hiring out of a municipal hall to a ratepayer for a function for one evening or on an ad hoc basis, or even for the regular use of that facility when use is not considered to be exclusive to one party only, but able to be enjoyed by the community. It would be difficult in a large municipality to obtain council's approval in each instance for short term rentals or lease arrangements and it would therefore be important that council delegate to the accounting officer its approval power (*refer regulation 34(4)*) to deal with short term rentals or that the municipal council clearly approve in council policy the granting of short term rentals of the capital asset. Such a council policy must also clearly set-out the purpose for which the capital assets may be used when leased-out, how such will be advertised to the community in compliance with the SCM regulations, the basis for awards, fees and how the public can make applications for such requests and the administration deal with such.

## **CONSIDERATIONS PRIOR TO GRANTING A RIGHT**

### **6.1 STEP 1 – DETERMINE THE NATURE OF THE PROPOSAL**

In general a transaction will be subject to Chapter 4 of the ATF regulations if it is **NOT** any of the following two types of transactions:

- If the transaction involves the permanent transfer of a capital asset to an organ of state in the circumstances set-out in regulation 20, Chapter 3 of the ATF regulations will apply (Refer part 5 of the Guide); and
- If the transaction involves the permanent transfer or disposal of municipal capital assets to a private party or organ of state, Chapter 2 of the ATF regulations in conjunction with the SCM regulations will apply (Refer part 4 of the Guide).

#### **6.1.1 Is the proposal part of the appointment of a service provider?**

**Only assets associated with the service are to be considered**

If the proposal to grant a right to use, control or manage a capital asset with a value in excess of R10 million for longer than three years, is part of the appointment of a service provider (either a private sector party or organ of state) to perform an entire service in terms of regulation 41(2)(a) for the performance of a municipal service, or regulation 41(2)(b) for the performance of a commercial service, then the municipality or entity must properly identify those assets needed or directly related to the performance of that service (*regulation 42(a)*).

Although the proposal is concerned only with the granting of a right to use, control or manage the assets associated with the service, and it does not suggest the transfer of ownership of those assets, the municipality should identify any staff associated with the asset concerned. For example, the granting of the right may affect the work conditions of such staff where all the busses will be leased out and the municipal bus drivers will have no more busses to drive. In such a case the possibility of re-deploying staff or seconding staff as part of the lease agreement, should be considered.

## Case Study – Valleydale Soup Kitchen Leasing Proposal

### Background

The Valleydale municipality was recently approached by the Valleydale Soup Kitchen, a community based NGO providing meals to indigents, to obtain a social lease of a part of the old municipal offices for a period of 6 years to operate a soup kitchen from. The Soup Kitchen indicated that due to financial constraints it can only afford to pay rental of R499 per year. The accounting officer requested advice regarding whether Chapter 4 of the ATF regulations and SCM regulations applies to social leases such as these.

The ATF regulations do not make any differentiation in leases for different purposes, the same process applies. Hence, Chapter 4 and the SCM regulations also apply to social leases. Leases below fair market value, like any other lease, must be done in terms of a process that is fair, equitable, transparent, competitive and cost-effective and in accordance with the SCM Regulations. In this instance, when council considers the mandatory considerations in order to approve in principle the granting of a right to use the municipal office, it should apply the principles set-out in regulation 13(2), in considering what is best in terms of the public interest factor and document such when making a decision on whether the asset is to be leased-out for below market value. Council in its decision should also make its policy clear regarding the criteria for awards to the public of the asset below market value e.g. number of indigents to benefit from the award/ purpose for which asset are to be used, etc. For example advertising the municipal office for lease below market value to any project that will benefit the most No. of indigents will ensure that various soup kitchens or other NGO's can apply ensuring a fairer process and potential better benefits to the community of the use of public resources (municipal office).

## 6.2 STEP 2 - DETERMINE IF THE PROPOSAL IS CONSIDERED LONG-TERM HIGH-VALUE

### 6.2.1 Is the proposal considered to be a 'long-term high-value' proposal?

In determining the process to be followed to grant such a right, the municipality must first determine if the proposed right will exceed three years AND if the value of the asset is greater than R10 million (*regulations 34(2) and 37(2)*). For the purposes of the Guide, we shall call those proposals in which the terms of the granting of the right exceed three years and the asset value exceeds R10 million as "long-term high-value" proposals.

Chapter 4 of the regulations does not contain a provision for determining the value of a capital asset in respect of which the municipality proposes to grant a right to use, control or manage such capital asset. Hence, in instances where the municipality has not yet finalized its asset register and the value of the specific asset is unknown, it is suggested that the municipality follow a similar approach than that contained in ATF Regulation 5(5) to determine the value of the asset for purposes of Chapter 4 of the ATF Regulations. It is recommended that the method selected is the same as what the municipality decided in its policy for the evaluation of all its other assets to ensure apples can be compared with apples for purposes of the transaction and also for overall reporting in the Annual Financial Statements later-on.

Council will not be able to take an in-principle decision to grant such a right without having considered all the mandatory information required in terms of ATF Regulation 36.

### **6.2.2 If not considered a long-term high-value proposal**

If the proposal is not considered to be a long-term high-value proposal, the council or in the case of a municipal entity the council of the parent municipality may consider the proposal at a council meeting and resolve to either reject it or *approve in-principle of the proposal* subject to it considering the factors described below. The actual process to grant a right will vary depending upon the decision as to whether the asset is needed to provide a minimum level of basic municipal service (*regulations 34(1)(b) and 37(1)(b)*).

### **6.2.3 If a long-term high-value proposal**

If the proposal is considered to be a long-term high-value proposal, the accounting officer of the municipality or entity must conduct a public participation process similar to that required when transferring a high value capital asset in terms of Chapter 2 (transfers of non-exempted capital assets), before it can approve in-principle of the proposal (*regulations 34(1)(a) and 37(1)(a)*).

#### **Authorization of public participation**

As in the Chapter 2 process, the public participation process referred to may only be authorized by the council or in the case of an entity the council of the parent municipality. The request must be submitted to the council with an information statement which shows the reasons for the proposal, and the expected benefits, proceeds and gain or loss that could be realized or incurred if the proposal went ahead. In the case of an entity, the information statement provided to the council of the parent municipality must first be approved by the board of directors of the entity.

Although the valuation of the capital asset and method of valuation is not required to be disclosed in the information statement, accompanying the public participation, it will be necessary to value the asset in order to determine if it is high value (exceeding R10 million) (*regulations 34(3) and 37(3)*). In instances where the municipality has not yet finalized its asset register and the value of the specific asset is unknown, it is suggested that the municipality follow a similar approach than that contained in ATF Regulation 5(5) to determine the value of the asset for purposes of Chapter 4 of the ATF Regulations.

