# **BITOU LOCAL MUNICIPALITY**



Long Term Financial Plan

2022/23 - 2031/32





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# **TABLE OF CONTENTS**

TAB	LE OF CONTENTS	3
LIST	OF FIGURES	4
LIST	OF GRAPHS	4
LIST	OF TABLES	4
ABB	REVIATIONS USED	5
EXE	CUTIVE SUMMARY	6
1.	INTRODUCTION	.11
2.	OBJECTIVES OF THE LONG-TERM FINANCIAL PLAN	.12
3.	PERSPECTIVE	.13
S	patial & Demographic Perspective	14
E	conomic Perspective	. 14
Н	ousehold Infrastructure Perspective	. 17
Fi	inancial Perspective	. 17
4.	KEY FOCUS AREAS	20
5.	DEMAND FOR FUTURE CAPITAL EXPENDITURE	.32
6.	FINANCIAL MODEL	.35
7.	FUTURE MUNICIPAL REVENUE	.42
8.	FUTURE OPERATIONAL EXPENDITURE	.45
9.	AFFORDABILITY OF FUTURE CAPITAL EXPENDITURE	.47
10.	FUNDING OF FUTURE CAPITAL EXPENSES	.49
11.	ALTERNATIVE SCENARIOS	.52
12.	RECOMMENDATIONS	.63
ANN LOC SITU	IEXURE 1: INDEPENDENT FINANCIAL ASSESSMENT AGAINST THE BACKGROUND OF BIT AL MUNICIPALITY'S DEMOGRAPHIC, ECONOMIC & HOUSEHOLD INFRASTRUCTI JATION	TOU URE .71
ANN	IEXURE 2: BASE CASE SUMMARY PROJECTED FINANCIAL STATEMENTS	72
ANN	IEXURE 3: RATIO ANALYSIS	.75
ANN	IEXURE 4: VIABILITY FRAMEWORK	.80
ANN	IEXURE 5: ASSETS EARMARKED FOR REPLACEMENT	.84

# **LIST OF FIGURES**

FIGURE 1: PLANNING PROCESS	12
FIGURE 2: LTFM FRAMEWORK	

# LIST OF GRAPHS

GRAPH 1: BITOU: ANNUAL AVERAGE GVA GROWTH RATE % P.A	15
GRAPH 2: BITOU: COMPARATIVE ECONOMIC RISK (MRRI)	16
GRAPH 3: BITOU: COMPARATIVE HOUSEHOLD ABILITY TO PAY RISK (MRRI)	16
GRAPH 4: BASE CASE: BANK BALANCE IN RELATION TO MINIMUM REQUIRED LIQUIDITY LEVEL	40
GRAPH 5: BASE CASE: ANALYSIS OF SURPLUS	41
GRAPH 6: BASE CASE: GVA GROWTH P.A	43
GRAPH 7: BASE CASE: INCOME & EXPENDITURE	43
GRAPH 8: BASE CASE: EXPENDITURE ITEMS	46
GRAPH 9: BASE CASE: REPAIRS & MAINTENANCE EXPENDITURE	46
GRAPH 10: BASE CASE: CAPITAL AFFORDABILITY, RM P.A	48
GRAPH 11: BASE CASE: NEW DEBT RAISED	48
GRAPH 12: BASE CASE: FUNDING OF FUTURE CAPITAL INVESTMENT, RM P.A	50
GRAPH 13: BASE CASE: GEARING	50
GRAPH 14: BASE CASE: DEBT SERVICE TO TOTAL EXPENSE RATIO	51
GRAPH 15: SCENARIO: COLLECTION RATE IMPROVEMENT: BANK BALANCE	53
GRAPH 16: SCENARIO: COLLECTION RATE IMPROVEMENT: SURPLUS ANALYSIS	53
GRAPH 17: SCENARIO: INCREASED TARIFFS: BANK BALANCE	56
GRAPH 18: SCENARIO: INCREASED TARIFFS: SURPLUS ANALYSIS	56
GRAPH 19: SCENARIO: INCREASED TARIFFS: REVENUE & EXPENDITURE	57
GRAPH 20: SCENARIO: REDUCED OPEX: BANK BALANCE	58
GRAPH 21: SCENARIO: REDUCED OPEX: SURPLUS ANALYSIS	58
GRAPH 22: SCENARIO: REDUCED OPEX: REVENUE & EXPENDITURE	59
GRAPH 23: SCENARIO: EXTENDED LOAN TENOR: BANK BALANCE	60
GRAPH 24: SCENARIO: EXTENDED LOAN TENOR: GEARING	60
GRAPH 25: SCENARIO: REDUCED LOADSHEDDING: BANK BALANCE	62
GRAPH 26: SCENARIO: REDUCED LOADSHEDDING: SURPLUS ANALYSIS	63

# LIST OF TABLES

TABLE 1: SUMMARIZED BASE CASE FINANCIAL OUTCOMES	9
TABLE 2: SECTOR SHARE OF TOTAL GVA	15
TABLE 3: ASSUMPTIONS OF BASE CASE VARIABLES	37
Table 4: Loadshedding Impact	38
TABLE 5: BASE CASE FINANCIAL OUTCOMES	39
TABLE 6: SELECTION OF RATIOS (SEE ANNEXURE 3 FOR COMPLETE LIST)	40
TABLE 7: FORECAST AVERAGE ANNUAL GROWTH OF REVENUE ITEMS	44
TABLE 8: ESTIMATED 10-YEAR CAPITAL INVESTMENT & FUNDING	49
TABLE 9: SCENARIO: COLLECTION RATE IMPROVEMENT: OUTCOMES	52
TABLE 10: SCENARIO: INCREASED TARIFFS: OUTCOMES	55
TABLE 11: SCENARIO: REDUCED OPEX: OUTCOMES	57
TABLE 12: SCENARIO: EXTENDED LOAN TENOR: OUTCOMES	60
TABLE 13: SCENARIO: REDUCED LOADSHEDDING: OUTCOMES	61
TABLE 14: OPERATIONS FRAMEWORK	64



# **ABBREVIATIONS USED**

AFS	Annual Financial Statements
ARC	Asset Replacement Cost
CPI	Consumer Price Index
CRC	Current Replacement Cost
CRR	Capital Replacement Reserve
EAP	Economically Active Population
FY	Financial Year
FYE	Financial Year End
GVA	Gross Value Added
BLM	Bitou Local Municipality
IDP	Integrated Development Plan
INCA	Infrastructure Finance Corporation
IPM	INCA Portfolio Managers
LM	Local Municipality
LTFM	Long Term Financial Model
LTFP	Long Term Financial Plan
MRRI	Municipal Revenue Risk Indicator
MSCOA	Municipal Standard Chart of Accounts
MTREF	Medium Term Revenue and Expenditure Framework
NERSA	National Energy Regulator of South Africa
PPE	Property, Plant and Equipment
PPP	Public Private Partnership
Rm	Rand x 1 000 000
Rb	Rand x 1 000 000 000
SDF	Spatial Development Framework

