NATIONAL TREASURY

MFMA Circular No. 51

Municipal Finance Management Act No. 56 of 2003

Annexure to MFMA Circular No. 51

This Annexure to MFMA Circular No.51 provides updated information to municipalities and municipal entities regarding:

1. Eskom's increase in the municipal electricity bulk tariff increase;
2. NERSA's municipal guideline tariff increase;
3. Applications to NERSA for tariff approvals;
4. The inflation rate to be used for calculating wage increases;
5. Matters relating to the Municipal Property Rates Act; and
6. The Metro's fuel levy allocations.

Eskom bulk tariff increases

On 15 March 2010, the Minister of Public Enterprises, in terms of section 42 of the MFMA, tabled in Parliament Eskom's Amended Pricing Structure: Retail Tariffs for Municipalities 2010/11. A copy of this document has been sent to each municipality by e-mail.

For the period 1 July 2010 to 30 June 2011, Eskom will increase the municipal tariff rates for bulk electricity by 28.9 per cent.

For 2011/12 and 2012/13, municipalities should budget for increases in the bulk price of electricity of 25.8 per cent and 25.9 per cent respectively. Note, however, that these increases may change in future.

When calculating their electricity retail tariffs to customers, municipalities must only apply the above increases to the bulk electricity component of their electricity cost structure. **This implies that under normal circumstances the municipality's electricity retail tariffs should not increase by more than about 22 per cent for 2010/11** (assuming bulk electricity costs constitute 67 per cent of total input costs, and an 8 per cent increase for other costs). However, in their tariff applications to NERSA municipalities may motivate for higher increases, after considering all factors that impact on their electricity services including:

- ensuring a reasonable rate of return on electricity assets;
- previous under- or over-recovery due to last year's increase being less than or greater than the actual 31.3 per cent increase;
- the cost of capital expansion programmes and repairs and maintenance;
- the labour (i.e. the wage agreements with unions) and other input costs of services provided by the municipality or entity;
- the need to ensure financial sustainability;
- local economic conditions; and
- the affordability of electricity services, taking into consideration the municipality's indigent policy.

NERSA's municipal guideline tariff increase

The Municipal Fiscal Powers and Functions Act, 2007 requires NERSA to set a base tariff (reflecting cost of service) and National Treasury to set the surcharge on Electricity Services. While the separation of these two complimentary processes is not complete, the price adjustment will continue to be done as before, where NERSA sets the base tariff based on benchmarks and National Treasury supplements with required adjustments to these benchmark base tariffs to ensure the municipal budgets are sufficient to maintain financial sustainability of the municipalities. The following therefore clarifies the information released to date regarding municipalities' electricity tariff adjustment:

When NERSA announced its decision regarding Eskom's *Revenue Application - Multi Year Price Determination 2010/11 to 2012/13 (MYPD 2),* on 24 February 2010, it also included the following paragraph:

> 7. For those municipal distributors who implemented the 34 per cent increase in the 2009/10 financial year, a municipal guideline increase of 15.33 per cent is approved for implementation with effect from 1 July 2010 followed by 16.03 per cent from 1 July 2011 and another 16.16 per cent from 1 July 2012. For those municipal distributors who implemented a different increase, the Energy Regulator will consider applications on a case by case basis.

NERSA communicated similar information to municipalities via a letter dated 24 February 2010 with the heading *Municipal Electricity Tariff Guideline Increase for 2010/11, 2011/12 and 2012/13*.

The above municipal guideline increase was calculated using the 24.8 per cent price increase Eskom is permitted to charge in order to generate its 'allowed revenue from tariff based sales' within its financial year which runs from 1 April to 31 March. *In other words, the guideline is not based on the bulk electricity tariff increase of 28.9 per cent that the Minister of Public Enterprises has announced Eskom will charge municipalities for the period 1 July 2010 to 30 June 2011 (see above). Therefore in order not to expose the municipalities to the financial risk of under-recovery, municipalities need to calculate their tariff increase for their 2010/11 budgets based on this 28.9 per cent increase.*

The NERSA guideline letter also indicates that the guideline calculation included a claw-back that is only intended to apply to those municipalities that increased their entire tariff by 34 per cent (and not just the bulk electricity component of their costs), which would have resulted in an over-recovery of costs of about 9 per cent by those particular municipalities. This claw-back is based on the premise that the unreasonable over-recovery of electricity costs by a municipality is unfair towards customers and therefore needs to be phased out over the next three years.

The above does not preclude any municipality that requires different increases from the NERSA guideline, applying to NERSA with an appropriate motivation for such increases. Hence, National Treasury advises that all municipalities requiring higher increases to those indicated in the NERSA guideline make applications to NERSA for municipal electricity tariff increases based on the following methodology as a starting point:

(Percentages)	**Actual increase in 2009/10**	**Corrected increase for 2009/10**	**Actual increase for 2010/11**
% bulk cost of input cost	0.67	0.67	0.67
% bulk price increase	0.34	0.313	0.289
Increase in other costs	0.34	0.12	0.08
Overall increase in tariffs	**0.34**	**0.25**	**0.22**
Over-recovery in 2009/10		0.09	
Less 1/3 of over-recovery			0.19
Increase to cover future capital or for other reasons			0.19 + X

The basic formula used to calculate the 'overall increase in tariffs' is as follows:

Tariff increase = (% B x % BPI) + (% OC x % OCPI)

Where:

% B = the % weight of bulk cost in total input costs
% BPI = the % bulk price increase
% OC = the % weight of other costs in total input costs (i.e. 1-% B)
% OCPI = the assumed % price increase of other input costs

Given that wages are the most important cost component in other costs, National Treasury advises municipalities to use 12 per cent and 8 per cent for the increase in other costs in 2009/10 and 2010/11 respectively. This takes into account the impact of the wage settlement between the unions and SALGA.

