MISA PRESENTATION
Key infrastructure challenges in rural municipalities, opportunities and solutions.

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BACK TO BASICS: SERVING OUR COMMUNITIES BETTER
Presentation Outline

1. Background and Context
2. Trends in Infrastructure Financing
   • Analysis, conditional infrastructure grants
   • Conditional infrastructure grants and MIG
   • Alternative Mechanism of local government infrastructure financing
   • Alternative Sources of Infrastructure Funding
3. Non-revenue Water and Electricity
4. Framework Contracts
5. Funding for Capacity Building
Context and Introduction

- In the South African local government context; there are many challenges in small rural municipalities and this present various opportunities to be explored by the business sector.

- These challenges include failure to render adequate services to communities and a lack of consultation between municipalities and business sector.

- Inadequate sourcing strategies, deficiencies with procurement procedures fails service delivery. The operations and maintenance of infrastructure remained a challenge in poorer municipalities.

- Due to supply chain bottlenecks, water purification chemicals at remote water treatment plants are often in short supply resulting in poor drinking water quality.
Context and Introduction (Cont’d)

• A shortage of funds for operating and maintaining infrastructure including repairs to a defective pump unit[s], these are often postponed and this lead to prolonged interruptions in service delivery and inconvenience to local residents as well as health risks associated with sewage spills and municipal asset registers in most instances are not updated.

• At present, several smaller municipalities are struggling to operate and maintain their services infrastructure in a cost –effective and sustainable manner. There is continued prolonged disruption in service delivery and these challenges exist mainly to typical smaller or rural municipalities.

• Local government plays a key role in funding, operating and maintaining infrastructure.

• There is also a serious infrastructure deficit and limited resources for infrastructure
The politics of funding: Funding poorer municipalities depends on government grants and loans. Rural municipalities are unable to draw on substantial tax base; the residents from these municipalities are unable to pay for services and therefore this has a severe impact in maintaining the existing infrastructure.

Financial Challenges: Because of budget constraints, maintenance of assets and construction plants are always neglected, leading to a municipal failure to respond to elementary operations and maintenance tasks and unable to respond to infrastructure failures in time.

Water and waste water treatment plants: basic equipment necessary to perform routine tasks is always missing. Research points that in smaller municipalities, a number of waste water treatment plants do not have a potable water supply, making it impossible for operators to prevent sludge accumulation.
Context and Introduction (Cont’d)

- **Rural –urban interdependency**: According to (IUDF) urban development is not an alternative to rural development. Rural and urban areas complement each other and coexist in production, trade, information flow and governance. They are further connected through flows of people, and natural and economic resources. Rural and urban spaces share structural, social, economic and cultural linkages. Developing solutions to benefit the whole country is difficult if rural and urban areas are seen as opposites. Strong linkages is necessary to enhance growth.

- **Rapid urbanization and unviability of rural areas**: current trends reflect that as per NDP paper that by 2050 South Africa will no longer have poverty traps in rural areas and urban townships; workers isolated in the periphery of cities; inner cities controlled by slumlords and crime.

- **Poverty and Inequality**: Local government is yet to be strengthened to deal with poverty, inequality and unemployment.
Context and Introduction (Cont’d)

- **Economic Infrastructure and social infrastructure**: There is continued deficit and limited resources to fund infrastructure. Economic infrastructure includes transport sector, environmental sector, utility sector and telecommunication sector whilst social infrastructure includes, education sector, public health and public facilities such as libraries. Rural municipalities are faced with some backlogs for infrastructure upgrades and repairs. Aging and underfunded infrastructure is the greatest challenge for poorer or rural municipalities.

- **Other challenges**: Many challenges contribute to the funding of infrastructure. A discussion paper on Investment Growth and urbanization (2015) shows that government spending on infrastructure has not kept pace with the investment demands of population growth. Cities and countries continued to face major investment gaps in funding infrastructure projects. The crux of this presentation is to highlight challenges facing smaller municipalities and propose solutions.
Trends in Infrastructure Financing

• Cities account for the largest amount of infrastructure spending whilst township and rural municipalities accounted for the smaller amount of infrastructure spending by type of local government.

• Global local government survey of 2016, shows that infrastructure requires innovative funding options and that infrastructure improvement could be through additional infrastructure funding.