# **EXECUTIVE SUMMARY**

## Introduction to the Report

- 1. This report contains the proposed long-term financial plan of the Bitou Local Municipality ("Bitou", "Bitou LM" or "BLM"). It is submitted to the municipality for its consideration and adoption.
- 2. The proposed plan was preceded by an Independent Financial Assessment of Bitou LM prepared by INCA Portfolio Managers in January 2023, drawing on the audited financial statements for the past 8 years up to FYE2021/22. This assessment is attached as Annexure 1. The report in Annexure 1 includes a summary of the latest available information on the demography, economy and household infrastructure of the BLM. Based on the findings of the Independent Financial Assessment, Bitou LM finds itself in a reasonable financial position, however there is underperformance on certain key metrics, creating financial risks. The underperformance is driven by low collection rates, a severely deteriorating liquidity position, high creditor payment days ratios and consistent cash shortfalls on the minimum liquidity requirements. The municipality's solid performance in the provision of municipal services over the review period, which resulted in decreased levels of infrastructure backlogs, is at risk of being undone should the underperformance not be addressed.
- 3. Bitou LM achieved a shadow credit rating of **4.7** on the INCA Shadow Credit Rating Model. This is "Investment Grade" and equates to a rating of **BBB-** on the National Credit Ratings Scale. With a history of unqualified audit reports with findings BLM should have the ability to access external borrowing at reasonably competitive rates.
- 4. The municipality's cash needs compared to the operating cash flows it can expect to generate, based on the economy and population of the sub-region, was modelled. This forms the basis to determine the future financial sustainability of the municipality.
- 5. A number of potential outcomes or scenarios were modelled. The "MTREF Case" forecasts sustained Operational Deficits driven by high increases of electricity bulk purchases due to NERSA tariff increases for the next two financial periods which may not be fully passed on to the consumer.
- 6. The drivers or variables causing some of the negative impacts on the MTREF case, were addressed and presented as the Base Case Model. This includes measures to improve the poor liquidity position, as well as the overdraft position the municipality is expected to find itself in. The collection rate was increased, while electricity and water distribution losses were reduced. While the MTREF capital investment was unchanged, the MTREF period funding mix was altered to incorporate an increase in borrowings with the aim of significantly alleviating pressure on cash reserves. The NERSA tariff increases were incorporated into the Base Case Model, and consequently the corresponding tariffs that



will be passed onto the consumer were increased accordingly. Finally, a Loadshedding impact scenario was incorporated into the Base Case. These assumptions will be discussed in more detail in **Section 6** of this report.

7. This LTFP report includes the effects of the ongoing energy crisis and how it has impacted on the financial position of the municipality. Our recommendations are aimed at guiding the municipality towards long-term financial sustainability while navigating the financial and operational challenges presented by the lack of electricity supply and consequent loadshedding. The model continues to assess the potential impact of unexpected events and a range of operational and policy responses to help mitigate these impacts.

# Key Findings

- 8. The following summary observations, pursuant to the *Independent Financial Assessment* for the historic period FYE2014/15 to FYE2021/22 and the interpretation of the socioeconomic and infrastructure data published by *IHS Global Insight Rex* database, were made:
  - 8.1. Bitou has a total population of approximately 65 660 (2021) growing at 2.87% per annum over the last 5 years. 58.4% of the population falls in the working age group of 25 64 years with 42.8% of the population being regarded as economically active.
  - 8.2. Annual per capita income of R 83 716 is low in the district (R 99 108) and provincial (R 100 034) contexts. Approximately 25.6% of all households have an income of less than R 42 000 p.a. and, in theory, should qualify for free basic services.
  - 8.3. The Official Unemployment Rate of 35.5% for 2021 exceeds that of the district (26.0%), province (24.8%) and country (33.6%). This is a concerningly high figure and is showing a worrying trend, with a 14.5% increase since 2018. The Official Unemployment Rate employs a narrow definition which excludes discouraged workers and those not actively searching for work, thus in actuality this rate is considerably higher.
  - 8.4. The local economy (GVA) amounted to R 6.13 billion in 2021, comprising 9.2% of the Garden Route District economy. The local economy is underpinned by the Finance, Community Services and Trade sectors which together contribute 67.7% of Bitou's total GVA. Bitou's 5-year economic movement has essentially been idle, with a 5-year average **contraction** of 0.2%. The municipality's Tress Index of 49.24 is indicative of a reasonably diversified economy.
  - 8.5. There was a decline in the total number of formally employed people to a total of 15 282 people in 2021. Employment in Bitou is driven by the Trade, Finance and Community Services sectors with 56.8% of jobs being produced by these three sectors.



- 8.6. Total tourism spend saw a significant increase in 2021, to a total of R1.81 billion, despite the total number of trips declining for the second consecutive year. The integral nature of the tourism sector to the local economy is underpinned by a total GVA contribution of 27.32% in 2021.
- 8.7. The municipality's service delivery improved significantly during the review period, with reduced backlogs in the provision of all services, with the exception of refuse removal services.
- 8.8. The liquidity ratio was acceptable for the period between 2015 and 2019, after which there has been a considerable deterioration with a ratio of just 1.05:1 in FY2020/21 & FY2021/22. This is well below the NT benchmark range of 1.5:1 to 2:1. The current liquidity position poses a significant financial risk.
- 8.9. The municipality has successfully deleveraged its debt profile throughout the review period, reducing its gearing ratio from 29% to just 10% over the 8-year period. The affordability of the current debt profile provides scope to accelerate the external borrowing programme.
- 8.10. The collection rate was 83% as at FYE2022, with a 5-year average of just 79%. This is well below the NT benchmark of 95%. Debtor days came to 31 days at year-end, in line with the NT norm of 30 days. Creditor payment days totalled 104 days at year-end, greatly exceeding the NT norm of 30 days.
- 8.11. Unencumbered cash and cash equivalents fully covered the minimum liquidity requirements in just two of the eight years under review, resulting in significant cash shortfalls for the remainder of the review period. This is of major concern and leaves the municipality vulnerable to potential financial shocks.
- 8.12. Financial performance was generally acceptable throughout the review period. However, upon the exclusion of capital grants, operating deficits have been realised in three of the most recent four years, highlighting the recent deterioration in financial performance and reliance on grant funding.
- 8.13. Bitou LM managed to generate cash from its operations throughout the review period, with the exception of FY2019 in which cash utilisation was realised.
- 8.14. As the main income contributor, contributing an average of 24% p.a. of revenue, electricity services maintained an average surplus margin of 22% for the review period however, there has been a declining trend since FY2019.
- 8.15. Expenditure on repairs and maintenance as a percentage of property plant and equipment averaged 3% over the review period. This is well below the NT benchmark of 8%.