National Treasury advises municipalities to do the above calculation based on information relevant to their own electricity cost structures, and how they calculated their tariff increases for 2009/10, and to include a similar table when they submit their tariffs to NERSA for approval.

A municipality that needs to increase its electricity tariff by more than the amount indicated in the NERSA guideline when applying the above methodology may do so provided that they are able to give sufficient reasons in their price application to NERSA, taking into consideration numbered item 3 in the letter from NERSA referred to above.

Applications for NERSA approval of electricity tariffs

Ideally, NERSA approval of a municipality's electricity tariffs should be given before the municipality tables its budget for approval by council on 1 June 2010, so that the council approves the new electricity tariffs together with the budget.

NERSA has indicated that the deadline for municipal tariff applications is 30 April 2010 for implementation on 1 July 2010. However, in order to facilitate the finalisation of budgets, and to ensure municipal councils approve the new electricity tariffs together with their budgets, *National Treasury advises municipalities to submit their tariff applications to NERSA by* ***1 April 2010***, which will enable NERSA to bring the date for the approval of the applications received by that date forward to 28 May 2010.

The inflation rate to be used for calculating wage increases

According to the *SALGA Salary and Wage Collective Agreement 2009/10 to 2011/2012*, the inflation rate to be used for calculating wage increases is the average CPI percentage for the period 1 February 2009 until 31 January 2010, plus 1.5 per cent. According to Statistics South

Africa the historical CPI for this period is set at 6.2 per cent year-on-year as at end January 2010.

Historical CPI (January 2010)	6.2%
SALGA addition	1.5%
NT benchmark	**7.7%**

Consequently, National Treasury suggests that municipalities use 7.7 per cent as a benchmark for determining wage increase for the 2010/11 financial year.

Note that Municipal Managers and those employees appointed as managers directly accountable to the Municipal Managers in terms of Section 57(6) if the Municipal Systems Act 32 of 2000 are excluded from the collective agreement.

Matters relating to the Municipal Property Rates Act

On 12 March 2010 the Minister of Cooperative Governance and Traditional Affairs in concurrence with the Minister of Finance amended the Municipal Property Rates Regulations as published in Government Notice No. R363 on 27 March 2009 to include a ratio for the public benefit organisation category of property. These regulations, as they apply to public benefit organizations, are effective from 1 July 2010 and as they apply to agricultural and public service infrastructure took effect from 1 July 2009. Government Gazette No. 33016, Notice No. R. 195 set out the ratios as follows:

Categories	**Ratio in relation to residential property**
Residential property	1:1
Agricultural property	1:0.25
Public service infrastructure property	1:0.25
Public benefit organisation property	1:0.25

Note that the definition of 'public benefit organisation property' is limited to property owned by public benefit organisations and used for any specified public benefit activity listed in item 1 (welfare and humanitarian), item 2 (health care), and item 4 (education and development) of part 1 of the Ninth Schedule to the Income Tax Act.

This section should be read in conjunction with any circular that is issued by the Department of Cooperative Governance and Traditional Affairs regarding a ratio for the public benefit organisation category of property.

Budgeting for the Sharing of the General Fuel Levy with Metros

Metros were advised in a letter dated 11 February 2010 of the delay in securing the latest (2009) fuel sales data. Metros were also informed that, due to this delay, the National Treasury cannot provide them with allocations for the 2010 MTEF. We have recently been informed that the required data is still not available. We accordingly advise municipalities to use the indicative figures for 2010/11 and 2011/12 that were provided in our allocation letter dated 25 March 2010 until the latest data is obtained. Also, to assist municipalities with their three year budgeting we provide the following table which includes provisional figures for the 2012/13 financial year based on 2008 fuel sales figures.

Provisional Fuel Levy Allocation 2010/11 - 2012/13 MTEF

R Thousands	2010/11	2011/12	2012/13
City of Cape Town	1 517 439	1 619 494	1 696 105
City of Johannesburg	2 288 212	2 235 233	2 123 198
City of Tshwane	1 081 936	1 164 784	1 230 499
Ekurhuleni Metro	1 099 552	1 212 624	1 311 171
eThekwini Metro	1 161 584	1 423 070	1 683 416
Nelson Mandela Bay Metro	393 623	415 056	429 385
Total 6 Metros	**7 542 346**	**8 070 261**	**8 473 775**

Please note that these are provisional figures only and **WILL** change either positively or negatively for all metros in terms of the latest fuel sales figures and should therefore be used for preliminary budgeting purposes only. As soon as the updated sales figures are available and metros are provided with updated allocations, figures should be adjusted in the budgets to reflect the final allocations. The 2009 fuel sales figures are expected to be available towards the middle of April 2010 therefore allocations can be expected towards the end of April 2010.

All relevant documents mentioned in this circular are available on the National Treasury website, www.treasury.gov.za/legislation/mfma. Municipalities are encouraged to visit it regularly as documents are regularly added / updated on the website.

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