# Annexure A4

**City of Cape Town – 2020/21 Budget (January 2021)**
**2020/21 MTREF amended chapter required to be included in the IDP**

## *Overview of budget assumptions applied to the 2020/21 MTREF*

### Introduction

The Local Government Municipal Systems Act, Chapter 5, Section 26, prescribes the core components of the Integrated Development Plan (IDP). Section 26 (h) requires the inclusion of a financial plan, which should include a budget projection for at least the next three years. This financial plan aims to determine the financial affordability and -sustainability levels of the City over the medium term.

Part 2 of the MBRR (Budget-related policies) requires the Accounting Officer to ensure that budget-related policies are prepared and submitted to Council. One of these policies relates to the long-term financial plan, which aims to ensure that all long-term financial planning is based on a structured and consistent methodology, thereby ensuring long-term financial affordability and sustainability.

A municipality's financial plan integrates the financial relationships of various revenue and expenditure streams to give effect to the IDP. It provides guidance for the development of current budgets and assesses financial impacts on outer years' budgets by incorporating capital expenditure outcomes, operating expenditure trends, optimal asset management plans and the consequential impact on rates, tariffs and other service charges. The City has developed a financial model, namely the Long Term Financial Plan (LTFP), which aims to determine the appropriate mix of financial parameters and assumptions within which the City should operate to facilitate affordable and sustainable budgets for at least 10 years into the future. In addition, it identifies the consequential financial impact of planned capital projects on the City's operating budget.

The LTFP model is reviewed annually to determine the most affordable level at which the City can operate optimally taking the following into account:

- Fiscal overview;
- Economic climate;
- Demographic trends;
- National- and Provincial influences;
- IDP and other legislative imperatives; and
- Internal governance, community consultation and service delivery trends.

The key budget assumptions of the 2020/21 MTREF include a discussion of the sources of information used to develop assumptions for revenue and expenditure that drive the 3-year MTREF of the City under the following headings:

- Financial Strategic Approach;
- Financial Modelling and Key Planning Drivers;
- Economic outlook / external factors (including demographics);
- National and Provincial influences;
- Expenditure analysis – a three-year preview;
- Revenue analysis – a three-year preview; and
- Local Government Equitable Share and Fuel Levy.

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On 15 March 2020, President Cyril Ramaphosa declared a national state of disaster in terms of the Disaster Management Act to enable government and the country at large to manage the spreading of the COVID-19 virus. As part of the measures introduced to curb the spreading of the virus, the President prohibited gatherings of 100 or more people. On 23 March 2020, the President declared a nationwide lockdown, whereby all citizens, except those that form part of essential services, were ordered to stay home for a period of 21 days. The nationwide lockdown commenced at midnight on Thursday 26 March 2020.

On the 9 April 2020 the nationwide lockdown was extended until the end of April 2020 and on the 23 April 2020 the President announced the lifting of certain restrictions as the country eased into level 4 lockdown from 1 May 2020.

This had a devastating effect on the economy of South Africa coupled with the impact of the pandemic on the global economy. Financial modelling and drafting of the tabled MTREF in March 2020, was pre the impact of the COVID-19 pandemic. The sections below will thus include the initial approach and amendments post the tabling of the budget in March 2020. The amendments refer to the development of an amended, viable financial plan over the short to medium term, taking the variables and impacts emanating from the COVID-19 pandemic into account.

### 2.1.1 Financial Strategic Approach

The backdrop of the 2020/21 MTREF preparation was initially against the following scenario - a 2018/19 financial year outcome confirming that the City's budget requires material review and adjustment - major under-expenditure coupled with over-recovery of revenue consistently result in a much higher than anticipated surplus. This furthermore manifests in balance sheet positions on, for example, a high surplus/free cash position for a public sector institution such as a municipality.

In addition, the public outcry on the seemingly high rates and tariffs for the 2019/20 financial year needed urgent intervention and consideration during the drafting of the 2020/21 MTREF.

The LTFP theme for the 2020/21 MTREF was therefore getting to a realistic, deliverable MTREF and addressing the Cape Town opprobrium (public outcry).

The direction provided during the Strategic Review phase of the Strategic Management Framework (SMF) process was for the organisation to focus, plan, review and reprioritise programs ensuring alignment to the following themes/topics:

- Implementation of the following:
  - Current IDP,
  - MSDF, and
  - The Water Strategy;
- Maintain Assets;
- Protect existing infrastructure and staff to ensure service delivery; and
- Violent crime and social challenges.

The Organisational Strategy Brief 2020/21 in preparation of the 2020/21 MTREF issued provided a summary of the strategic drivers and budgeting priorities for the City to guide and inform the organisation's planning of the MTREF.

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The economic, social and financial shock and stress of the COVID-19 pandemic impacted on the City's operations financially and strategically which required urgent interventions. The City's immediate response to the pandemic was focused on its vulnerable citizens during the restrictions and more specifically the lockdown period by, inter alia:

- shelter for the homeless (currently being decommissioned);
- ensuring provision of water and sanitation to underserviced and unserviced Informal Settlements sites;
- ramped up area cleaning at homeless shelters and informal settlements;
- immediate procurement of PPE emergency supplies (i.e. Masks, Sanitisers, Soaps, Glove, Bleach etc.) for frontline staff; and
- 3G cards and data contracts to facilitate employees working from home.

The comprehensive response to COVID-19 was set out in the City's Response Plan which included elements for which the City is responsible for and those for which it is not. This plan provided guidance against which additional requirements for COVID-19 related expenditure was sourced from the various directorates. In addition to this, directorates were further required to provide impacts of underspending and potential loss of revenue as a result of the pandemic.

Based on latest mid-year budget and performance assessment, changes to the City's Budget was incorporated in the January Adjustment budget as set out in the rest of this document.