- 8.16. Heavy reliance has been placed on capital grants and own cash to fund capital expenditure, with no external financing undertaken since FY2018. The cumulative capital expenditure amounted to R670.2 million for the 8-years under review.
- 8.17. Bitou LM underspent on its capital budget throughout the same period, with actual capital expenditure as a percentage of budgeted capital expenditure being consistently below the NT norm range of 95% and 100%.

#### Conclusions drawn from Financial Model

A long-term financial model was developed, based on the FY2021/22 Audited AFS of the municipality and populated with several assumed variables. A summary of the outcome of the Base Case of the model is presented in <u>TABLE 1</u> below.

Outcome	10-Years up to 2032
Average annual % increase in Revenue	6,9%
Average annual % increase in Expenditure	4,6%
Accounting Surplus accumulated during Planning Period (Rm)	R 60
`Operating Surplus accumulated during Planning Period (Rm)	-R 280
Cash generated by Operations during Planning Period (Rm)	R 508
Average annual increase in Gross Consumer Debtors	23,5%
Capital investment programme during Planning Period (Rm)	R 841
External Loan Financing during Planning Period (Rm)	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203

#### TABLE 1: SUMMARIZED BASE CASE FINANCIAL OUTCOMES

9. In the *Base Case Scenario*, the municipality will, over the 10-year planning period from FY2022/23 to FY2031/32 realise an Accumulated Operating deficit of R 280 million, generate Cash from Operations of R 508 million and can afford a Capital Investment Programme of R 841 million.

#### Recommendations

- 10. **Chapter 12** of the main report lists a comprehensive list of recommendations. These recommendations are based on the historic independent financial assessment and long-term financial model. In summary, a financial plan is recommended with the following focus areas:
  - 10.1. Improve the liquidity position through implementing measures to improve the efficacy of collection procedures, whilst reducing pressure on cash reserves through fostering an optimal funding mix with prudent use of external financing.



- 10.2. Ensuring that all applicable consumers are billed, at the correct amounts and that this revenue is collected.
- 10.3. Develop a cost-reflective tariff model and ensure that the full costs of providing all services are shared by as many households as possible.
- 10.4. Develop clear policies for the implementation of the capital budget, ensuring projects that promote economic growth are prioritized.
- 10.5. Reduce distribution losses for water and electricity services through safeguarding of infrastructure, fostering a proactive approach to maintenance and policing of illegal activity that contributes to these losses.
- 10.6. Ensure stringent management of operating expenditure, with a particular focus on expenditure that is efficient, prioritized, and targeted.



# 1. INTRODUCTION

- 1.1. This Long-Term Financial Plan report is prepared by INCA Portfolio Managers ("IPM") with part-funding being provided by the INCA Capacity Building Fund (ICBF), a not-for-profit company established in 1998 as a joint venture between Infrastructure Finance Corporation Limited (INCA) and Agence Française de Development (AFD). The funding of the report, as mentioned in the Introduction for the Independent Financial Assessment (IFA), is through the recapitalisation grant that has been received by SECO.
- 1.2. The second phase of this assignment, undertaken by INCA Portfolio Managers ("IPM"), is to develop a Long-Term Financial Plan ("LTFP") of Bitou Local Municipality for a period of 10 years from 1 July 2023 to 30 June 2032, based on a Long-Term Financial Model ("LTFM").
- 1.3. In this assignment, a historic financial assessment of the municipality with the financial information up to 30 June 2022 has been included.
- 1.4. The recommendations provided later in this report reflect the outcomes of the analysis and aim to enhance the long-term financial sustainability of Bitou LM.
- 1.5. The following sources of information have been scrutinised and taken into consideration in the Independent Financial Analysis (IFA) and the development of this LTFP:
  - a. The audited financial statements for the years ending 30 June 2013 to 30 June 2022
  - b. Bitou LM Adjusted Budget Report: FY2022/23-FY2024/25.
  - c. The Medium-Term Revenue & Expenditure Framework FY2022/23 FY2024/2025.
  - d. Various other documents of the municipality that are publicly available.
  - e. Economic, demographic and household infrastructure data extracted from *IHS Global Insight's Regional Explorer*.

# 2. OBJECTIVES OF THE LONG-TERM FINANCIAL PLAN

- 2.1. The purpose of a long-term financial plan is to recommend strategies and policies that will maximise the probability of the municipality's financial sustainability into the future. This is achieved by forecasting future cash flows and affordable capital expenditure based on the municipality's historic performance, future plans and the environment in which it operates.
- 2.2. The plan provides guidelines, within the context of an uncertain future, of what the municipality can afford.
- 2.3. The generic process (adapted for each municipality pending availability of data) that was followed in reaching the objective of the Long-Term Financial Plan, is illustrated in the diagram below:



# **3. PERSPECTIVE**

An assessment of the Bitou LM historic financial performance for the period 2015 to 2022 is presented in more detail in Annexure 1: <u>Bitou Local Municipality:</u> <u>Independent Financial Assessment against the Background of the Municipality's</u> <u>Demographic, Economic & Household Infrastructure Situation, June 2022.</u> The BLM is characterized by the following socio-economic and financial indicators:

- The total Population of 65 660 (iHS 2021), represents 9.66% of people living in the Garden Route District. 5-year average population growth is 2.87%. Approximately 58.4% of the population falls in the working age group of 25 64 years with 42.8% of the population being regarded as economically active.
- **Annual per capita income** of R 83 716 is low in the district (R 99 108) and provincial (R 100 034) contexts. Approximately 25.6% of all households have an income of less than R 42 000 p.a.
- The Trade, Finance and Community Services are the main drivers of the local economy and contributes approximately 67.7% to the **Gross Value Add** (GVA).
- **Unemployment Rate** of 35.5% exceeds the Provincial unemployment rate of 24.8% and National rate of 33.6%. This is a narrow definition of the unemployment rate, in actuality it is much higher.
- Weak *liquidity ratio* of 1.05:1 as at FYE2021/22, which is below the NT benchmark range of 1.5:1 to 2:1.
- The *collection ratio* as at FYE2022 was 83%, this is below the NT benchmark of 95%.
- Analysis of financial performance reveal that on exclusion of capital grants, the municipality made *operating deficits* in 3 of the most recent 4 years, while *cash was generated by operations* in each year under review except for FY2018/19.
- **Cash vs Minimum Liquidity Requirements:** Unencumbered cash and cash equivalents fully covered the minimum liquidity requirements in just 2 of the 8 years under review, with a cash shortfall of R 58 million for FYE2021/22.
- Overall, the financial indicators reflect a rapidly deteriorating financial position, however, there is a clear path to the improvements that need to be made, in order to bring the municipality into a situation of financial sustainability.
- 3.1. An assessment of Bitou Local Municipality's historic financial performance for the period 2015 to 2022 is presented in more detail in Annexure 1: <u>Bitou Local Municipality:</u> <u>Independent Financial Assessment against the Background of the Municipality's</u> <u>Demographic, Economic & Household Infrastructure Situation, June 2022.</u> This is summarised below:

# **Spatial & Demographic Perspective**

- 3.2. Bitou's Total Population increased from 46 785 in 2012 to 65 660 in 2021.
- 3.3. 5-year average population growth rate of 2.87% is the highest of the municipalities within the district and higher than the provincial (1.62%) and national (1.44%) rates.
- 3.4. 58.4% of the population falls in the working age group of 25 64 years with 42.8% of the population being regarded as economically active.
- 3.5. Bitou's annual per capita income of R 83 716 is higher than that of the country (R 73 121) but is lower than that of the district (R 99 108) and province (R 100 034).
- 3.6. 25.6% of households in Bitou earn an annual income of below R 42,000 p.a.
- 3.7. The unemployment rate which increased to 35.5% in 2021, from 25.8% in 2020, is high in the provincial (24.8%) and national (33.6%) contexts. The increasing trend in unemployment is more pertinent, and of more concern, than the absolute level of unemployment in the municipal area.

## **Economic Perspective**

- 3.8. Bitou's local economic output, i.e., Gross Value Add (GVA) of R 6.13 billion represents approximately 9.2% of the district economy and just 0.8% of the provincial economy. GVA annual growth has been stagnant (-0.2% p.a.) over the most recent five years.
- 3.9. Concerningly, the 5-year average population growth rate exceeds the GVA growth rate over the same period.
- 3.10. The local economy is largely underpinned by the Trade, Finance and Community Services sectors which constitute a combined 67.7% of the GVA.
- 3.11. Trade is the predominant provider of employment with 3 363 people (22%) employed by this sector.
- 3.12. Tourism trips declined to 72 214 trips in 2021, with trips for leisure/holiday purposes seeing the biggest decline. Tourism spend saw a significant resurgence after the Covid-19 effected 2020, to a total of R1.81 billion in 2021. This represents 27.32% of total GVA, making it the single largest GVA contributor, highlighting the integral nature of the tourism industry to the municipal economy.

#### TABLE 2: SECTOR SHARE OF TOTAL GVA

Sub Sector	2012	2021
1 Agriculture	3,2%	3,9%
2 Mining	0,1%	0,0%
3 Manufacturing	12,0%	10,5%
4 Electricity	1,2%	0,9%
5 Construction	12,6%	9,5%
6 Trade	22,9%	21,6%
7 Transport	7,5%	7,3%
8 Finance	21,0%	24,3%
9 Community services	19,6%	21,8%

GRAPH 1: BITOU: ANNUAL AVERAGE GVA GROWTH RATE % P.A.



- 3.13. IPM has developed the Municipal Revenue Risk Indicator ("MRRI"), which measures the risk of a municipality to generate its own revenues. This risk is on the one hand a function of the economy (size of the economy as measured by the GVA per capita, GVA growth rate and Tress Index) and on the other a function of households' ability to pay (measured by the % of households with income below R 42 000 p.a., unemployment rate and Human Development Index).
- 3.14. The economic contraction and the ability of households to pay for services delivered by the municipality, rates BLM as a "**High**" risk on IPM's Municipal Revenue Risk Indicator scale. There is a high risk that the municipality will not be able to generate enough own revenue in future. Additionally, Bitou's economy is not highly diversified, while

unemployment is extremely high. This indicates that the ability-to-pay risk is high, as evidenced in the decrease in collection rate in recent years.

The following graphs illustrate Bitou's relative position in comparison to the other local municipalities in the Garden Route District. Scrutiny of the two below graphs reveals that on balance, in the district context, Bitou has the most significant risk of not being able to generate its own revenues in future.



GRAPH 2: BITOU: COMPARATIVE ECONOMIC RISK (MRRI)



GRAPH 3: BITOU: COMPARATIVE HOUSEHOLD ABILITY TO PAY RISK (MRRI)

# **Household Infrastructure Perspective**

- 3.15. The level of service delivery as expressed by the Infrastructure Index for Bitou LM increased from 0.82 in 2012 to 0.87 in 2021, higher than the national (0.76) index, but lowest within the district.
- 3.16. Bitou LM outperformed the Garden Route District in the provision of electricity and sanitation services, while underperforming in the provision of water and refuse removal services. BLM managed to reduce the level of backlogs in all services over the review period, except for refuse removal services.
- 3.17. The rate of household formation in Bitou between 2012 and 2021 was 34.8%, the highest in the district by a substantial margin. This equates to a total of 5 610 additional households to a total of 21 746 households in 2021. The municipality must be commended for improving its Infrastructure Index over the review period, in light of such a rapid increase in household formation.
- 3.18. The percentage of households with access to a level of service of RDP or higher, is lower than the percentage of households with income above the R 42,000 p.a. bracket, i.e., 86.6% vs. 90.6%. The 4-percentage point difference is relatively large and indicates an imbalance between the level of service delivery and household income on average. This may indicate that the municipality is not billing enough and in theory missing out on potential revenue that can easily be collected, i.e., the level of services provided to residents with the ability to pay, is lower than the minimum (RDP) level provided for through the Equitable Share.

# **Financial Perspective**

# Financial Position

- 3.19. The liquidity ratio fluctuated between a peak of 1.78:1 FY2016/17 and a low of 1.05:1 in both FY2020/21 & FY2021/22. This is concerningly low and does not meet the NT norm requirement of 1.5:1.
- 3.20. The municipality realised cash shortfalls on the minimum liquidity requirements in six of the eight years under review. This is of concern and is partly as a result of extensive use of cash reserves to fund capital investment.
- 3.21. The collection ratio as at FYE2021/22 was 83%, which is well below the minimum NT benchmark of 95%, whilst Net Debtor days stood at 31 days at year-end, in line with the NT benchmark of 30 days. Net Creditor days were 104 days at year-end, considerably more than the 30-day NT benchmark.