• On the demand side, government spending on infrastructure has not kept pace with the investment demand of population growth whilst on the supply side rising capital construction costs; shrinking public infrastructure funding sources; and constrained public sector budget due to rising health care and pension costs threaten the future sustainability of local infrastructure finance.

• The National League of cities survey (2016) shows that there is a declining and unstable state of funding and increasing pressure on local government to finance infrastructure.
Analysis: Conditional Infrastructure Grants

- The following Conditional Infrastructure Grants are primary infrastructure funding sources:
  - Municipal Infrastructure Support Grant (MIG) – Reticulation infrastructure for water and sanitation services, roads and storm water, waste management service, sports and other public services.
  - Municipal Water Infrastructure Grant (MWIG) – intermediate water supply in municipalities with the highest backlogs.
  - Regional Bulk Infrastructure Grant (RBIG) – bulk infrastructure for water supply.
  - Integrated National Electricity Programme (INEP) Grant – electrification programme to connect consumers to the grid.
  - Provincial Roads Maintenance Grant (RAMG) – development and maintenance of roads and storm water infrastructure.
Conditional Infrastructure Grants
## Conditional Infrastructure Grants

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<tbody>
<tr>
<td><strong>Direct transfers</strong></td>
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<td>2 831</td>
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<td>1 980</td>
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<td>2 087</td>
<td>1 904</td>
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<td>–</td>
<td>1 850</td>
<td>1 865</td>
<td>1 957</td>
<td>2 066</td>
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<td>Rural roads asset management systems</td>
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<td>Municipal disaster recovery</td>
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<td>Water services infrastructure</td>
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<td>659</td>
<td>298</td>
<td>852</td>
<td>608</td>
<td>642</td>
<td>678</td>
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<td>Bucket eradication programme</td>
<td>84</td>
<td>975</td>
<td>831</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
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<tr>
<td><strong>Total</strong></td>
<td>41 967</td>
<td>46 985</td>
<td>47 166</td>
<td>49 503</td>
<td>47 995</td>
<td>49 780</td>
<td>52 519</td>
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</tbody>
</table>

1. Excludes provisional allocations

Source: National Treasury
Municipal Infrastructure Grant (MIG)

- MIG is the **largest infrastructure** transfer to municipalities (32% of grants)

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>Baseline MIG 2018/19 MTEF Allocation</th>
<th>Reduction</th>
<th>Revised 2018/19 MTEF Allocation</th>
<th>% Reduction in baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018/19</td>
<td>R16,787,685,000</td>
<td>R1,500,000,000</td>
<td>R15,287,685,000</td>
<td>8.94%</td>
</tr>
<tr>
<td>2019/20</td>
<td>R17,733,731,000</td>
<td>R2,000,000,000</td>
<td>R15,733,731,000</td>
<td>11.28%</td>
</tr>
<tr>
<td>2020/21</td>
<td>R18,709,086,000</td>
<td>R2,110,000,000</td>
<td>R16,599,086,000</td>
<td>11.28%</td>
</tr>
<tr>
<td>Total</td>
<td>R53,230,502,000</td>
<td>R5,610,000,000</td>
<td>R47,620,502,000</td>
<td>10.54%</td>
</tr>
</tbody>
</table>

- Total Conditional Grants for infrastructure is **R150bn** over MTEF
- Baseline reductions on conditional grants has a negative impact on the delivery of infrastructure
- Although doing well w.r.t to the development of infrastructure, conditional grants (as the MIG) still do not make provision for the total lifecycle support w.r.t Master Planning and O&M
- Opening the **revenue envelop** is critical to support the above such as:
  - Improving *income generation capabilities* of municipalities
  - Appropriate *borrowing by municipalities, but not over committing them*
Alternative mechanism of local government infrastructure financing

- MIG is a direct grant reserved for category B and C municipalities. Municipalities are provided with an industry guideline to assist them estimate reliable projections in terms of unit project costs information and making for application for MIG funding stages.

- An important inclusion in the latest update “Allows green infrastructure, alternative technologies and innovation in the various areas to be appropriately articulated that will allow municipalities to consider the full spectrum of infrastructure technologies and associated operations and maintenance solutions”.

- The municipalities are found to be lacking capacity to spend MIG. Project Management Units were established to address a lack of capacity in municipalities to spend MIG grant and put together Project Management Engineering contracting and procurement skills needed to deliver infrastructure projects and entire project lifecycle from identification to closure.
Alternative mechanism of local government infrastructure financing …

• A lack of capacity by municipalities has been noted through Regional Bulk Infrastructure Grant [RBIG] which is a grant designed to large bulk water and waste water projects within a municipality.