**LTFP rationale and financial strategies implemented**

Changes to the initial strategies were necessary to address the financial impact of the COVID-19 pandemic:

- The initial strategy during the approval of the 2020/21 budget of a more stringent approach to loan take-up had to be reviewed as previous years' surplus cash had to be redirected to fund the impact of the COVID-19 pandemic. ~~From no loans previously envisaged,~~ External loans of R2.5 billion ~~was~~ previously envisaged to ~~will now~~ be taken up in the 2020/21 financial year is no longer required.~~to cover part of the EFF-funded capital projects of R5.2 billion~~. This is due to the City's current financial position.
- A depreciation strategy in an effort to utilise available cash and reduce tariffs.
  - This strategy sees the City using its surplus cash flow to negate the recovery of a depreciation charge of R500 million per year over seven years. This is done in order to offset revenue increases, due to loans not taken up previously.
  - This has resulted in the Budgeted Financial Performance showing a bottom-line deficit although the City's budget is fully funded as reflected in the Budgeted Cash Flow statement.
- The other strategy proposed in the tabled budget of providing for a revenue budget but not including a portion of the revenue in the calculation of the rate-in-the-Rand (for Rates) or the tariff calculation (for Water & Sanitation and Electricity) was reversed.
  - This strategy in response to continuous previous years' trends of collection of higher than budgeted revenue as a result of 'old' debt being paid in current years was reversed as the impact of COVID-19 on the consumer was quicker evident in the first few months of the pandemic and subsequent lockdown.
  - As services already had to review their collection rate due to consumer ability to pay no further pressure could be placed on them with the application of an intervention factor.

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### 2.1.2 Financial Modelling and Key Planning Drivers

The principles applied to the MTREF in determining and maintaining a sustainable financial plan included:

- A base reduction on various expenditure categories of R356 million across all directorates in response to performance outcome of the 2018/19 financial year.
- Staff and vacancies:
  - Budgeting at 95% of employee costs; and
  - a differentiated percentage budget approach on vacancies.
- No increases on overtime provision except for labour intensive directorates where higher than inflation increases are applied.
- Repairs and maintenance growth based on the previous year's actual expenditure, service delivery needs and efficiencies identified.
- A 100% capital expenditure implementation rate.
- Credible and realistic collection rates based on current and projected trends considering the impact of the pandemic.

National- and Provincial allocations as per the 2020 Division of Revenue Act, 2020 Division of Revenue Amendment Bills and the 2020 Provincial Gazette Extraordinary 8217, 8316, 8345 and 8358. ~~and the allocations to municipalities adjusted in the Western Cape Adjustments Appropriation (COVID-19) Act (2020/21 Financial Year).~~

The following were included in the MTREF:

- In response to the SMF Operational Review process, additional allocations of R504 million to various directorates across the organisation were made.
- To capacitate the newly approved HR business model, R21 million was allocated across directorates.
- To provide for the City's portion of the Law Enforcement Advancement Program (LEAP), R133 million, R146 million and R125 million was allocated for the 2020/21 financial year and two outer years' respectively.
- The City noted with concern the risk after the 3-year contract expires in 2023/24 as the City might be faced with additional expenditure of R550 million (estimated rates revenue increase requirement of 6%).
- Subsequent to the tabling of the budget the following impact of COVID-19 pandemic was included in the MTREF for the 2020/21 financial year:
  - Additional COVID-19 related operating expenditure of R903.9 million;
  - Increased debt impairment as a result of lower collection rate expected for both all services of R1 499.1 million;
  - Reduction in the operating expenditure budget of R1 703.9 million as a result of projections on projects/programmes not going ahead and reprioritization of budget to cover for the additional impact; and
  - Reduction in revenue projections for both rates and tariff funded services revenue elements of R1 427.8 million.
  - To balance the 2020/21 approved budget various expenditure items were adjusted by a further R450m and existing reserves of R1 522 million was utilised to absorb the additional requirements related to COVID-19 and the impact thereof on revenue.
  - During the August Adjustment Budget an amount of R428.4m ex Equitable Share was utilized to absorbed expenditure to be funded from existing reserves. This reduced the funding required from existing reserves.

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### 2.1.3 Economic outlook / external factors

The preparation of the drafting of the MTREF commenced with a macro environmental scan of the economy as one of its determinants. The factors taken into consideration included the CPI, interest rates, exchange rates, service growth and GDP, which is briefly discussed below.

Globally the COVID-19 pandemic has become both a health and economic crisis. This event is viewed as unprecedented the world over and has damaging effects on world economies. Uncertainty around the duration of the pandemic and the impact it will have on the future economic activities also makes it challenging to forecast future trends. Amidst this uncertainty the South African Reserve Bank (SARB) expects GDP to contract by 6.1% in 2020 and to grow by 2.2% in 2021 and by 2.7% in 2022. GDP is expected to grow by 2.2% in 2021 and by 2.7% in 2022.

Considering current economic pressures which includes the contraction in growth, volatile exchange rate, unstable business sector and the sovereign credit rate downgrade the Monetary Policy Committee (MPC) in April reduced the repo rate by 100 basis points making more capital available and mitigating the financial impact. A quarterly reduction in the repo rate by 25 basis points is projected until the first quarter of 2021.

Major influences to the fuel price are the Brent Crude oil price and the Rand/Dollar exchange rate. The pandemic had a distressing impact on Brent Crude oil price, reducing it to levels below $30 per barrel due to sluggish demand. This amidst major suppliers such as OPEC reducing production. The Monetary Policy Committee (MPC) in April forecasts that Brent Crude oil price will average $42 per barrel in 2020 and $45 per barrel in 2021. The South African Rand also depreciated over the last few months reaching levels of R18.6/$ in May due to the impact of the pandemic. The Bureau of Economic Research (BER) forecasts the Rand to end 2020 at an average of R17.81/$ and 2021 at R16.78/$.

Inflation predictions are still expected to be in line with the SARB inflation targeting range of between 3 to 6 percent. It was however reduced considering the shrinkage in demand, lower consumer purchasing power and the reduced cost of fuel resulting from the impact of the pandemic. The SARB expects inflation to be subdued for 2020 and increasing over later years as the economy stablises. The Bank' s headline consumer price inflation forecast averages 3.6% for 2020, 4.5% for 2021, and 4. 4% in 2022.

**Demographic trends**

The population of Cape Town in 2019 was estimated at 4 488 546, growing at 2.01% from 2018 to 2019 (Mid-year Population Estimates, Statistics South Africa, 2019). This makes Cape Town one of the larger metropolitan municipalities in South Africa and the main urban centre in the Western Cape.