## Financial Performance

- 3.22. On exclusion of capital grants, the municipality realised operating deficits in three of the last four years under review. This is indicative of an increased reliance on grant funding in recent years, coupled with deteriorating financial performance.
- 3.23. Bitou managed to generate cash from its operations throughout the review period with the exception of FY2018/19, in which cash of R29.0 million was utilized.
- 3.24. BLM managed to maintain gross surplus margins on water and electricity services throughout the 8-year period. As the main income contributor, electricity services maintained a gross surplus margin averaging 22% over the 8-year period, with a declining trend noted since FY2018/19. Water Services maintained an average gross surplus margin of 100% over the same period, since the municipality makes use of its own water sources and no water was purchased by the municipality.
- 3.25. Staff costs as a percentage of total operating expenditure increased over the review period and were below the NT norm range between 30% and 40% for FY2021/22. However, when the current year contracted services contribution of 12.7% is considered, the NT maximum benchmark is exceeded.
- 3.26. Expenditure on repairs and maintenance as a percentage of property plant and equipment was 4% as at FYE2021/22, below the NT benchmark of 8%.

#### Cash Flow Statement

- 3.27. Cumulative Capital expenditure of R 670.2 million over the 8-year period was primarily funded by capital grants (62%), followed by own cash (25%) and external financing (13%).
- 3.28. Bitou LM consistently underspent on its capital budget throughout the same period, with actual capital expenditure as a percentage of budgeted capital expenditure being on average 83%, well below the NT norm range of 95% and 100%.

#### **Cash Forecast**

- 3.29. The municipality has budgeted for increasing operating surpluses from R 7.2 million in FY2022/23 to R105.2 million in FY2024/25. Although a positive trend was observed since FY2020/21, it seems unlikely that the extent of the improving trend depicted in the MTREF will materialize.
- 3.30. The MTREF **current ratio** is budgeted to improve from 1.05:1 in FY2021/22 to 2.9:1 in FY2024/25. Unless drastic improvements are made, this seems highly unlikely given the decreasing trend in the municipality's liquidity ratio and collection rate.

- 3.31. Capital expenditure is budgeted to fluctuate between R76.2 million and R120.3 million, based on the FY2022/23 MTREF. The budgeted funding mix does not seem realistic due to the municipality's current liquidity constraints and weak cash position. The budgeted capital expenditure programme could be achieved, but the level of borrowings will need to be significantly increased in order to do so.
- 3.32. Cash and cash equivalents are forecast to increase in FY2022/23 to R 113.2 million and increase further to R 324.3 million in FY2024/25. Given the municipality's current cash position, low collection rate and the budgeted use of cash to fund capital investment, these increases seem unlikely.

# 4. KEY FOCUS AREAS

Due to geographical restrictions and the ease with which virtual business meetings were accepted during the COVID-19 situation, IPM did not meet with the municipality in person. However, IPM and municipal staff met in a series of virtual meetings during April 2023. The final outcomes of this report and the presentation thereof will be delivered in person, however.

This section summarizes the key issues raised and discussed during the meetings with the Bitou LM directorates. This is an important part of the LTFP process and helps the team to get a better understanding of key issues the municipality is dealing with. Importantly, it ensures that the desktop work, the outcomes of the LTFM and the recommendations are aligned with the realities at ground level. This section does not necessarily capture all of the matters raised but focuses on matters which will potentially impact (positively or negatively) on the long-term financial position of the Bitou LM.

This section is organised as follows:

- Points of Departure
- Rapid Expansion and Development
- Financial Matters
- Infrastructure and Technical Services
- Organisational, Institutional and Corporate Services
- Other Matters

# 4.1. Points of Departure

- 4.1.1. Bitou LM operates in a complex and dynamic socio-economic environment. To formulate a coherent long-term plan, one must recognise the following key characteristics underpinning the developmental, socio-economic, institutional, and financial challenges. Whilst some are typical of South African urban environments, the municipality faces some unique challenges:
  - The Bitou LM area of responsibility is small covering a geographical area of 992 km<sup>2</sup>, the smallest in the Garden Route by a considerable margin. The small geographical area lends itself to a high population density of 66.2 people/km<sup>2</sup>.
  - There are varying levels of development within the municipality, ranging from more developed towns such as Plettenberg Bay, to rural areas such as Kurland. This requires a focused and prioritised approach to ensure services are delivered, regardless of the disparities in household types.
  - Bitou LM has experienced a rapid increase in the number of households within the municipality over the last 10 years, with household formation of 34.8%. The trend of urbanisation is rapidly increasing demand for housing and land and the municipality is struggling to keep up with this added demand. As a result, informal settlements

have been established. This further strains the municipality's financial position due to the resultant increase in illegal electricity and water connections which lead to losses in revenue, damaged infrastructure and thus increased repair costs.

- A consequence of Bitou LM's geographical location, is that the municipality is the first stop into the Western Cape from places such as the Eastern Cape, resulting in an influx of people seeking improved service delivery and job opportunities. An added complication is the fact that the majority of the population moving into Bitou would be considered of indigent status and thus would not have the ability to pay for services. This heavily impacts on the municipality's financial position as well as increases strain on the municipality's ageing infrastructure. It is clear that further investment is required to develop and improve existing infrastructure to be able to meet the required levels of service delivery.
- From a municipal perspective, most concerning is the severely aged infrastructure for water and electricity provision as well as the roads management. While the management of major roads leading into the municipality are under the province's mandate, it is in Bitou's interest to ensure that the access roads flowing into the municipality are of the required standard and condition. This is of utmost importance in creating the desired environment and impression for residents and tourists alike. Roads have been built without a stormwater drainage system which is problematic as the risk of floods is severely increased in this situation, thus threatening the safety of residents as well as leading to severe damage to already ageing infrastructure.
- The energy crisis is wreaking havoc on the municipality's electricity infrastructure, with consistent interruptions to energy supply causing significant damage. In an effort to alleviate some of these struggles, the municipality has included the possibility of implementing renewable energy projects through IPPs in the Electricity Masterplan. This may provide a solution to the current energy constraints, further exploration regarding funding, the potential for PPPs and market appetite is being assessed. It must be noted that this will be a medium to long-term solution, with implementation not viable in the short-term.
- This LTFP is the first such exercise that Bitou LM has undergone for a number of years, with the last engagement taking place in 2017. This strategic document should be consulted whenever needs are assessed, policy decisions are made, and resources allocated. Developing a strong planning approach and discipline to manage these processes and its results could assist in the optimization of the municipality's potential.

