

Discussion Paper

A Checklist on the Fitness for Municipal Pooled Financing

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Background

There has been an intensive discussion about alternative or additional revenue or funding instruments for South African municipalities. This discussion has been structured and supported by two institutions:

The first is the “Urban Finance Working Group (UFWG)” at National Treasury. This group broadly looks at different models of local public revenue or funding instruments. It discusses their advantages and disadvantages in a South African context and how they best could be implemented. Some of the instruments are:

- Pooled Finance;
- Revenue bonds;
- Tax increment financing;
- Development charges;
- Special purpose vehicles;
- Special districts;
- Etc.

The UFWG seeks to conceive optimal rules for this type of instruments that can be stipulated into the legal framework.¹

The second institution is the “Task Team on Sub-national Pooled Financing”, established by SALGA-GP. This task team focuses on this one specific funding instrument, given in its name. It seeks to organize a country case or pilot project for South Africa, in Gauteng. Thus, the following municipalities have joined the task team:

- City of Ekurhuleni;
- City of Johannesburg;
- City of Tshwane;
- Emfuleni Local Municipality;
- Mogale City.

¹ See NT/ UFWG (2016-04).

The task team discusses the strengths, weakness, opportunities and threats of different Municipal Pooled Financing Mechanisms (MPFMs). It sets up programmes to develop the necessary capacities for a successful pilot.²

Starting Point, Purpose and Use of this Checklist

A borrowing transaction assigns a lot of new rights and obligations to the borrower. The borrower needs a lot of capacities to properly deal with these rights and obligations.

For many years, some South African municipalities have borrowed money and developed capacities in how to deal with the resulting rights and obligations. There were hardly any cases in which obligations were severely neglected, as would be, for instance, a default.

However, Municipal Pooled Financing brings a new quality into the borrowing transaction. Municipalities come together in a pool to jointly borrow money. Hence, new and joint rights and obligations arise out of this.

According to the Systems Theory, the whole is not equal to the sum of its parts. The pool is a system that consists of its elements, the municipalities, and a structure, the specific mechanism. This means that the joint rights and obligations will not be the sum of those out of single transactions. They will have a special quality, follow an own logic, be in general more complex. Therefore, the member municipalities need additional, more sophisticated capacities to properly deal with them.

This checklist intends to assist in the development of such capacities. Municipalities can use it to check their fitness for MPF, as single elements of a pool, and joint via a specific mechanism. The checklist has adopted a conception of fitness that mainly draws from:

- A Systems Theory;
- A Theory of Welfare;
- A Theory of Sustainability;
- A Theory of Civil Rights and Responsibilities;

² See SALGA-GP/ TTSPFM (2016-04).

- A Theory of Financial Health.

Based thereon, the checklist sets up and describes a number of indicators. These indicators are of different types and scales. For some of them, the values might already be known, for others, they still might have to be measured. Each indicator can be assessed and compared but their values cannot or should not be weighted or aggregated. Thus, there will be no overall fitness score at the end. In contrast, results should be interpreted and conclusions drawn in a qualitative, context oriented approach. This can better be done in cooperation with an expert for this checklist. This way, both sides can learn from each other and more adequately specify.

The Fitness of the Members

Economic Fundamentals and Dynamics

<i>Indicator</i>	<i>Aspect</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Number of households per square km	Demand for public services			
Average household size	Structure of demand for public services; Stability of demand			
Per capita income	Economic power; Ability to pay			
Rate of population employed	Need for economic infrastructure			
Unemployment rate	Unused resources ; Quality of economic coordination			
Indigence rate	Quality of economic system;			

	Financial claims on state			
Tax and tariff quota	Power of state to charge			

Social Fundamentals and Dynamics

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Population density	Demand for social infrastructure			
Birth rate	Reproductive strength of social system			
Life expectancy	Quality of existing systems altogether			
Dependency rate	Pressure on social and economic systems			
Degree of cohesion	Stability; Responsiveness			
Rate of violent crime	Disintegration; Destruction of systems			
Rate of corruption	Distrust; Inequality; Deviations from proper logic			

Ecological Fundamentals and Dynamics

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
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Stock of mineral resources per GDP	Specific potential in production; Independence in production			
Proportion of fertile land	Potential in agriculture; Independence in consumption			
Average temperature	Conditions for production and consumption			
Fluctuation of temperature	Need for resilience in production and consumption			
Basic amount of rainfall	Potential regeneration of basic natural resource			
Fluctuation of rainfall	Need for water management			
Frequency of extreme weather	Natural risk			

Political Fundamentals and Dynamics

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Voter participation rate	Interest in political system (demand)			
Party membership rate	Commitment to political system (supply)			
Distribution of seats in council	Effectiveness of political decision-making			

Average age of councillors	Time preference			
Audit results	Compliance			

Financial Fundamentals and Dynamics

Balance Sheet

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Municipal assets relative to private assets	Relative static financial power of local government			
Terms of assets	Maturities; Returns; Options; Conditions			
Liquidity of assets	Ability to pay			
Asset risks	Stability of balance; Need for risk management			
Total liabilities relative to total assets	Financial pressure			
Terms of liabilities	Maturities; Costs; Options; Conditions			
Total equities relative to total liabilities	Financial independence			

Degree of collateralization	Credit risk; Effective financial power			
Equity risk	Stability of institution; Need for management and restructuring			

Statement of Revenue and Expenditure

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Total revenue relative to per capita income	Relative dynamic financial power of local government			
Own-source revenue per total revenue	Financial independence; Self-contained success			
Grants per total revenue	Financial dependence; External determination of policy			
Revenue risk	Ability to pay over time			
Capital expenditure per total expenditure	Investment orientation of local government			
Debt service per total expenditure	Financial dependence			
Expenditure risk	Need for financial provisions			