In the context of the current novel COVID-19 pandemic facing the City and Cape Town, it is complex and not yet possible to consider what the shorter and longer terms impacts on demographic trends maybe. However, at a high-level, it is still expected that the broad trends will be similar and Cape Town's population is expected to continue to grow as has been the trend.

It is estimated that the population will grow to around 4.7 million in 2025 (City of Cape Town, 2018). Moreover, the number of households in Cape Town in 2019 was 1 402 million, an increase of 10.7% since 2015 (City of Cape Town 2019, using Mid-year estimates). The average household size has declined from 3.3 persons in 2015 to 3.2 persons in 2019 (City of Cape Town, 2019).

These trends of steadily increasing population growth (albeit at a declining growth rate) and increasing numbers of households, with fewer persons per household, form some of the informants to City planning and service delivery for the residents of Cape Town. These trends will continue to be monitored, and refined as needed to inform COVID-19 and post COVID-19 responses and planning.

**National and Provincial influences**

**a) National Treasury MFMA Circular No. 98, issued in December 2019**

The purpose of this annual budget circular is to guide municipalities with the compilation of the 2020/21 MTREF.

The objectives of the circular are to, inter alia, demonstrate how municipalities should undertake annual budget preparation in accordance with the budget- and financial reform agenda and associated "game changers".

Key themes from this circular include the following:

- The dire economic environment confronting government over the next several years;
- Macro-economic forecasts to be considered when preparing the 2020/21 MTREF municipal budgets;
- Changes to local government allocations;
- The equitable share and the allocation of the general fuel levy to local government constitute unconditional funding. Municipalities were reminded that this funding allocation is formula driven and designed to fund the provision of free basic services to disadvantaged communities;
- Conditional grant funding must be utilised for the intended purpose within the stipulated timeframes, as specified in the DoRB published in February 2020. Funds not spent must be returned to the fiscus and requests for roll-overs will only be considered in extenuating circumstances;
- Addressing unfunded budgets in local government;
- Changes to the structure of local government allocations;
- Version 6.4 of the mSCOA chart is effective from 2020/21 and must be used to compile the 2020/21 MTREF;
- Municipalities must comply with Section 18 of the MFMA and ensure that they fund their 2020/21 MTREF budgets from realistically anticipated revenues to be collected;
- Municipalities should pay attention to reconcile the valuation roll data to the billing system to ensure that revenue anticipated from property rates are accurate;
- Setting cost reflective tariffs and having a credible budget to ensure tariffs results in financial sustainability;
- Municipalities to consider the following when compiling their 2020/21 MTREF budgets:
    - Improve the effectiveness of revenue management processes and procedures;
    - Pay special attention to cost containment measures by, inter alia, controlling unnecessary spending on 'nice-to-have' items and non-essential activities as per the Municipal Cost Containment Regulations (MCCR) issued on 7 June 2019;

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- Ensure value for money through the procurement process;
- Affordability of providing free basic services to all households; and
- Curb consumption of water and electricity by indigents to ensure that they do not exceed their allocation.

**b) National Treasury MFMA Circular No. 99, issued in March 2020**

This budget circular is a follow-up to MFMA Circular No. 98 and aims to provide further guidance to municipalities with the preparation of the 2020/21 MTREF with the key focus being grant allocations per the 2020 Budget Review and the 2020 DoRB.

The Circular further sets out the key focus areas for the 2020/21 Municipal Budget process, highlighting the need for municipalities to improve their collection rates; reminding municipalities that all allocations included in their budgets must correspond to the allocations listed in the DoRB and provided the response to the Finance and Fiscal Commission (FFC)'s recommendations.

The key themes from this circular – over and above what was covered in the previous circular - are:

- Reviewed macro-economic forecasts;
- Eskom Bulk Tariff increases: In absence of NERSA determination, municipalities to utilise the March 2019 increases;
- Budgeting issues: The wage bill, Pension fund and SARS contributions, Water management and attracting economic investments;
- Borrowing for multi-year capital projects and Refinancing of existing loans: Reiterating the requirements of the MFMA; and
- Highlighting the criteria for the roll-over of conditional grant funding.

**c) National Treasury Annexure to MFMA Circular No 99 in April 2020**

The Annexure to MFMA Circular No 99 was issued to provide municipalities guidance regarding Government Gazette No. 43181 which provides for exemption from the Act and Regulations that was published on 30 March 2020. This gazette in essence provides for exemption from the timeline provisions in the MFMA until such time that the national state of disaster declaration is lifted by the President.

The key matters raised in the Circular include:

- On the MFMA Exemption Notice, attached a list of key time bound actions to be taken by municipalities which may be affected during the National State of Disaster;
- Only one adjustments budget allowed between date of the declaration of the national state of disaster and 15 June 2020;
- The Socio-economic impact;
- Core principles in an event of disasters for rapid and impactful responses but remaining within financial and governance practises;
- Budgetary implications – guiding principles on credit control and debt management; tariff increases post tabling; limiting COVID-19 related expenditure to municipal mandate in terms so the Constitution;
- Conditional grants to respond to COVID-19;
- Tabling and adoption of 2020/21 MTREF budgets and 2019/20 reporting requirements; and
- Revenue and Expenditure Management during this period.

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### 2.1.4 Expenditure analysis – a three-year preview

**a) General inflation outlook and its impact on municipal activities**

The City continued with the differentiated approach adopted in previous years in the compilation of this year's budget. Inflation was therefore not the only or primary driver.

The City's CPI applied over the 2020/21 MTREF is 5.10%, 4.98% and 5.01% over the respective three years as projected by BER at a point in time during the planning process. This is within the South African Reserve Bank's (SARB) inflation target range of between 3% and 6%. In terms of MFMA Circular No. 98, NT's CPI projection is 4.9% for 2020/21 and 4.8% for the two outer years. This was further reduced in MFMA Circular No. 99, issued in March 2020, to 4.5% for 2020/21 and 4.6% for the two outer years.

**b) Contracted Services, Overtime and Operational Cost**

The outcome of the 2018/19 performance had a strong influence on the MTREF approach similar to previous years where budget reductions, reprioritisation and a differentiated approach was implemented. The differentiated approach consisted of a combination of zero-based, and different percentage increases based on the nature of expenditure, the nature of the service department (e.g. labour intensive in the case of overtime) and previous performance.