Upon receiving the request, the council may choose to further consider the proposal by authorizing the public participation process or alternatively, reject the request in which case no further action will be required.

## **The public participation process**

The public participation process and requirements to solicit community, stakeholder and government views and recommendations are identical to those set out in Chapter 2 (regulation 6).

Where council authorizes the public participation process to help facilitate its decision on whether to grant the right, the municipal manager of the municipality (or the chief executive officer of the entity) must make the proposal and information statement public, invite the community and other interested parties to submit their comments or representations and ask for the views and recommendations of the National Treasury and the relevant provincial treasury (*regulations 35 and 38*). As in the case of a Chapter 2 transfer, the process must be followed in accordance with section 21A of the MSA. This must be done at least 60 days before the council meeting in which the matter is to be discussed i.e. the meeting where the matter is to be considered by council.

After the completion of the public participation process, the council after having considered a number of factors described below, may either resolve not to grant the right or alternatively, *approve in-principle to grant the right* (*regulations 34(1)(b) and 37(1)(b)*).

### **6.3 STEP 3– undertake mandatory considerations**

#### **6.3.1 Mandatory considerations for in-principle proposals**

##### **Standard considerations**

Whether a long-term high-value proposal or not, the council of the municipality or council of the parent municipality must *before approving in principle* to grant the right, take into account the following factors:

- whether it may need the asset during the period for which the right is granted;
- compensation for use of the asset;
- management of any risk;
- stakeholder comments and recommendations; and
- the impact on its own strategic, legal and economic interests (*regulations 36 and 39*).

The municipal administration will have to prepare the information and include such in the supporting documentation for the council meeting at which council is to consider whether to grant a right to use, manage or control a municipal capital asset.

### **Mandatory Considerations - Stakeholder comments and representations**

Only in instances where the rights to use, manage or control municipal capital assets are long-term and high-value (refer regulation 34 and 37), will the public participation process envisaged in regulation 35 or 38 be required. It therefore follows that mostly only in long term high value cases will there be:

- comments or representations on the proposed granting of the right received from the local community and other interested persons; and
- written views and recommendations on the proposed granting of the right by the National Treasury and the relevant provincial treasury (regulation 36 and 39).

Although regulations 36 and 39 make it mandatory for council to consider any such comments received, regulation 36 and 39 should not be interpreted to mandate the municipality to solicit such comments other than where required.

It is important to note that there may be other instances where the local community, other interested persons, the National Treasury or provincial treasury provided input, where the assets are not high-value and long-term (as part of the normal public consultation process even though not required). If such comments were received, it must also be considered in terms of ATF regulation 36 and 39, even if it was not solicited.

When soliciting the comments of the National Treasury and provincial treasury information addressing whether the municipality followed due processes in terms of public consultation, transparency, and compliance with the MFMA, Asset Transfer Regulations and the Municipal Supply Chain Management Regulations, etc. must be provided. It would also be useful to provide information arising out of any public consultation process pertaining to the specific asset.

### **Considerations relating to maintenance and safeguarding**

Before granting such a right, the council of the municipality or council of the parent municipality must also ensure that the private sector party or organ of state can demonstrate that it can adequately maintain and safeguard the asset (*regulation 41(4)*). Again given that the asset is not actually being transferred, the municipality or municipal

entity will not have to consider the loss or gain, or longer term impacts on its financial position or credit rating.

### **Special conditions relating to assets required to provide a minimum level of basic municipal service**

A municipal council can only approve in-principle to grant a right relating to an asset needed to provide a minimum level of basic municipal service, if the right is granted subject to conditions that ensure that the right immediately lapses if the private sector party or organ of state ceases or becomes unable to provide the service; and that the asset may not be provided to another party to use, control or manage without the written consent of the municipality (*regulation 44*).

It is advisable should the municipality wish to streamline the approval process, that where possible the information necessary to help guide the council in applying the conditions required by regulation 40, and make the considerations required by regulations 36, and 41(4) and where relevant 44, be made available at an early stage of deliberations. Ideally this information should accompany the information statement which is provided during the public participation process.

Upon consideration of these impacts, and the application of the discretionary conditions described above the council may *approve in principle* to grant the right as requested.

## **6.4 STEP 4 – APPLY DISCRETIONARY CONDITIONS**

### **6.4.1 Discretionary conditions on in-principle proposals**

In any in-principle decision and whether the transaction involves a long-term high-value proposal or not, the council of the municipality or council of the parent municipality *may impose* conditions on the proposal, including conditions specifying:

- the type of right to be granted, the period of the right and the way it is to be granted;
- minimum compensation to be paid; and
- a framework in which direct negotiations may be applicable (*regulation 40*).

The administration, may also recommend such conditions to council. It is suggested that such be included in the supporting information containing the mandatory and other information required to facilitate council's decision making.

It is important to note no conditions, contravening what is allowed in terms of the prevailing legal framework, can be imposed. For example conditions regarding the way in which the right is to be granted, is subject to the SCM Regulations. Hence, a condition that an asset is leased to Company X (that approached the municipality with an offer to lease the asset outside of a competitive process) will be subject to the unsolicited bid framework contained in SCM Regulation 37.

## **PROCESS TO GRANT THE ACTUAL RIGHT**

### **6.5 STEP 5 – GRANT THE RIGHT**

#### **6.5.1 Decision to be carried out in accordance with disposal management system**

Once the council has approved the granting of the right, the municipality or municipal entity may commence proceedings to implement that decision – which irrespective of the value of the asset, the period for which the right is granted or whether the right is to be granted to a private sector party or organ of state, can only be done in accordance with the disposal management system of the municipality (*regulation 41(1)*).

#### **6.5.2 Circumstances when direct negotiations with selected bidders are allowed**

Five exceptions to this requirement relate to circumstances in which the right is granted to a service provider on the basis that the asset is an integral component for the performance of a service. These are:

- 1) when a municipality undertakes a review of service delivery mechanisms in terms of Chapter 8 of the MSA and selects or appoints through a competitive bidding process a private sector party or organ of state to perform a municipal service;
- 2) when a municipality appoints through a competitive bidding process a private sector party or organ of state to perform a commercial service;
- 3) when the right is granted as part of a reorganisation of powers and functions between a municipality and its entity;
- 4) when the right is granted in terms of Chapter 11, section 110 of the MFMA i.e. procurement through the supply chain management process of the municipality or entity; or
- 5) any other circumstance not provided above, on condition that the asset to which the right is to be granted is considered by the council of the municipality or council of the parent municipality to be surplus to the requirements of the municipality or entity (*regulation 41(2)*).

In each of these exception cases, a municipality or entity may negotiate directly with the bidder (*regulation 41(3)*).