# 4.2. Rapid Expansion and Development

4.2.1. A theme throughout this section of this report will be the rapid rate of household formation and resultant population influx, many of whom are of indigent status, into Bitou LM. As mentioned in the IFA report, the high rate of household formation of 34.8% since 2012 has significantly increased demand for municipal services and as a result massive strain has been placed on the municipality to provide these services.

- 4.2.2. The geographical location of Bitou, as well as the perception of a higher level of service delivery and opportunities present in the Western Cape, has contributed to the substantial influx of people who are looking for opportunities for work and to improve their living conditions. Bitou is the first stop into the Western Cape from other provinces such as the Eastern Cape and as such, has experienced the largest population influx in the Garden Route District over the last 10 years.
- 4.2.3. The increasing number of residents of indigent status creates further complications for the municipality, as these residents increase the demand for municipal services but do not contribute to the funding of these services. This places huge strain on municipal finance and infrastructure.
- 4.2.4. The municipality cannot keep up with the increasing demand for affordable housing and land due to the huge population influx as well as a current lack of land availability. This is contributing to further increases of the approximate 8 000 housing backlog.
- 4.2.5. The combined effect of the population influx and lack of housing and available land is the increased number of informal settlements, illegal land occupations and invasions. It has been mentioned that the municipality has begun the implementation of measures to combat these issues. The efficacy of these measures must be assessed and improved upon if the desired results are not being achieved.

# 4.3. Financial Matters

# General:

- 4.3.1. It is clear from the IFA submitted earlier that Bitou LM's financial position has deteriorated in recent years. Based on the MTREF and the forecast from the LTFM, it is now also clear that without any corrective and effective measures by Bitou LM, this negative trend can quickly spiral, and the financial position of the municipality will become unsustainable.
- 4.3.2. Political instability continues to severely hinder the financial performance of the municipality. Lack of continuity in management creates opportunities for financial mismanagement and corruption. The municipality would benefit greatly from a more stable political environment in which key personnel are maintained and are given fair and sufficient opportunity to execute on their plans that are aimed at improving the financial position of the municipality.
- 4.3.3. Before turning to proposed solutions, it is necessary to identify the key factors contributing to this situation. There are a range of complex factors involved and although a focused long-term approach is required to turn the situation around, it would be helpful to develop a prioritized and sequenced series of interventions focusing on the immediate, short, medium and long-term. In the LTFM we demonstrated the impact of some of the proposed interventions. The LTFM is used



to shape the LTFP and help with strategic decisions to ensure the interventions and implementation thereof are effective.

- 4.3.4. The key financial risk factors are:
  - Low collection rate
  - Declining surplus margins and high technical losses
  - Outstanding debtors, majority of which are older than 90 days (77%)
  - High creditor days
  - Increased pressure on revenue base
  - High reliance on grants and own cash reserves to fund the capital investment programme
  - Inability to implement capital investment programme
  - Cost of living increases causing reductions of the revenue base
  - Incomplete valuation roll
  - Inaccurate billing
- 4.3.5. It is important to note that all these risk factors are interrelated, and an integrated approach would be required to ensure an effective change in the financial trajectory of Bitou LM. However, it is also evident that some of the matters can be addressed immediately, are reasonably easy to implement and have a measurable impact on the financial position of the municipality.
- 4.3.6. Based on the outcomes of the scenarios in the LTFM, it is recommended that a phased prioritized intervention strategy be followed. Broadly, it could be as follows:

Immediate- and short term (stabilisation):

- Confirmation of correct billing details for debtors and updating of database.
- Normal collection practices to be applied with discipline, including preparation of bills, meter reading, sending out of bills, follow-up notices on outstanding amounts, and if required, disconnection of services.
- Conduct analysis on operational expenditure, reducing where possible.
- Monthly audits on billing to be conducted.
- Provide clear accurate communication to residents explaining the above approach.
- Curb technical losses on both electricity and water services through improved policing, safeguarding infrastructure and effective law enforcement with other security agencies.
- Utilise the scope for accelerated external financing to reduce reliance on cash reserves to fund capital investment.
- Review and implement an updated liquidity policy, the implementation of thereof must be conducted with discipline.

Shorter- to medium term (normalisation):

- Improve billing accuracy and reliability by upgrading and installing pre-paid metering systems.
- Improve billing distribution process and regular issuing of bills.
- Implement a prioritised maintenance programme.
- Conduct further analysis to determine the true cost of supply of municipal infrastructure services, with a view of implementing cost-reflective tariffs. This can be achieved through undergoing a detailed tariff modelling process.
- Outsourcing the management of the Plettenberg Bay Airport.
- Ensure market related charges for rentals of investment property, otherwise consider disposals of non-revenue generating investment property.
- Improve accuracy of indigency classification and verification.
- Verify indigent cases, particularly within sub-economic areas to avoid excessive loss of electricity revenue.
- Conduct review of overtime expense, the implementation of a shift system is recommended.

Longer term (expansion and sustainability):

- Reduce the housing backlog, enabling residents to contribute to and join the rate payer base.
- Identify new sources of revenue, e.g. renewable sources of energy generation.
- Expand the rate payer base through continuing to develop the municipality as an attractive destination for rate-contributing residents.
- Further expansion of the rate payer base can be achieved through capitalising on the increased demand for retirement villages.
- Ensure valuations are accurate prior to the implementation of a new valuation roll.
- Ensure the supplementary valuation roll is complete, all properties must be included and charged.
- Provide sufficiently for correction of errors in the valuation roll to avoid unnecessary costs.
- Implement a formal capital investment prioritisation programme, aimed at investment in capital projects that will create an enabling environment for economic growth, this will further contribute to the expansion of the revenue base.

# Funding of capital expenditure:

4.3.7. A key objective of the LTFP is to ensure that Bitou LM is financially sustainable, and able to accelerate its capital expenditure programme to meet the infrastructure needs. To achieve this, municipalities need to borrow within the normal fiduciary limits as determined by National Treasury.