The Municipal Cost Containment Regulations, followed by the City's Cost Containment Policy, approved by Council in October 2019, reiterated the importance of ensuring that value for money is achieved and resources of the municipality are used effectively, efficiently and economically.

Contracted services, overtime and operational cost were of the categories of expenditure impacted by the COVID-19 pandemic, which reduced due to programmes and projects not going ahead and increased due to impact of COVID-19 related additional requirements.

**c) Interest rates for investment of funds**

Investments are made in terms of the City's Cash Management and Investment Policy, which aims to secure sound and sustainable management of the City's surplus cash and investments. The pandemic also negatively affected the City's investment income. Investment interest rates for the 2020/21 MTREF was reviewed based on the latest drop in the prime rate and the expectation of further interest rates cuts. Based on this an average investment interest rate of 4.81% is forecasted for 2020/21 and 4.55% for the outer years of the MTREF.

**d) Collection rate for Property Rates and Service charges**

NT Circular 99 states that "The declining economic growth which might be impacted on further by the Corona virus pandemic and international companies closing down as a result, the deteriorating state of the finances for state-owned entities, continued high unemployment and water and electricity shortages will put pressure on the ability of municipalities to raise revenue". It further states that municipalities should, amongst other, adopt realistic budgets.

~~In addition, the City's revenue collection has been negatively affected by the economic downturn as a result of the precautionary measures put in place nationally to curb the spread of the COVID-19 pandemic over the last few weeks. In this regard, consumers across sectors are currently showing strain in their ability to pay municipal accounts. Given that we are currently in uncharted waters with little empirical data available, it was challenging to predict what next year would hold for consumer payment behaviour.~~

The 2020/21 budget was prepared with uncertainty on how the pandemic would affect consumer payment behaviour, lower collection rates were therefore predicted. However, the collection rate outcomes for the first five months of the 2020/21 financial year remained strong, showing higher outcomes when compared to budgeted collection rates. Collection rates are therefore being revised with the January 2021 adjustment budget.

~~Nevertheless, considering current collection trends, predicted COVID-19 lockdown projections and to give effect to the NT Circular 99 both Rates and Tariff funded services' collection rates were reviewed and adjusted for the 2020/21 financial year. Outer years will be reviewed as more certainty on the pandemic and consumer behaviour is known.~~

**Table 1 Collection Rates**

| Services | Base Budget 2019/20 | Budget Year 2020/21 | Budget Year +1 2021/22 | Budget Year +2 2022/23 |
|---|---|---|---|---|
| **Rates** | 93.0% | 90.0% | 96.0% | 96.0% |
| **Electricity** | 98.0% | 98.5% | 99.0% | 99.0% |
| **Water** | 84.0% | 85.0% | 91.2% | 91.2% |
| **Sanitation** | 85.5% | 85.0% | 94.2% | 94.2% |
| **Refuse** | 87.0% | 85.0% | 90.0% | 90.0% |

Rates collection rate is projected at 90% for 2020/21 and is primarily as a result of consumers' ability to pay due to the impact of COVID-19

Electricity collection rate for 2020/21 is projected at 96.7%, which is lower than previous years' collection rate and is a direct consequence of the projected COVID-19 impact and the expected inability of consumers to pay. The outer years' projection averages 99%. The Electricity collection rate for 2020/21 was revised upwards to 98.50% in the January 2021 adjustment budget.

The projected collection rate for both Water and Sanitation is 82.3% for the 2020/21 financial year. The collection rate for both Water and Sanitation showed improvement over the first half of the 2019/20 financial year, due to debt management actions and indigent debtors methodology applied. However, due to the impact of the pandemic and latest payment trends the projections for 2020/21 were adjusted downwards. The collection rates for the outer years' averages 91.2% for Water and 94.2% for Sanitation. %. The Water and Sanitation collection rates for 2020/21 were revised upwards to 85.00% in the January 2021 adjustment budget.

There are two main factors driving the collection rate for Refuse, namely the impact of the COVID-19 on consumer's ability to pay and an adjustment in the rebate categories based on property value to bring about an alignment in who is deemed indigent across services. Accordingly, a 100% rebate is extended to property values between R1 and R300 000. Considering these factors, the projected collection rate for Refuse is 76% for 2020/21 and 90% for the two outer years of the MTREF. The Refuse collection rate for 2020/21 was revised upwards to 85.00% in the January 2021 adjustment budget.

**e) Salary increases**

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The 2020/21 financial year is the last year of the 3-year salary and wage collective agreement approved in 2018. In the absence of an agreement for the two outer years of the 2020/21 MTREF, the principle applied for 2020/21 was assumed.

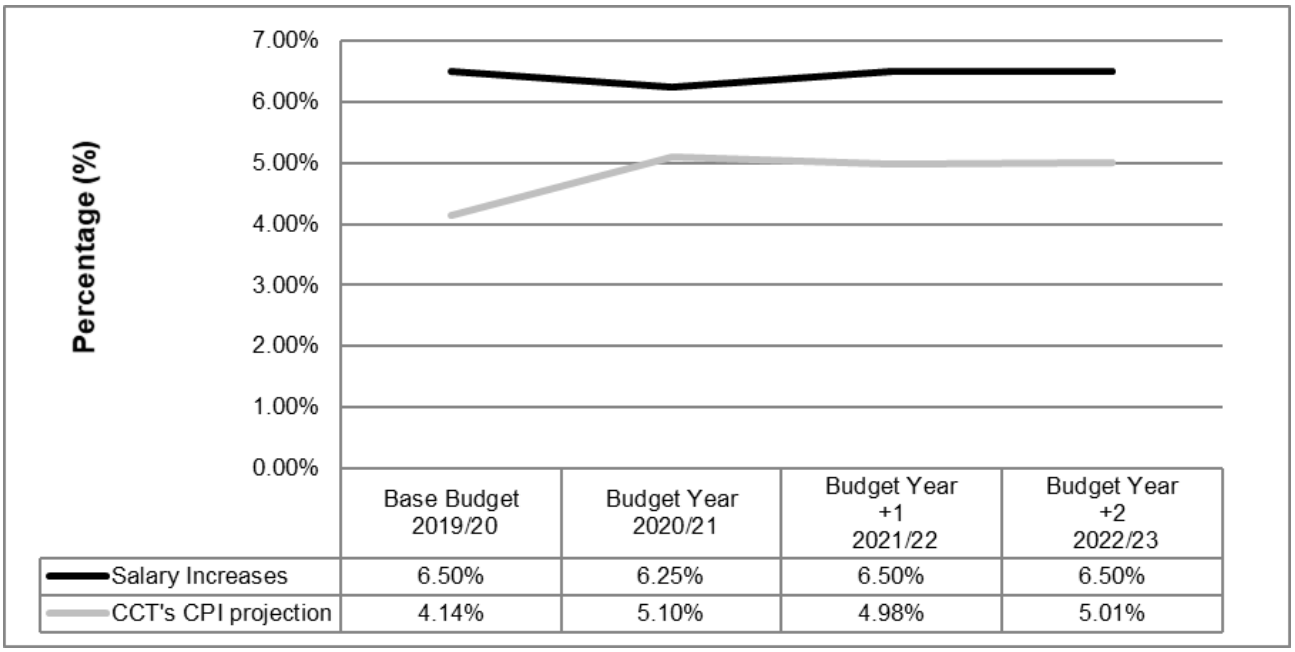
In terms of the salary and wage collective agreement, the increases per municipal financial year are to be calculated as follows:

- 2020/21: CPI percentage for 2020 as projected by January 2020 MPC plus 1.25%; and
- 2021/22 and 2022/23: Projected at 6.5% in the absence of an agreement.

Furthermore, the salary and wage collective agreement states that if in any of these years the average CPI percentage is less than 5%, the average CPI will be deemed to be 5%, and in the event that the average CPI is above 10% the average CPI will be deemed to be 10%.

The CPI projected by the January 2020 MPC Statement was 4.7% for 2020. Based on this, the salary provision for the 2020/21 financial year was 5% plus 1.25%. A further provision of 2% was made for incremental allowances to cater for performance- and other notch increases.

The figure below shows the correlation between the City's CPI and the salary increase over the MTREF.




| | Base Budget 2019/20 | Budget Year 2020/21 | Budget Year +1 2021/22 | Budget Year +2 2022/23 |
|---|---|---|---|---|
| Salary Increases | 6.50% | 6.25% | 6.50% | 6.50% |
| CCT's CPI projection | 4.14% | 5.10% | 4.98% | 5.01% |

**Figure 1 Correlation between the City's CPI and the salary increase over the MTREF**

In addition to the above increases, the City continued with the method of budgeting for salaries at 95% as introduced in the 2018/19 financial year. The 2020/21 MTREF also saw the continuation of budgeting partially for vacancies, due to previous years' outcomes showing a recurring under performance. This approach was adopted as the turnaround time of vacancies has attributed significantly to the underperformance on the salaries budget. Subsequent to the tabling of the budget a decision to only budget for 50% of performance increases from T-level 14 and above were implemented.

**f) Ensuring maintenance of existing assets**

The differentiated approach introduced in previous years was applied to repairs and maintenance expenditure accounts for the 2020/21 MTREF. This approach considered previous year's performance, service delivery needs, efficiencies and the nature of the function that individual services provide. The following varying parameters were applied:

- CPI increase to both services where the nature of business is primarily to provide repairs and maintenance and where the condition of the assets must be secured, and for services, which although their main function is not providing repairs and maintenance but the nature of business and facilities requires a proper maintenance provision; and
- No increase for support services.

NT Circular No. 55 and NT Circular No. 70 set the ratio of operational repairs and maintenance to asset value (write down value of the municipality's property, plant and equipment (PPE)) at 8%. The City's averages 8% over the 2020/21 MTREF.

### g) Operational financing for capital depreciation

Calculation of depreciation on new capital expenditure is based on variables such as asset class and lifespan, depending on the nature of the asset. An annual capital expenditure implementation rate of 100% was assumed. Depreciation of existing assets is calculated based on simulated SAP data that reflect actual values per annum. Assets under construction (AUC) are calculated based on asset class lifespan and projected capitalisation dates.

### Credit rating outlook and borrowing

The City needs a credit rating to demonstrate its ability to meet its short- and long-term financial obligations. Potential lenders also use it to assess the City's credit risk, which in turn affects the pricing of any subsequent loans taken. Factors used to evaluate the creditworthiness of municipalities include the economy, debt, finances, politics, management and institutional framework.

On 6 April 2020, Moody's Investors Service provided an update to the City's credit opinion after a downgrade in the credit rating of the sovereign, the RSA Government. The City's global scale rating was downgraded to Ba1/NP from Baa3/P-3, while its national scale rating as well as its negative outlook were both affirmed.

The City's national scale rating is currently Aaa.za/P-1.za, which reflects the City's credit profile of strong financial performance supported by prudent financial management, a large and diverse economic profile and predictable sources of revenue from property taxes and service charges. The City has consistently generated operating surplus, strong liquidity compared with that of its peers in South Africa and low debt. The City's credit profile is constrained by Cape Town's capital spending pressure as a result of water shortage because of drought, infrastructure backlogs and population growth. The City's known ratings over the last period were as follows:

**Table 2 Credit rating outlook**

| Category | Currency | Current 6 April 2020 Update following downgrade of Sovereign | Previous 13 March 2020 | Current 11 November 2019 Changes in outlook |
|---|---|---|---|---|
| Outlook | - | Negative | Negative | Negative |
| NSR Issuer Rating | Rand | Aaa.za | Aaa.za | Aaa.za |
| NSR ST Issuer Rating | Rand | P-1.za | P-1.za | P-1.za |
| NSR Senior Unsecured | Rand | Aaa.za | Aaa.za | Aaa.za |

- Stable Outlook – reflects that a credit rating assigned to an issuer is unlikely to change;
- Negative Outlook - reflects that a credit rating assigned to an issuer may be lowered;
- Rating under Review - a review indicates that a rating is under consideration for a change in the near term;
- NSR Issuer Rating – Aaa.za - Issuers or issues rated Aaa.za demonstrate the strongest creditworthiness relative to other domestic issuers;
- NSR ST Issuer Rating – P-1.za – Issuers (or supporting institutions) rated Prime-1 have the strongest ability to repay short-term senior unsecured debt obligations relative to other domestic issuers; and
- NSR Senior Unsecured – Aaa.za - Issuers or issues rated Aaa.za demonstrate the strongest creditworthiness relative to other domestic issuers.