### **6.5.3 Special conditions on decisions that involve a service provider**

#### **In-principle decision to be considered when appointing a service provider**

As stated in 6.1.1, if a municipality or entity intends to grant a right to a service provider for the performance of a municipal or commercial service, all assets associated with the performance of that service must be properly identified (or ring-fenced) (*regulation 42(a)*). All considerations involved in the original in-principle decision must be taken into account in appointing the service provider (*regulation 42(b)*). Documents prepared for those decisions must be considered in any feasibility study conducted to determine the implications of appointing that service provider (*regulation 42(c)*).

#### **Continuity of service**

If a municipality or entity intends to grant such use for the performance of a service, it must ensure that the granting of the right will result in the continuation of that service to the same or a better standard than would otherwise have been provided (*regulation 43*).

## **6.6 STEP 6 - NEGOTIATE THE COMPENSATION PAYABLE**

### **6.6.1 Compensation to be paid**

Compensation payable to a municipality or municipal entity for use of a capital asset in terms of Chapter 5 of these regulations should be in line with the disposal management system of the municipality.

The SCM regulations require all municipalities to have a supply chain management policy to provide for, amongst other, the effective letting of assets. The SCM Regulations require that immovable property be let at market related rates except when the public interest or the plight of the poor demands otherwise. The rates, fees or charges associated with certain rights of use relating to the letting of immovable property should be developed by the municipality or entity and incorporated into a council policy which should be adopted by council and reviewed each year at the time of budget tabling and approval, when all other financial policies are also reviewed. (Refer SCM Regulation 40(2)(c) and MFMA Circulars No 22, 25, 29, 33 and 34, etc.).

This exercise should form part of the drafting of the budget of the municipality and revised tariffs approved by council with the adoption of the budget. The preference point system also applies to the letting of assets. Paragraphs 5(1) and 6(2) of the Preferential Procurement Regulations, 2001 should be referred to in this regard.

The leasing of municipal capital assets at a lower than market related price, except when the public interest or plight of the poor demands otherwise, is not encouraged and it is recommended that the municipality apply the principles mentioned in ATF regulation 13 in considering what is best in terms of the public interest factor.

It is important to note that the SCM regulations prohibit any award to a person in the service of the state, this includes leases of municipal capital assets e.g. immovable property, municipal trucks, etc. (Refer SCM Regulation 1, 40 and 44).

Existing leases must be reviewed to ensure compliance with the ATF Regulations and SCM regulations. An unsolicited bid proposal from an individual to lease municipal property is governed by section 113 of the MFMA and regulation 37 of the SCM regulations.

The SCM policy should set-out how market-related rate is obtained. In this regard we advise that a qualified valuer determine such. In the case of very low valued properties and immaterial leases, if may be appropriate for the Accounting Officer to determine the lease fee if the cost of engaging a qualified valuer is more than the income to be derived. The municipality must be able to demonstrate how the lease has been determined, including whether it considered the asset value (in the asset register) the rateable value (for rating purposes - Municipal Property Rates Act, 2004) and research similar property leases in the municipality.

It goes without saying that all these steps must be well documented so that they can be audited by the external auditors. Moreover, you may want to approach the municipal internal audit unit for assistance in ensuring compliance.

## FORMALISING THE GRANTING OF THE RIGHT

### 6.7 STEP 7 – FINALISE AND DOCUMENT AGREEMENT

#### 6.7.1 Detail of transfer agreements

A municipality or municipal entity may only grant a right to use, control or manage a capital asset through a written agreement signed by the parties (*regulation 45(1)*). This agreement must include:

- the terms and conditions on which the right is granted;
- details of the asset concerned including any subsidiary assets where appropriate;
- the period of the agreement;
- compensation to be paid and the terms and conditions for payment;
- requirements for the party to maintain and safeguard the asset;
- sharing arrangements where applicable;
- requirements for and terms and conditions relating to improvements and enhancements;
- the effective date in which risk and accountability are to be transferred; and
- requirements that the party may not cede or subcontract their rights to another person (*regulation 45(2)*).

If the contract relates to a long-term high-value right for a municipal or commercial service, then the agreement must also provide for contract termination in case of non- or under- performance, dispute resolution and a periodic review. Section 33 of the MFMA regarding long term contracts in excess of three years should be read in conjunction with this section.

This agreement may also be incorporated into the service delivery agreement or procurement contract if relevant (*regulation 45(3)*). All agreements of this nature must be made available in its entirety to the council and also be made publicly available unless legislation requires that it should be withheld from public scrutiny (*regulation 46*).

Attachment 8 provides an illustration of the process required to grant a right to use, control or manage capital assets in terms of Chapter 4 of these regulations.

## **6.8 COUNCIL MAY DELEGATE CERTAIN AUTHORITY**

### **6.8.1 Permitted and not permitted delegations**

The council of the municipality or the council of the parent municipality in the case of a municipal entity can delegate its authority to the municipal manager or chief executive officer respectively to approve in-principle of the granting of a right to use a capital asset (*regulations 34(4) and 37(4)*). This delegation does not extend however, to cover long-term high-value transactions. This can only be decided by the council.

Only the municipal council or the council of the parent municipality may authorize a public participation process referred to in regulations 34(1)(a) and 37(1)(a). The council or the accounting officer delegated in terms of regulation 34(4) or 37(4) must undertake the mandatory considerations outlined in regulations 36 and 39 before it can *approve in principle* the granting of a right to use, manage or control a municipal capital asset.

## **6.9 RESPONSIBILITIES OF MUNICIPAL ENTITIES**

### **6.9.1 Council, the parent municipality and the municipal entity**

The granting of a right to use, control or manage a capital asset for a municipal entity is basically similar to the process for a municipal entity to transfer or dispose of a non-exempted capital asset in terms of Chapter 2 of the regulations.

As stated in the previous section, only the council of the parent municipality of the entity may approve in-principle of the granting of a right in terms of a long-term high-value asset transaction, and only the council of the parent municipality may authorise the regulation 37(1)(a) public participation process.

The council or the accounting officer of the entity (delegated in terms of regulation 37(4)) must undertake the mandatory considerations outlined in regulations 39 before it can *approve in principle* the granting of a right to use, manage or control a municipal capital asset.

## 6.10 BUDGET AND TIMING CONSIDERATIONS

### 6.10.1 Strategic and financial considerations in asset transfers and disposals

The timing of decisions relating to the granting of rights to use, control or manage capital assets should be consistent with that applied to Chapter 2 transfers of non-exempted capital assets. Both require a public participation process for larger transactions and both are bound by the policies and processes stipulated in the municipality's disposal management system.

As is the case with Chapter 2 and 3 transfers or disposals, the municipality and municipal entity should commence its process to transfer these assets at the time of other budget planning processes so that all transfers can be reflected in the following financial year's three-year budget.