The Fitness of the Mechanism

Management of Funded Projects

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Number of project managers per value and diversity of projects	Coverage of A&L complexity			
Qualification of project managers	General skills; Specific skills			
Structure of project management	Coordination; Checks and balances			
Number of operation and maintenance managers per value and diversity of O&M	Coverage of A&L complexity			
Qualification of O&M managers	General skills; Specific skills			
Structure of O&M management	Coordination; Checks and balances			
Relevance for development	Integrated development plan; Specific study on economic, social and ecological impact			
Interconnectedness	Monetary and non-monetary externalities; Correlations of cash-flows			
Technical complexity	Planning costs; Control costs			
Organizational complexity	Number of stakeholders;			

	Diversity of stakeholders			
Total budget of project relative to equity	Financial importance of investment			
Expected return	Operational efficiency			

Asset and Liability Management

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Number of A&L managers per value and diversity of A&L	Coverage of A&L complexity			
Qualification of A&L managers	General skills; Specific skills			
Structure of A&L management	Coordination; Checks and balances			
Total assets of mechanism relative to total assets of member municipalities	Relative static financial power of mechanism			
Terms of assets	Maturities; Returns; Options; Conditions			
Liquidity of assets	Ability to pay			
Asset risks	Market values; Portfolio management			
Total liabilities relative to total assets	Financial pressure			

Terms of liabilities	Maturity; Costs; Options; Conditions			
Total equities relative to total liabilities	Financial independence			
Degree of collateralization	Credit risk; Effective financial power			
Equity risks	Stability of institution; Need for management and restructuring			

Revenue and Expenditure Management

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Number of R&E managers per amount and diversity of R&E	Coverage of A&L complexity			
Qualification of R&E managers	General skills; Specific skills			
Structure of R&E management	Coordination; Checks and balances			
Revenue from project per total revenue	Self-contained success			
Capital expenditure per total expenditure	Investment effectiveness			
Debt service per total expenditure	Financial dependency; Time structure			

Risk and Portfolio Management

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Number of portfolio managers per values and diversity of risks	Coverage of PF complexity			
Qualification of PF managers	General skills; Specific skills			
Structure of PF management	Structural steering capacities			
Number of risk managers per amounts and types of risks	Coverage of RM complexity			
Structure of risk management	Internal and external coordination; Internal and external checks and balances; Hedging			
TYPES OF RISKS				
Assets risks	Project capital			
Liability risks	Debt conditions			
Equity risks	Market development			
Revenue risks	Demand for use of project capital; Financial inflow			
Expenditure risks	Debt conditions;			

	Legal obligation of project management			
Operational risks	Individual failure; Internal information asymmetries; External information asymmetries			
Market risks	Capital market; Labour market			
Regulatory risks	Norms from different spheres of government			
RESULTS OF RISK MANAGEMENT				
Avoided risks	Discarded activities			
Reduced risks	Skills; Responsible units; Derivatives			
Shared risks	Joint ventures			
Retained risks	Financial provisions; Human resource provisions			

Accounting

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
TYPES OF ACCOUNTING				
Financial	Revenue and expenditure; Assets and liabilities			

Economic	Overall benefits and costs; Externalities			
Ecological	Balance of natural capital			
Social	Social gains and losses			
SUSTAINABILITY ORIENTED QUALITY CRITERIA				
Stakeholder inclusiveness	Relationships; Participation			
Sustainability context	Internal and external stability			
Materiality	Interest; Impact; Relevance			
Completeness	Logic; Consistency			
Balance	Advantage or disadvantage; Gain or loss; Success or failure			
Comparability	Change in time and space; Relative value of change			
Accuracy	For measurable items: correct measurement; For non-measurable items: educated, controlled and consensual assessment			
Timeliness	Possibilities to correct			
Clarity	Standards of understanding			

Reliability	Learning from the past; Learning from others			
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Compliance

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Competence	Selection of employees; On-the-job training; Formal professional training			
Control	Internal board and audits; External institutions audits			
Positive sanctions	Financial rewards; Non-financial rewards			
Negative sanctions	Financial punishments; Non-financial punishments			

Supervision

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
TYPES				
Internal	Board: members and structure; Competences			
External	Higher institutions;			

	Competences			
OBJECTS				
Rights	Bases; Enforcement			
Obligations	Definitions; Means to commit			
WORK FACTORS				
Resources	Human; Technical; Financial			
Structure	Information channels			
ORIENTATION				
Stakeholder involvement	Information policy; Means to participate			

Capacity Development

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
METHODS				
Internal	Own tradition; Effectiveness			
External	Intervention; Cost efficiency			
RESOURCES				
Human	Organizational structure; CD-experts			
Technical	IT-infrastructure; IT-expertise			

Financial	Special budgets; CD-friendly control			
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Emergency Management

<i>Name</i>	<i>Aspects</i>	<i>Norm</i>	<i>Actual Value</i>	<i>Comment</i>
Emergency Authority	Implementation of new strategy; Agenda setting; Budgeting; Liquidation of assets; Personnel dismissal			
Mechanism management	Disclosure of special information; Assistance of Emergency Authority Accept budget cuts; Accept sanctions for former failure			
Members	Funding of mechanism; Withholding of gains; Restrictions to participation; Control restrictions			
Creditors	Cooperation in debt restructuring plan; Commitment to resolved plan;			

	Acceptance of reduced payment			
Debtors	Cooperation in debt restructuring plan; Commitment to resolved plan; Advanced payments			
Stakeholders	Accept other priorities; Accept reduction in stakeholder engagement			

Conclusions

[To be drawn at the end of the check in consultation with the municipalities]

Further Reading

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