- 4.3.8. Our approach to municipal borrowing is in line with the guidelines from National Treasury, i.e. municipalities should borrow within the fiduciary limits and not deplete cash reserves to fund long-term infrastructure assets. The IPM model forecasts the future capex that a municipality can afford; based on the operational cash flows it can expect to generate, and within the financial ratio guidelines from National Treasury.
- 4.3.9. IPM encourages municipalities to make use of external financing for infrastructure capital expenditure. It is our view that the use of affordable external financing with appropriate loan tenors is the correct financing method for funding the capital investment programme. Extensive utilisation of cash reserves for this purpose not only depletes available cash reserves but diminishes the liquidity position of the municipality. Bitou LM is not in a financial position to further strain its liquidity. The LTFP aims to stabilize and expand the revenue base of the municipality, ensuring that revenue collection is optimized and that the financial position of the municipality is secured. This will increase the likelihood of the municipality accessing competitive lending rates from the external market, which will unlock the acceleration of the capital investment programme.
- 4.3.10. It is recommended that Bitou LM considers the financing strategy and limits determined in the LTFM dealt with in Chapter 10 below. The outcomes of the modelling that has been performed, indicated that if the optimal capital funding mix that has been proposed (such as taking up more substantial external borrowings and being less reliant on grant funding) is maintained and managed prudently, the capital investment programme will remain affordable and once the financial situation of the municipality has improved, can be accelerated. Chapter 11 includes a scenario in which the impact of an extension of the average loan tenor on new debt was assessed. This is a strategy that the municipality must explore as the benefits that can be derived could potentially directly contribute to the strengthening of one of the municipality's main weaknesses, being the liquidity position.

# Tariff model:

- 4.3.11. IPM is currently in the process of developing a detailed Tariff Model. Once the institutionalisation of this has come to pass, this will be of immense value to the municipality in ensuring that tariffs are cost-reflective and that sufficient revenue is generated.
- 4.3.12. A detailed tariff modelling process, combined with accurate and efficient billing and collections, will have a tremendous impact on revenue generation and as a result, the financial position of the municipality.

#### 4.4. Infrastructure and Technical Services

#### **Electricity infrastructure:**

- 4.4.1. For many years, the infrastructure of the electrical grid in Bitou LM has been serviced as and when breakdowns occurred, with the municipality employing a reactive rather than a proactive approach to maintenance. This, coupled with increased damage due to loadshedding, has contributed to many electricity infrastructure assets being in critical need of replacement (approx. R14 million worth). The risk of failure of these assets is rapidly increasing, as the demand for the provision of electricity services has increased with the population influx into the municipality.
- 4.4.2. Electricity provision is one of the main revenue generating streams of municipalities country wide, and failure to properly provide access to such a big revenue generating source is a risk for the sustainability of the entire municipality. It is no surprise that the energy crisis and consequent loadshedding, that the constant switching between on and off is causing further damage to infrastructure. This further emphasises the need for a proactive approach to the maintenance of the municipality's electrical infrastructure.
- 4.4.3. The high rate of household formation and influx of new residents into Bitou has placed the electrical grid infrastructure under increased strain and has contributed to capacity constraints. In order for the municipality to keep pace with the increased demand for the provision of electricity services, an expansion of current capacity will need to be considered. Renewable energy IPP projects are currently under consideration, these must be explored further.
- 4.4.4. Another portion of the electrical system that needs upgrading, and that assists with revenue collection, is the pre-paid metering systems. There are areas in the municipality in which access is difficult to obtain resulting in readings not being taken, a challenge which pre-paid meters may address. Safeguarding one of the primary revenue streams of the municipality should be of paramount importance and assist the municipality in collecting revenue from residents. It may result in making illegal connections more difficult, collecting revenue more efficient and reduce expenses in terminating illegal connections.
- 4.4.5. A key element of the plan to limit potential electricity losses is to provide legal electrical connections to informal households as part of the of the upgrading process. This approach must however go together with programmes which strongly discourage further illegal connections, meter tampering and damage to infrastructure. This is a process that is already underway and is a contributing factor to a reduction in electricity distribution losses.

#### Water and sanitation services and water losses:

- 4.4.6. The municipality experiences many challenges regarding the provision of water and sanitation services, these challenges rain from external, uncontrollable challenges such as the lack of rain in the Garden Route, to inaccurate billing and damaged, ageing infrastructure. Water losses in Bitou LM totalled 37.71% according to the FY2021/22 Audited AFS. This is very high and notwithstanding the many challenges facing the municipality, needs to be urgently reduced.
- 4.4.7. A significant portion of the high level of water losses may be attributable to faulty meters and inaccurate billing. It is recommended that a full water audit is conducted to assess the main drivers and nature of water losses. It is critical that the municipality addresses the issue of inaccurate billing as this is contributing to a significant loss of revenue, which the municipality cannot afford. Lack of access to certain areas is also a contributing factor to water losses as the municipality is unable to take readings of water meters in these areas.
- 4.4.8. As previously mentioned, it is recommended that the municipality undergoes an indigent classification and verification process to ensure that not only are verified indigents receiving the support that they require in the provision of water services, but also to ensure that the municipality is not losing out on additional revenue through residents who do not qualify for indigency receiving free services. Maintenance support to indigent households will contribute to the reduction of water losses through limiting wastage through leaks as an example.
- 4.4.9. The rapid expansion of households within the municipality has also highlighted the need to improve and upgrade the existing water network. Urban areas such as Plettenberg Bay have seen an increase in formal housing and this provides an opportunity for the municipality to increase its operational revenue through service charges.
- 4.4.10. Long-term financial sustainability depends not only on ensuring that revenue collection remains high, but that the full cost of services (capital, maintenance, and replacement) be shared by as many households as possible.
- 4.4.11. An added complication that the municipality is faced with, is the current situation of the Roodefontein Dam. This is the primary water source of the municipality, and it is shared with the Griekwa Settlement. The complication therein is the fact that while Bitou is allocated a certain percentage of the dam to supply the municipality with water, the Griekwa community, which includes many farmlands, enjoys unregulated usage. This creates significantly increased pressure on Bitou, particularly in an environment of water restrictions, as the municipality's usage is further limited. This must be addressed with the Western Cape province as the current situation creates a significant water security risk for Bitou LM.

4.4.12. Sanitation and wastewater infrastructure is ageing and is often subject to sabotage that is exacerbating the current situation through further damaging infrastructure. The reasoning for such sabotage may be political, or potentially due to general littering and ignorance. Regardless of the reasoning for such sabotage, measures need to be implemented to limit this damage. General education campaigns may be beneficial in this regard.