Any gain or loss from a transfer of this nature must be provided for in the municipality's or entity's budget or alternatively in the next adjustments budget of the municipality or entity (*regulation 47*).

Case Study 6 over the page provides an illustration of the processes involved to consider a bus leasing proposal with another municipality over a number of years.

## Case Study 6 – Valleydale Truck Leasing Proposal

### Background

The Valleydale municipality recently considered a proposal to purchase ten trucks from the Hilltown municipality to expand on its own fleet. In considering the costs and benefits and feasibility of the proposal Hilltown found that it did not have the required R2 million to purchase the trucks. After exploring other options, it resolved to approach Valleydale municipality to propose a long-term leasing arrangement in which Hilltown would lease all ten trucks over a five year period and pay a monthly lease fee which would incorporate all overhead costs such as maintenance, repairs, licensing and insurance.

#### Is the proposal considered 'long-term high-value'?

The proposal effectively involves the granting of a right to use assets, through a leasing arrangement. This transaction therefore is subject to the provisions of Chapter 4 of the regulations. As the nature of the transfer does not involve the transfer of a service, the municipality transferring the trucks does not need to identify all assets. Even though the term of the lease proposal will in all likelihood exceed three years, the total value of the proposal does not exceed R10 million and therefore the transaction will not be considered to be 'long-term high-value'.

#### Process to consider proposal

As the proposal is not considered to be 'long-term high-value', Valleydale municipality is able to make an in-principle decision itself to approve or reject the Hilltown proposal, without the need to conduct a public participation process. It is also able to delegate this task to the municipal manager.

However, it was found that as the proposal was to be over a five year period, it would fall within the ambit of section 33 of the MFMA as a contract having future budgetary implications. This being the case, the Valleydale council does not delegate the task to the municipal manager and acknowledges the need to make public any draft contract and an information statement surrounding the proposal should negotiations lead to an agreement. Hilltown municipality also acknowledges that it will also be required to make public the draft contract and information statement under similar circumstances.

#### Conditions attached to the granting of the right

Valleydale council in considering the proposal from Hilltown, resolved to approve in-principle the long-term leasing arrangement subject to a number of discretionary conditions and mandatory considerations, imposing conditions on the proposal and stipulating a lease fee of R250 000pa and a minimum lease period of ten years.

The municipality also considered certain other mandatory matters: whether the trucks would be needed by the municipality during the period in question, the risk associated with the proposal; the impact of the proposal on its own strategic, legal and economic interests and compensation issues.

#### The process of granting the right

Whilst the Valleydale municipality had agreed internally to an annual

lease fee of R250 000 and a minimum lease period of 10 years, and whilst it was aware that it could, without going through the disposal management system of the municipality, provide the lease to Hilltown municipality; it resolved to test the market through a process of competitive bidding.

Acknowledging its preference that any process to lease the assets should remain fair, equitable, transparent, competitive and consistent with the municipality's disposal management system, the council also stipulated that the municipal manager first advertise the proposal to obtain further expressions of interests from any other party wishing to similarly lease these assets.

Upon the expiration of this notice, three expressions of interests were received by the municipality:

Hilltown municipality	R260 000
Pleasant View Mining Corp	bid submitted to buy only
Hilltown Construction	R140 000

The Pleasant View Mining Corporation bid was not considered as it did not address the specifications, of the remaining bids, the Hilltown municipality's bid was resolved to be successful based on price and other terms and conditions which were agreed in the municipality's tender bid for leasing.

#### Draft Contract

Following acceptance in-principle, both the Valleydale and Hilltown municipalities made public a draft contract (lease agreement) together with an information statement summarising their respective responsibilities under the proposal. Once views were received, and following consideration of these views and financial matters, both municipalities resolved to authorise and sign the contract.

#### Transfer agreement

Upon finalisation of the decision the Valleydale municipal manager was authorised to prepare a written lease agreement which contained details of lease terms and conditions, highlighting the exact nature of the trucks concerned, to be leased over a ten year period at a cost of R260 000pa. It also stipulated responsibilities concerning schedules for repairs and maintenance, and improvements and enhancements. The lease agreement also stipulated that the trucks were not to be used or subcontracted by the Hilltown municipality for use by another party. The lease agreement was subsequently signed by both parties concerned and the trucks were leased accordingly.

## **PART 7        CONSIDERATIONS REGARDING MUNICIPAL LAND AND HOUSING**

### **7.1        TRANSFER AND DISPOSAL OF MUNICIPAL LAND AND HOUSING**

#### **7.1.1    Broader legislative context of municipal land and housing**

Given the value and special nature of municipal land transactions, this section in the Guide is provided to offer some further clarity to the principles of the Regulations as they relate to land transfers and disposals.

Local government is a sphere of government and as such it is important to keep in mind that all municipal land and municipal housing is public property. As such the transfer of municipal land or housing takes place in the broader context of national or provincial policy on housing, planning for housing for the poor, community open space requirements, the built environment, land use management, land reform and agriculture related activities, to name a few, that need to be considered.

Any decision to transfer or grant rights of use over municipal land or housing should include a consideration by the council on how the municipality's decision will impact and support and align with government's policies overall. Hence, government's overarching policies impact on the decision whether a capital asset is needed to provide the minimum level of basic municipal services in terms of MFMA sections 14 and 90 and should be considered as part of those deliberations.

This Guide does not attempt to provide the information necessary to assist a municipality to consider all the issues and legislation surrounding municipal land or housing, it merely draws to the attention of the municipality the requirements of the municipal financial management framework and in particular the Municipal Asset Transfer Regulations and SCM Regulations.

Municipalities are urged to work closely with their planning departments, provincial departments responsible for housing and land management and the national Departments of Human Settlements and Land Reform and Rural Development on such matters as, it is anticipated that, these matters will be guided by further national policies.

There are certain exemptions to the abovementioned process to transfer land and housing in cases of:

- transfers of housing to the poor to beneficiaries of such housing (*regulation 4(3)(b)*);
- transfers to organs of state in the circumstances set out in *regulation 20*,

which are discussed below:

#### **7.1.2 Transfers of housing to the poor**

In general, when housing on municipal land is transferred or rights to use such housing is granted, the SCM Regulations jointly with Chapters 2 or 4 apply to such a transaction. However, where housing on municipal land for the poor is transferred to the beneficiaries of that housing, Chapters 2 does not apply. Only the SCM Regulations apply in these circumstances (*regulation 4(3)(b)*). Similarly where rights to use municipal land for housing for the poor are granted to beneficiaries of such housing, Chapter 4 does not apply. Again only the SCM Regulations apply (*regulation 33(2)(b)*).