• RBIG is intended for use to develop infrastructure that connects water resources to reticulation infrastructure, thus providing water and sanitation services to individual households. It has direct and indirect aspect of both transferrable by the department of water and sanitation. The grant is targeted at water services authorities [WSA]

• Well capacitated municipalities that implement projects independently are eligible to receive grants. It can be used for investment in the new infrastructure for upgrading and replacement of ageing infrastructure. DWS implement projects on behalf of municipalities through indirect grant where municipality has insufficient capacity to implement. The grant is allocated on a project basis to eligible water service authorities.
## Alternative Infrastructure Funding Models

<table>
<thead>
<tr>
<th>Funding mechanism</th>
<th>Categories</th>
<th>Key requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Internal reserves</strong></td>
<td>May be directly off current year operating budget or off funds accumulated in capital reserve fund</td>
<td>Municipality has to be sufficiently viable to have substantial cash surpluses. In the case of weaker, mostly rural municipalities they should not be using cash reserves to fund infrastructure, rather to improve operational activity.</td>
</tr>
<tr>
<td><strong>Borrowing (debt finance)</strong></td>
<td>Includes loans from development finance institutions (DFIs) and private banks. Bonds may also be included under this category but typically not applicable to town and rural municipalities. There are several non-government initiatives aimed at improving access to debt finance (see below).</td>
<td>Municipality requires a good credit rating (must be financially viable and have sound financial administration. Probably rural municipalities will be unable to meet lenders requirements. So most applicable to towns with relatively strong economies.</td>
</tr>
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</table>
## Alternative Infrastructure Funding Models

<table>
<thead>
<tr>
<th>Funding mechanism</th>
<th>Categories</th>
<th>Key requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land-based financing</td>
<td>Either direct provision of bulk and connector infrastructure by property developers or developer charges (payments made by property developers to municipality to cover cost of bulk and connector infrastructure serving the development).</td>
<td>Requires a municipality with a good administration systems and an economy where property developers are active.</td>
</tr>
<tr>
<td>Service provider funding</td>
<td>May be capital finance provided by SOEs (Eskom or water boards) or by private firms underrating concessions or BOT type contracts.</td>
<td>Requires a service to be sufficiently viable so that contractor is assured of having payments made for its services over the long term. Unlikely to be applicable to rural municipalities but could work for larger towns or groups of smaller towns. <em>In the case of SOEs the viability is less important but water boards and Eskom struggle to get municipalities to pay for their services in many cases.</em></td>
</tr>
</tbody>
</table>
Infrastructure Investment Programme for SA

1. Infrastructure Investment Programme for SA (IIPSA) was jointly setup by SA Govt & European Union (EU) for a total amount of €100 million.

2. The main purpose of IIPSA funding is:
   - to support the implementation of the government's infrastructure programme; and
   - to address the constraints to infrastructure development in South Africa and in SADC region.

3. DBSA has been appointed as the Fund Manager to implement the IIPSA Programme.

4. IIPSA is expected to provide innovative financing involving the co-funding of EU grants together with loans from participating DFIs.

5. Much of the added value of IIPSA will be in the technical exchange that takes place both during project preparation and implementation.
Public-Private Partnership Model

- There was high expectations that the Public-Private Partnership (PPP) Model would gain traction in local government as it has been the case at national and provincial government.

- Most of the PPPs concluded by national and provincial governments were predominantly in transport, office accommodation, health services, tourism and correctional service facilities.

- PPPs are by nature involves complex processed and most municipalities lack the necessary capacity to undertake the process.

- As a result only a few PPPs have been concluded at local government over in the last two decades, viz.

  ✓ Dolphin Coast and Mbombela Water and Sanitation Concessions being the most notable.
Public-Private Partnership Model (Cont’d)

• Another limiting factor is uncertainties around revenue generation to honour future obligations arising from PPP contract.

• For most municipalities to pursue the PPP option in financing their infrastructure programme a much simplified model is needed.

• There is high potential for PPP arrangements in energy and municipal waste projects.

• It is also essential for National Treasury to streamline the processes involved in PPP projects to enable smaller municipalities to pursue the options.