The City's borrowing is done in terms of Chapter 6 of the MFMA as well as the City's Borrowing Policy, in terms of which a long-term loan will only be entered into if it's affordable and sustainable. The City's loan requirements are determined by the capital investment requirement (excl. Transfers Recognised: Capital) and the projected cash position. The City primarily borrows against future revenue generating assets. Borrowing over the MTREF is calculated on an interest rate of 11% based on the annuity method.

The below table reflects the borrowing and interest rate over the MTREF.

| R' 000 | Budget Year 2020/21 | Budget Year +1 2021/22 | Budget Year +2 2022/23 |
|---|---|---|---|
| Borrowing | - | 4,528,192 | 5,000,000 |
| Borrowing Interest Rate (%) | 11% | 11% | 11% |

### 2.1.5 Revenue analysis – a three-year preview

**a) Growth**

**Property Rates**

Due to the expected shrinkage in the economy the growth projected for Rates is projected at 0.25% for the 2020/21 financial year. The outer years are expected to grow by 1.0% annually as it is expected that the economy will improve over the next financial years.

**Electricity**

Shrinkage in sales revenue of 6.5% is projected for 2020/21 and 1.5% over the two outer years of the MTREF. The large projected shrinkage in 2020/21 is mainly due to the expected reduction in demand of Electricity during the pandemic period. Other factors resulting in the shrinkage includes continued energy saving and efficiency plans implemented by consumers, which results in reduced consumption and declining revenue sales.

**Water and Sanitation**

A shrinkage in growth of 3.5% for water and 3% for sanitation (from the 2019/20 base volumes) is projected for 2020/21. This projection is based on 2019/20 volumetric consumer usage behaviour. A 1% growth is projected for the two outer years of the MTREF. This position will be reviewed in future years when more information/data is available and consumption levels have stabilised. It is viewed to be prudent for the new base to be established before making future projections.

**Refuse**

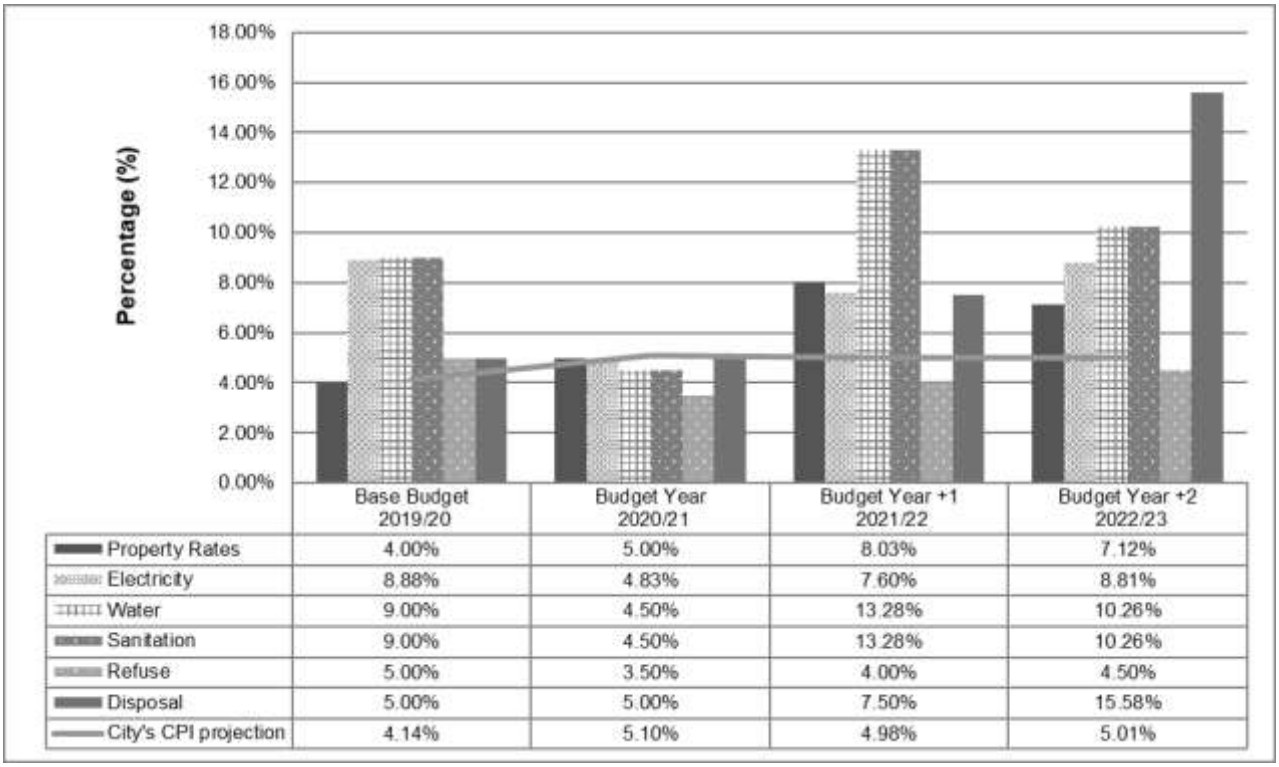
The average revenue growth over the last 3 years shows that a 2% growth for refuse is sustainable over the 2020/21 MTREF. This projected increase is driven by the growth in the requirement for this service.

**b) Major tariffs and charges: Rates and Trading services**

MFMA Circular No. 98 encourages municipalities to maintain acceptable levels of tariff increases to all consumers and requires municipalities to justify increases in excess of inflation.

The Circular further reiterates the need to set cost reflective tariffs, which is a requirement of Section 74(2) of the Municipal Systems Act, 2000 (Act No.32 of 2000) that states that tariffs must "reflect the costs reasonably associated with rendering the service". This is meant to assist municipalities to generate sufficient revenue to fully recover their costs, deliver services to customers sustainably and invest in infrastructure that promotes local economic development.