Chapter 3 is applicable in instances where the transfer of that housing or land is made to a national or provincial organ of state for housing for the poor or in line with a National or provincial housing policy. In such a transfer to an organ of state only the requirements of Chapter 3 of the regulations apply. The MFMA sections 14 and 90 do not apply in this instance (*regulation 19*).

#### **7.1.3 Transfers of land and housing to an organ of state**

Chapter 3 is applicable in instances where the transfer of that land or housing is made to an organ of state. In such a transfer to an organ of state only the requirements of Chapter 3 of the regulations apply. The MFMA sections 14 and 90 and SCM regulations do not apply in this instance (*regulation 19*).

Hence, in any transfer of land and housing to an organ of state in the circumstances set out below, only Chapter 3 of the regulations apply:

- when a municipality reviews its service delivery mechanisms in terms of Chapter 8 of the MSA, and appoints another organ of state to undertake the service;

- when there is a reorganisation of powers and functions between a municipality and its municipal entity;
- when a municipality's powers or functions are assigned to another organ of state as a result of national legislation or a power contained in national legislation;
- when municipal housing or land is transferred to a national or provincial organ of state for the poor in terms of national or provincial housing policy;
- when the transfer is required or permitted by national legislation that determines the conditions of the transfer; or
- any other circumstance not provided above, on condition that the asset to be transferred is considered by council to be not needed to provide a minimum level of basic municipal service and is surplus to the requirements of the municipality and entity.

In all of these instances, the transfer is relatively straight forward and is generally based on negotiations between the municipality and the organ of state, which is supported by the normal transfer agreement requirements which the organ of state must complete and document as due diligence relating to the transaction.

## **PART 8            EFFECTIVE DATE OF COMMENCEMENT**

### **8.1        EFFECTIVE DATE AND TRANSITION**

The regulations took effect on 1 September 2008. They became applicable for the transfer or disposal of capital assets of all municipalities and municipal entities from this date. Any transfer or disposal contemplated in terms of sections 14 or 90 after 1 September 2008 will be subject to these regulations.

Transfers of capital assets to organs of state that have substantially commenced prior to this date will not be affected, but will have to apply the process as set-out in the remainder of MFMA sections 14(1) to (5) and 90(1) to (5).

Any other transfers of capital assets, where the decision to transfer was taken prior to the commencement of the regulations, notwithstanding the fact that not all the legal and administrative actions necessary to give effect to that decision have been completed, will not be subject to these regulations. This statement is based on the assumption that the decision taken prior to 1 September 2008 was a valid decision, i.e. consistent and compliant with all procedural and legislative requirements of the MFMA and SCM Regulations prevailing at the time the decision was taken and that the council was provided with all relevant information to make an informed and valid decision.

Municipalities and entities in the process of transferring or disposing of a capital asset, in terms of valid decisions taken before these regulations became effective, are strongly urged to continue the transaction in line with the principles of these regulations.

## **PART 9 CONCLUSION**

It should be reiterated that the issues raised in this Guide are provided for practitioners to assist with their responsibilities under the Asset Transfer Regulations.

The Guide is not intended to provide a legal opinion on the various processes, and should not be used for those purposes.

## **PART 10 ATTACHMENTS**

### **Attachment 1 – The Constitution: extract of schedules 4B and 5B**

#### **Schedule 4B - Functional Areas of Concurrent National and Provincial Legislative Competence**

The following local government matters to the extent set out for national government and provinces in section 155(6) (a) and (7):

- Air pollution
- Building regulations
- Child care facilities
- Electricity and gas reticulation
- Fire fighting services
- Local tourism
- Municipal airports
- Municipal planning
- Municipal health services
- Municipal public transport
- Municipal public works only in respect of the needs of municipalities in the discharge of their responsibility to administer functions specifically assigned to them under this Constitution or any other law
- Pontoons, ferries, jetties, piers and harbours, excluding the regulation of international and national shipping and matters related thereto
- Stormwater management systems in built-up areas
- Trading regulations
- Water and sanitation services limited to potable water supply systems and domestic waste-water and sewage disposal systems

## **Schedule 5B - Functional Areas of Exclusive Provincial Legislative**

The following local government matters to the extent set out for provinces in section 155(6) (a) and (7):

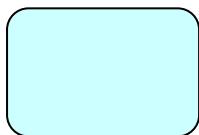
- Beaches and amusement facilities
- Billboards and the display of advertisements in public places
- Cemeteries, funeral parlours and crematoria
- Cleansing
- Control of public nuisances
- Control of undertakings that sell liquor to the public
- Facilities for the accommodation, care and burial of animals
- Fencing and fences
- Licensing of dogs
- Licensing and control of undertakings that sell food to the public
- Local amenities
- Local sport facilities
- Markets
- Municipal abattoirs
- Municipal parks and recreation
- Municipal roads
- Noise pollution
- Pounds
- Public places
- Refuse removal, refuse dumps and solid waste disposal
- Street trading
- Street lighting
- Traffic and parking

## Attachment 2 – Chart legend

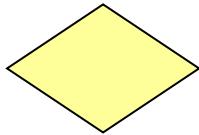
The *boxes* and *shapes* that appear in decision trees 1 to 4 (refer attachments 5 to 8) illustrate various actions commonly used in flowcharting. These represent the key processes or decision points in the way the different transfers or disposals must be carried out. The meanings of the various actions depicted are provided below:



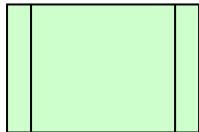
Process – dark blue depicts mandatory or required processes, light blue generally depicts a process that is a consideration, which is often discretionary;



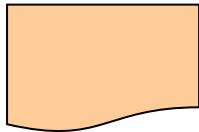
Alternative process (or option);



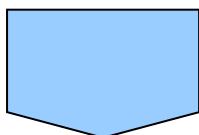
Decision;



Predefined process – these processes are governed by a separate procedure which is summarised in the transparent blue box;