• More opportunities to PPPs in local government are likely to emerge in the energy sector as sustainable energy sources become more viable.
Non-Governmental Funding Initiatives

The following initiatives for funding municipal infrastructure are at different stages of development

(a) WASFIN – This is a multi-country initiative funded by USAID aimed at increasing access to finance for water and sanitation services infrastructure.

(b) Dutch Water Finance Facility – This is also a multi-country initiative funded by the Government of Netherlands. The methodology is a type of pooled funding with large scale capital raised on the private finance market by the Fund and then smaller loans made to participating municipalities.

(c) Infrastructure Finance Corporation (INCA) Municipal Finance Facility – INCA is planning to set up a funding facility where it raises large scale funding on the private finance market and then on-lends to individual municipalities. It is backed by the French Development Agency (AFD).

(d) DBSA – DBSA has a range of interventions, with one of the more important being the programme to reduce unaccounted-for water (UFW).
Savings from Non-Revenue Water Management

- Funding for infrastructure could be realized from potential savings through improved management of non-revenue water.
- The percentage of non-revenue water lost from the system has been on the rise and currently is at an average of 42%.
- Majority of South African municipalities either do not have WC/WDM strategies in place or have developed strategies that do not add any value to the water loss challenge (DWA, 2011), due to resource constraints.
- Municipalities contribute to water losses through poorly maintained infrastructure within their water reticulation networks and improper asset management.
- Non-revenue water challenges are too big for Government address on its own, without private sector participation and would put a huge strain on the Government fiscus.
- Due to the size, the technical expertise and capital required to successfully implement this programme, private sector participation for assessment, prioritization, design, fund and implement approach is proposed.
MISA has initiated the setting up of framework contracts against which municipalities could place orders for municipal infrastructure goods and services.

Framework contracts allow municipalities to acquire infrastructure goods and services without undertaking separate supply chain processes.

Benefits of framework contracts include efficiency improvements, quality assurance and cost savings arising from bulk purchases through centralised procurement.

Framework contracts for acquisition of pole and ground mounted transformers have been concluded recently.

The setting up of framework contracts for water and waste-water treatment plants will be completed by September 2018.
Funding for Capacity Building

• Capacity Building Grants help to develop municipalities’ planning, technical, budgeting and financial management skills.

• There are 4 Capacity Building Grants amounting to a total of R6,9bn over 2018/19 MTEF of which 3 are direct grants to municipalities; namely;
  ✓ Local Government Financial Management Grant (LGFMG);
  ✓ Infrastructure Skills Development Grant (ISDG); and
  ✓ Energy Efficiency and Demand-side Management Grant (EEDMG)

• Only 1 of the 4 grants is an indirect grant to municipalities, viz. the Municipal Systems Improvement Grant (MSIG).

• The current allocation (2017/18) for the MSIG is R103m.

• This grant was established in 2013/14 FY and became an indirect transfer from 2016/17 to support the Back to Basics (B2B) Approach.

• For town and rural municipalities the MSIG is the major grant and it is not well focused and has not had sufficient success.
<table>
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<tr>
<th>Capacity Building Grant</th>
<th>Purpose</th>
<th>2018/19 MTEF Allocation</th>
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<tr>
<td><strong>Local government financial management grant</strong></td>
<td>The grant supports the building in-house municipal capacity to implement multi-year budgeting, linking integrated development plans to budgets, and producing quality and timely in-year and annual reports.</td>
<td>R84.6 million</td>
</tr>
<tr>
<td><strong>Infrastructure skills development grant</strong></td>
<td>The grant places interns in municipalities so they can complete the requirements of the relevant statutory council within their respective built environment fields.</td>
<td>R23.3 million</td>
</tr>
<tr>
<td><strong>Municipal systems improvement grant</strong></td>
<td>Municipalities set up adequate record management systems, drawing up organograms for municipalities and reviewing their appropriateness relative to their assigned functions, and assisting municipalities with revenue collection plans.</td>
<td>R365 million</td>
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Proposed solutions.

• In conclusion, Infrastructure funding has focused more on capital funding for new infrastructure.

• This has resulted to neglect of existing infrastructure in terms of funding for Operations and Maintenance (O&M) as well as refurbishment.

• It is critical thus that innovative funding for O&M of infrastructure should be explored.

• There is broadly an acknowledgement that South Africa need alternative delivery and funding Model to address infrastructure funding gap in order to accelerate the reduction of backlogs mainly in smaller or rural municipalities.
Thank You!

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