Considering the above and to ensure future financial sustainability, the following revenue increases are applied for 2020/21 MTREF. A decision to not amend any revenue parameters and tariff increases subsequent to the tabling of the budget was made although Annexure to MFMA Circular No 99 allowed for such increases post tabling of the budget.




| | Base Budget 2019/20 | Budget Year 2020/21 | Budget Year +1 2021/22 | Budget Year +2 2022/23 |
|---|---|---|---|---|
| Property Rates | 4.00% | 5.00% | 8.03% | 7.12% |
| Electricity | 8.88% | 4.83% | 7.60% | 8.81% |
| Water | 9.00% | 4.50% | 13.28% | 10.26% |
| Sanitation | 9.00% | 4.50% | 13.28% | 10.26% |
| Refuse | 5.00% | 3.50% | 4.00% | 4.50% |
| Disposal | 5.00% | 5.00% | 7.50% | 15.58% |
| City's CPI projection | 4.14% | 5.10% | 4.98% | 5.01% |

**Figure 2 Revenue parameters for the MTREF period**

**Property Rates**

The revenue parameter for Property Rates for the 2020/21 financial year is at level below the upper limit of the inflation target range. The low increase is as a result of various corporate initiatives proposed to reduce cost and reprioritise budgets.

**Electricity**

On 9 March 2020, NERSA provided a decision on Eskom's Retail Tariff and Structural Adjustment Application and Schedule of tariffs for the period 1 April 2020 to 31 March 2021. The approved allowable revenue by NERSA resulted in an average annual percentage price increase of 8.76% for the 2020/21 Eskom financial year.

This translated in an estimated Eskom increase to municipalities of 6.9% for 2020/21. This increase influences the bulk purchases cost and therefore the electricity revenue increase requirement. The business of providing an electricity service is the purchasing and redistribution of electricity, thus bulk purchases is a major influencing factor in determining the revenue increase. Bulk purchases averages 65% of the Energy & Climate Change directorate's total expenditure budget.

Due to the implementation of corporate cost savings measures the revenue increase for electricity was kept at levels lower than the projected Eskom increases for the MTREF. The electricity average revenue increase projected for the 2020/21 financial year is 4.83% and 7.60% and 8.81% for the two outer years,

respectively. The slightly below CPI increase is as a result of the bulk purchases cost, declining electricity sales and business enhancement initiatives.

**Water and Sanitation**

The average revenue increases applied for the MTREF for water and sanitation is 4.5% for 2020/21, 13.28% and 10.26%, respectively for the two outer years. This is based on level 1 tariffs and is recommended for implementation from 1 July 2020.

To make provision for drought restriction tariffs, five levels of tariffs are proposed for the 2020/21 financial year.

- The no-restriction and emergency levels restrictive tariff increase is as per the level 1 increase projected for 2020/21;
- Level 2 an increase of 6.5% is projected for water and 6.5% for sanitation; and
- Level 3 a restrictive tariff increase 6.5% is projected for water and 8% for sanitation.

Circular 99 states that “Municipalities should take strategic action to ensure effective water management and resilience to drought, including the security of water supply, environmental degradation, and pollution of resources to achieve economic growth, development and socio – economic priorities in an equitable and sustainable manner.”

Considering the requirements of Circular 99, the proposed increases for water and sanitation will make provision for amongst other the following:

- Requirements for the New Water Plan to ensure sustainable and resilient provision of water. Initiatives include the further investment in underground extraction from aquifers;
- Water demand management initiatives to limit the abuse of water;
- Upgrades and extensions to the wastewater treatment plants;
- Continued investment in asset replacement programs to ensure proper asset management;
- Continued investment in the repairs and maintenance program and maintaining required compliance standards; and
- Supplying water and sanitation at appropriate compliance, capacity, skills, service delivery and responsiveness levels; and
- Lower collection rate and the associated debt impairment cost requirement.

The revenue increases for Water and Sanitation in 2020/21 is in line with CPI as a result of various cost savings initiatives which includes the phasing out of the New Water Plan and reducing cost in areas which in previous years showed consistent underspend.

**Refuse**

Solid Waste Management in the City has a dual funding model with Collections and Disposal making up the tariff-funded services while Drop-off Facilities and Cleansing are funded from Property Rates.

NT Circular 99 states that “Investments in waste collection and treatment infrastructure should be made in tandem with industrial and urban developments to minimise pollution to our land and waters”. In this regard the following revenue increases is projected for Solid Waste Management over the 2020/21 MTREF.

Refuse revenue is the revenue received for the removal of waste from residential and non-residential properties. The average refuse tariff increase is 3.50% for 2020/21 and 4.00% and 4.50% for the two outer years, respectively. The average increase will allow for, amongst other things, the waste minimisation initiatives and expanding the footprint of the service as the customer base grows. increasing the property value threshold for 100% rebate qualifiers and the associated debt impairment cost associated with the lower collection rate.

Disposal revenue is the revenue received for the disposal of waste from residential and non-residential properties. The average disposal tariff increase for 2020/21 is 5.00% whereas the increases for the two outer years are 7.50% and 15.58%, respectively. This increase is required for the continued operational requirement of the service and for the capital investment of new, replacement and renewed assets. The capital investment includes the development of landfill infrastructure, development and upgrading transfer stations, additional two Material Recovery Facilities and Landfill Gas Generation to Beneficiation at all landfill sites.

**Housing rental (Council rental properties)**

The monthly rental charge for housing rental properties is based on a rate per square meter applied to the size of the unit being rented coupled with a set of premiums/deductions based on the location, maintenance level, facilities et al of the specific property for which the rent is charged.

Through addressing the economic challenges faced by many poorer communities residing in, particularly, the City's rental stock, the average total monthly rental charge percentage increase associated with the City's rental properties has been retained at an affordable level and is based on an annual increase of 3.76% (where the unit has a separate water meter) or 4.14% (for those units which include water in the rental charge) for 2020/21.

The projected rental charge increase is lower than CPI, due to rental units operating on a City-subsidised basis.

Tenants who are occupying rental properties since 2007 receive a subsidy of 20% of the rental charge, this being the final portion of the phase-out program, which was not fully implemented by the City to facilitate affordability of long standing tenants. This key initiative, reflected within the City's Credit Control and Debt Collection Policy, supports affordable rentals to many poor communities and the City's initiatives in terms of its housing debt collection drives whilst supporting the City's housing debtor book that it does not unduly increase due to, potentially, unreachable charges.