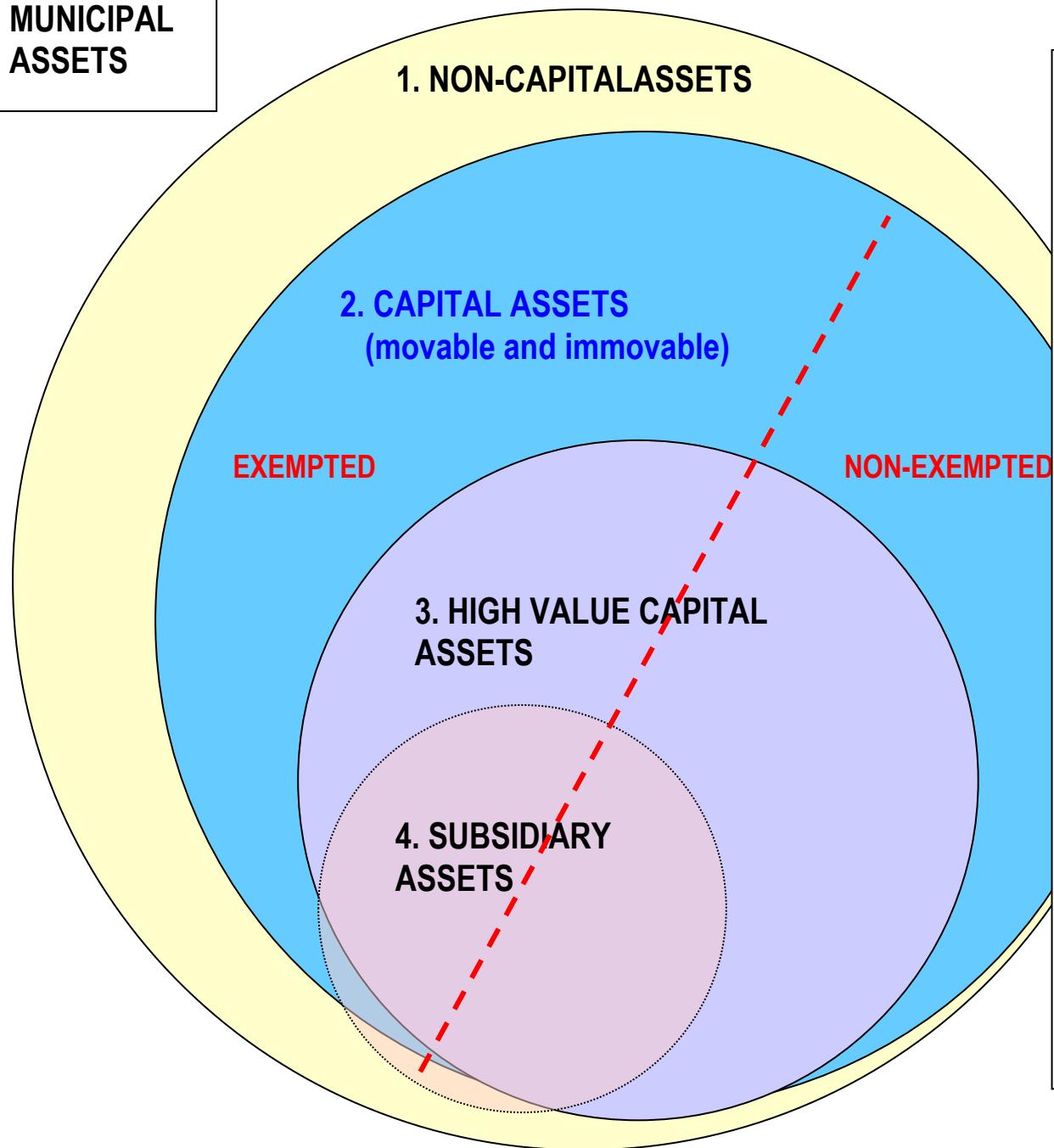
Document;



Connect to another chart.

If box is red, signifies the task may be delegated

If box is bold, signifies the task may not be delegated by the council



### Attachment 3: the categorisation of assets

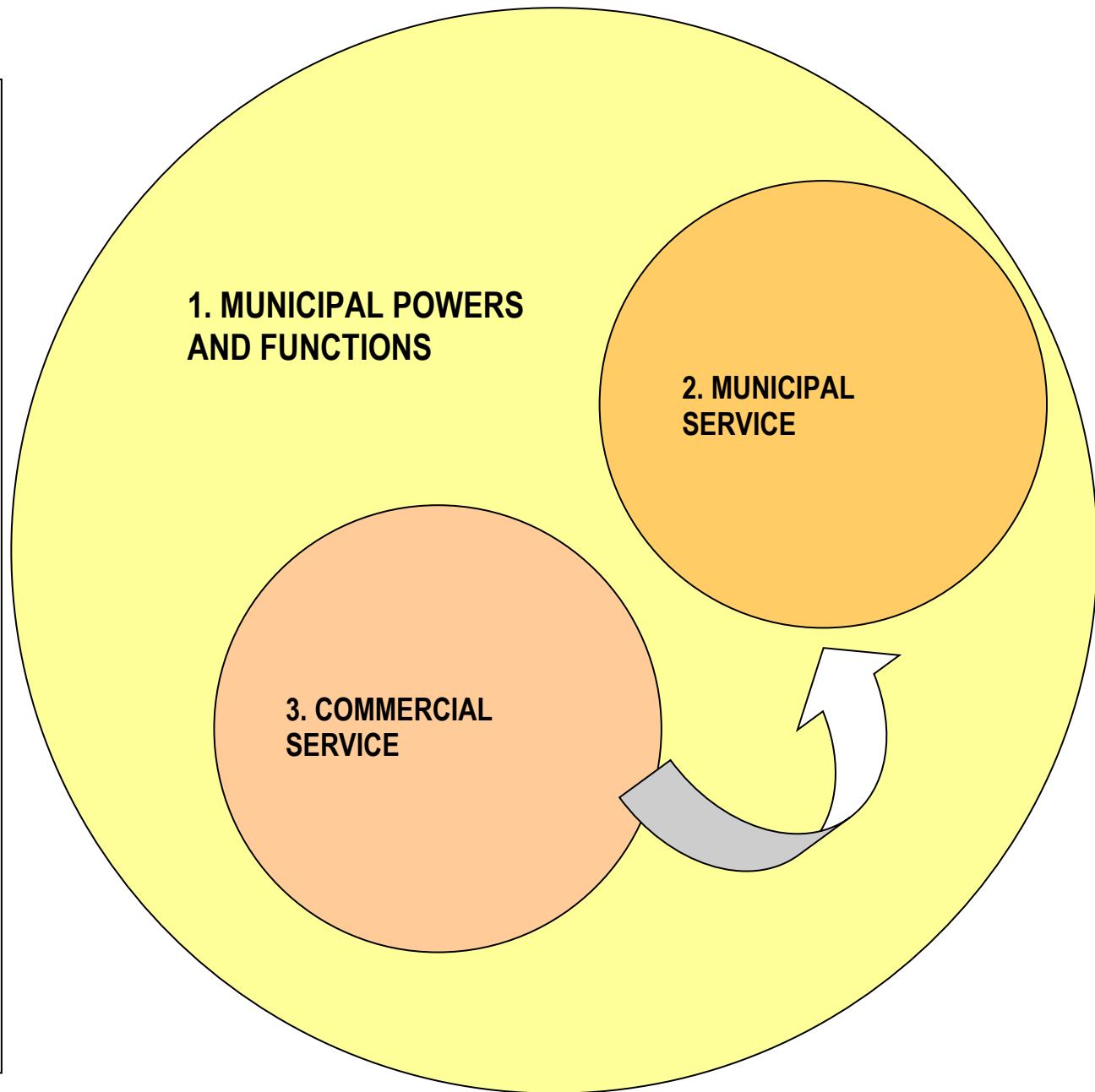
This diagram highlights the categorisation of all assets as provided for in the Municipal Asset Transfer Regulations.

1. Municipal assets consist of capital assets e.g. land and non-capital assets. Non-capital assets e.g. stationery that fall outside of the blue capital asset area are not covered by the regulations.
2. Municipal capital assets are effectively a very large subset of all municipal assets and include movable and immovable capital assets.
3. Municipalities must decide whether the capital asset they intend to transfer or dispose of is a high value capital asset, this impacts on what processes in the regulations apply. All capital assets whether high value capital assets or not, will be exempted or non-exempted in terms of the regulations, depending on the nature of the transaction.
4. Subsidiary assets are assets that are closely linked to capital assets – having a high value or otherwise, in relation to the main capital asset to which it is subsidiary. If the transfer of the capital asset is exempted the transfer of the subsidiary asset is also exempted, if it is transferred as part of the same transaction.

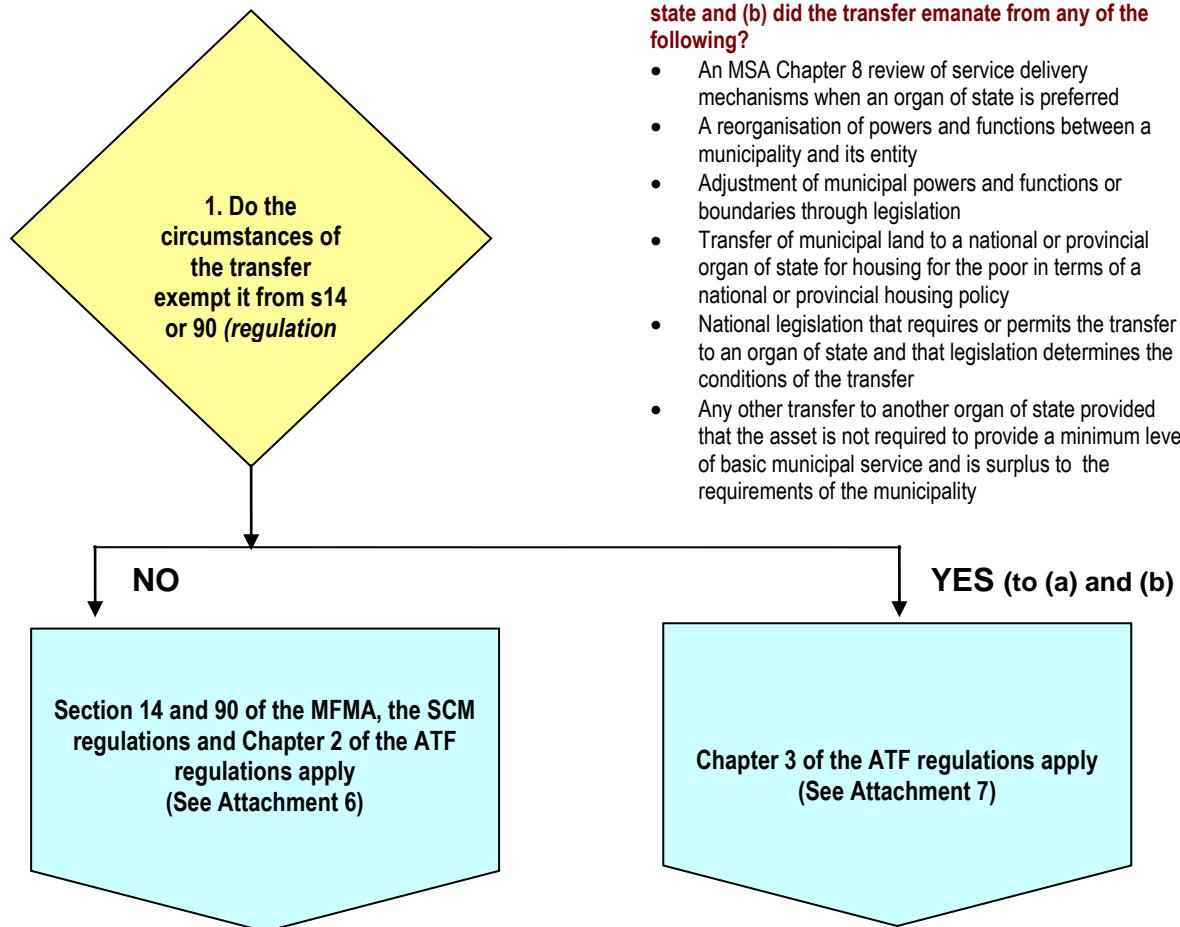
## Attachment 4: Municipal and commercial services

This diagram illustrates the relationship between municipal powers and functions and municipal and commercial services.