The proposed 2020/21 housing rental charge is in line with previous annual rental increases and is again aimed at ensuring affordability for the City's poorer communities. The rental rate (per square meter per month) is R11.27 (where the unit has a separate water meter) or a rental charge (including water charge where applicable) of R19.04 per square meter per month.

The City's housing premiums and deductions charge structure addressing the variations in the City's diverse rental properties remains as follows:

- Discounts on account
  - Outside toilet (R20 per month)
  - External Water (R30 per month)
  - No ceiling (R15 per month)

# Annexure A4

**City of Cape Town – 2020/21 Budget (January 2021)**
**2020/21 MTREF amended chapter required to be included in the IDP**

- Premiums on account
  - Saleable unit (R4,50 per month)
  - Well maintained (R5 per month)
  - Local environment (R3,50 per month)
  - Well located (R5 per month)
  - Hot water cylinder (R4 per month)

A surcharge for tenants earning a monthly income above the rental income threshold (R3 500) is charged as follows at a stepped rate of 8% for those earning R3 501 – R7 500 and 10% for those earning R7 501 – R10 000. Tenants who earn more than R10 000 per month will pay a surcharge of 25% of any amount above R10 000. A two (2) year lease agreement will be signed, which will not be renewed if the income remains more than R10 000.

### c) Capital funding

The capital budget was prepared considering very strict assessment criteria to ensure mainly the ability to implement the capital budget. In this regard the "Brick Wall" approach was adopted where screening and reviewing of projects takes place for procurement and implementation readiness, technical and financial feasibility and strategic alignment. This process culminated in the proposal of the following capital budget over the 2020/21 MTREF:

**Table 3 Capital Budget over MTREF**

| Capital funding<br><br>R' 000 | Budget Year 2020/21<br>R' 000 | Budget Year+1 2021/22<br>R' 000 | Budget Year +2 2022/23<br>R' 000 |
|---|---|---|---|
| Transfers recognised - capital | 1,812,397 | 3,198,691 | 3,428,035 |
| Borrowing | – | 4,528,192 | 5,000,000 |
| Internally generated funds | 5,566,504 | 930,577 | 1,104,457 |
| **Total** | 7,378,901 | 8,657,460 | 9,532,492 |

### 2.1.6 2020 Division of Revenue Act and Fuel Levy

**Equitable Share**

In terms of section 227 of the Constitution, local government is entitled to an equitable share of nationally raised revenue to enable it to provide basic services and perform its allocated functions. The local government equitable share is an unconditional transfer, which supplements the revenue that municipalities can raise themselves (including revenue raised through property rates and service charges).

The DoRA provided the following, which was included in the City's MTREF:

- 2020/21 – R3 081 million
- 2021/22 – R3 378 million
- 2022/23 – R3 678 million

In addition, the Division of Revenue Amendment Bill gazetted on 18 June 2020, provided for a further R428.4 million Equitable Share allocation to the City. This allocation was utilised to ease the financial pressure on the City's budget by converting COVID-19 expenditure previously funded from existing reserves to grant funded.

**Sharing of the Fuel Levy**

The general Fuel Levy is legislated by the Taxation Laws Amendment Act (Act 17 of 2009), which provides that each metropolitan's share should be announced in the government gazette.

The Fuel Levy allocation for 2020/21 was based on the 2018 fuel volume sales. Allocations for the two outer years of the 2020/21 MTREF is indicative; the actual allocations will be based on fuel sales.

The following amounts were allocated to the City, as per the 2020/21 allocation letter, and was included in the City's MTREF:

- 2020/21 – R2 595 million
- 2021/22 – R2 734 million
- 2022/23 – R2 817 million

It is expected that the outer years' indicative amounts will be impacted on due to the impact of the current lockdown situation and its impact of fuel sales, this will impact on both the 2021/22 and 2022/23 financial years.

### 2.1.7 Major parameters

The following table summarises the major parameters applied to the 2020/21 MTREF operating budget:

**Table 4 Summary of parameters applied to Operating Budget**

| | Budget Year 2020/21 | Budget Year +1 2021/22 | Budget Year +2 2022/23 |
|---|---|---|---|
| **CPI** | **5.10%** | **4.98%** | **5.01%** |
| **COLLECTION RATES** | | | |
| Rates | 90.00% | 96.00% | 96.00% |
| Electricity | 98.50% | 99.00% | 99.00% |
| Water | 85.00% | 91.20% | 91.20% |
| Sanitation | 85.00% | 94.20% | 94.20% |
| Refuse | 85.00% | 90.00% | 90.00% |
| **REVENUE PARAMETERS** | | | |
| Rates | 5.00% | 8.03% | 7.12% |
| Electricity | 4.83% | 7.60% | 8.81% |
| Water | 4.50% | 13.28% | 10.26% |
| Sanitation | 4.50% | 13.28% | 10.26% |
| Refuse | 3.50% | 4.00% | 4.50% |
| Disposal | 5.00% | 7.50% | 15.58% |
| **GROWTH PARAMETERS** | | | |
| Rates | 0.25% | 1.00% | 1.00% |
| Electricity | -6.50% | -1.50% | -1.50% |
| Water | -3.50% | 1.00% | 1.00% |
| Sanitation | -3.00% | 1.00% | 1.00% |
| Refuse | 2.00% | 2.00% | 2.00% |
| **EXPENDITURE PARAMETERS** | | | |
| Salary increase | | | |
| Salary increase (SALGBC Agreement) | 6.25% | 6.50% | 6.50% |
| Increment provision | 2.00% | 2.00% | 2.00% |
| Operational cost | Differentiated | Differentiated | Differentiated |
| Repairs & Maintenance | Differentiated | Differentiated | Differentiated |
| Interest Rates | | | |
| Interest paid | 11.00% | 11.00% | 11.00% |
| Interest on investment | 4.81% | 4.55% | 4.55% |
| **OTHER** | | | |
| Capital Borrowing expenditure | - | R4.53bn | R5.00bn |
| Equitable Share Allocation | R3.51bn | R3.38bn | R3.68bn |
| Fuel levy | R2.59bn | R2.73bn | R2.82bn |