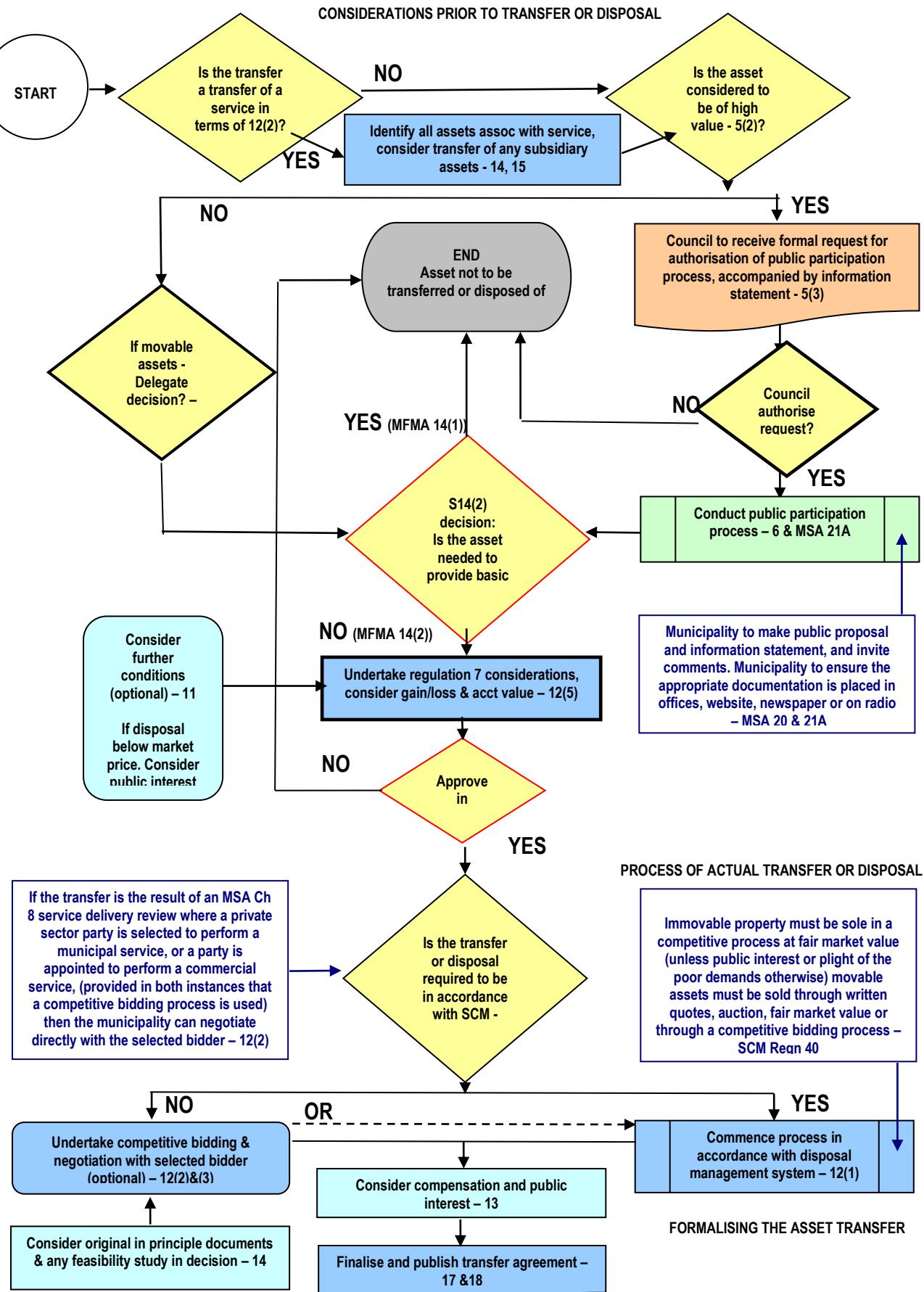
1. A municipality can only perform activities supporting its powers and functions in terms of the Constitution.
2. A municipal service is a service provided by a municipality in terms of its powers and functions to or for the benefit of the community (MSA).
3. A commercial service is a service provided by a private party or organ of state on a commercial basis to the municipality. The commercial service is procured to support the municipality in providing municipal services i.e. it is ancillary to a municipal service.
4. A municipal or commercial service must fall within the municipality's powers and functions.



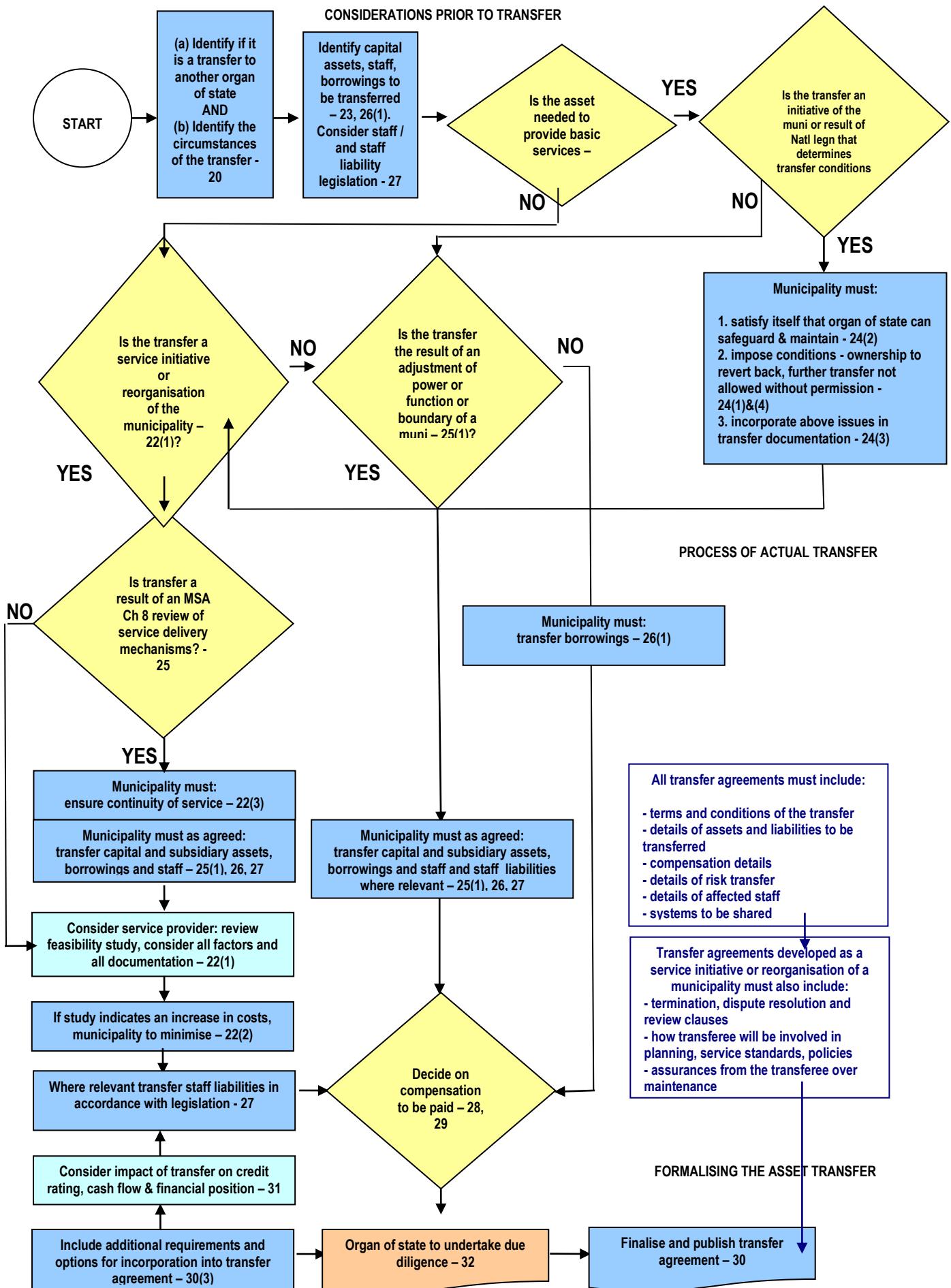
## Attachment 5 – Decision tree 1: General application of chapters



# Attachment 6 – Decision tree 2: Non-exempted capital asset transfers and disposals



# Attachment 7 – Decision tree 3: Exempted capital asset transfers



# Attachment 8 – Decision tree 4: Granting of rights to use, control or manage