## Service delivery models:

- 4.4.13. From the discussions it appears that there is cautious support for new infrastructure delivery models, and particularly models which provides for greater private sector participation. In this regard we noted for instance the possibilities of the development of renewable energy IPP projects to mitigate the impact of the energy crisis.
- 4.4.14. During the discussions Bitou LM indicated the potential for PPP models to be utilised in the development of these projects. IPM suggests that the potential for these models be explored further and not be limited to these projects, but also for projects whereby the municipality may not have the required expertise and where private sector involvement might be better suited.
- 4.4.15. We recommend that Bitou LM undertakes an initial assessment to identify potential projects / services that may be suitable for PSP delivery models. This should be based on clear investment selection criteria and where the greatest benefit may be achieved.

# Solid waste:

- 4.4.16. The growing population and resultant increase in demand for municipal services has naturally complicated the provision of waste management services. This service is of paramount importance for any municipality, but particularly so for a municipality such as Bitou that is heavily reliant on tourism. The need to present the municipality as clean and presentable is significant.
- 4.4.17. Bitou LM does not currently have its own landfill site and as a result is having to haul its waste to the landfill site in Mossel Bay on a daily basis. The added maintenance to the waste management trucks, along with the current exorbitant fuel prices, deems this to be financially unsustainable. The municipality is struggling to keep up with the increased demand, and this is reflected in the condition of the waste management fleet. Increased travel has contributed significantly to an increase in required repairs and maintenance to keep the fleet in working order. These repairs are often slow which then hinders the day-to-day operations of this department. Budget constrains make it difficult not only to procure replacement vehicles, but also do not allow for the provision of additional dumping sites closer to the municipality.

- 4.4.18. There are plans in place for the regionalisation of a landfill site for the entire Garden Route District. While this may provide a solution to the mentioned challenges, this will be an expensive endeavour and to our understanding may not be a short-term solution.
- 4.4.19. It is recommended that an audit is conducted to assess the efficacy and accuracy of billing related to waste management services. This is of critical importance as this department's operations are not currently funded through revenue generation, which further strains the municipality's financial position. A detailed tariff modelling process must be done to determine the true cost of supply and thus ensure that tariffs are cost reflective.
- 4.4.20. General littering is an issue country-wide and contributes to the increased demand for waste management services. In order to combat this, the municipality currently employs contractors to deal with issues such as litter picking, street cleaning, alien vegetation control and illegal dumping. This, coupled with a waste minimalization strategy, with built in incentives, can contribute to job creation within the municipality. These contractors include Plett Recycling who are responsible for the collection and sorting of recyclable material. Education campaigns around recycling must be intensified as this, if implemented effectively, will provide short and longterm relief to waste management services through reducing the amount of waste that must be transported.

# 4.5. Organisational, Institutional and Corporate Services

#### Performance management and productivity:

- 4.5.1. There are legitimate concerns about the proportion of the municipal expenditure that goes to employee-related cost (about 32% excluding contracted services). Several measures can be put in place to manage this expenditure item, such as:
  - Stricter control over overtime expenditure and a review of the discretionary items of salaries.
  - A wider organisational review to ensure the Bitou LM staff compliment is fit-forpurpose.
- 4.5.2. In general, the most common threats to the sustainability of a municipality in terms of employees are:
  - Staff productivity
  - Performance management at all levels
- 4.5.3. It is important to ensure the organizational size and composition of skills is such that it can execute on its constitutional mandate. However, when staff productivity is

insufficient it is mostly due to a lapse in very basic organizational discipline. It is essential that HODs and senior management set the tone for a disciplined work environment, ensure basic organizational disciplines (such as time keeping, record keeping, implementing standard procedures, maintenance schedules etc.) are maintained, clear targets set, and performance measured on a continuous basis.

- 4.5.4. Currently only the minimum compliance standards are met with regards to training due to a lack of available funding. This leaves no room for skills programmes, bursaries etc. This leaves the municipality with a staff compliment that lacks the required skills to execute on their mandate.
- 4.5.5. There are multiple long-outstanding funded vacancies that the municipality is struggling to fill. The size of Bitou LM contributes to the difficulty of filling critical posts with people with the required skills and experience due to issues such as salary requirements.
- 4.5.6. It is recommended that the HODs and senior management take full ownership of the organizational structure and performance, and that it secures the full buy-in and support from Council. Reviews must be conducted to determine the need for certain positions and managers, a cost-benefit analysis will be helpful. Reductions of the staff compliment may be beneficial in many ways, not limited to cost reductions but also to efficiency and productivity through more clearly defined responsibilities being set out.
- 4.5.7. It is recommended that Bitou LM implement performance management (irrespective of the type of tool / system being used) throughout the organisation, with clear consequence management where lapses in outcomes occur.

# Capacity to implement projects:

- 4.5.8. We noted that there are quite a few ongoing and envisaged projects in Bitou LM, with a particular focus on mitigating the impact of loadshedding as well as upgrades to the water services infrastructure. IPM recommends that there be a clear focus on catalytic projects and that the required project management is in place before the start of the project to ensure that when and if there is part or wholly grant funded mandates they are fully implemented and that such funding would not need to be returned to NT.
- 4.5.9. The full cost of these projects must be determined prior to their undertaking, consideration must be given to not only the development costs of the project, but to the long-term operational and maintenance costs as well.
- 4.5.10. An integral part of determining capacity to implement projects, is the sourcing of funding for these projects. The municipality's poor liquidity position leaves the



municipality in a position whereby over-utilisation of cash reserves to fund capital investment will threaten long-term sustainability. It is therefore recommended that the municipality makes use of external financing sources to supplement capital grants to fund the earmarked projects.

### 4.6. Other Matters

#### Uncategorized matters:

- 4.6.1. Issues regarding the ICT of the municipality often stem from the frequent need to tender for service providers. It would be beneficial for the municipality to enter into long-term agreements with suitable service providers to ensure consistency and reliability in the provision of these services. Another issue is the lack of suitable training of staff who are not all skilled enough with working with computers, this hinders the general productivity of the municipality. This must be addressed with proper training programmes.
- 4.6.2. The record management systems of the municipality need to be digitized. It is recommended that the municipality outsources this function to a suitable service provider that can meet the municipality's needs. This will be of immense value to the municipality, through improving the efficiency and safeguarding of municipal records.
- 4.6.3. A general concern is that the municipality is overly reliant on tourism. This was most evident during the Covid-19 pandemic in which the tourism sector was heavily affected. To avoid a similar situation in future, it is recommended that the municipality explores further diversification of its economy.

# 5. DEMAND FOR FUTURE CAPITAL EXPENDITURE

- 5.1. The replacement cost at a future replacement date for assets in the asset register was determined. "Replacement" could also imply rehabilitation, enhancement (upgrade) or renewal (refurbishment) of that asset but excludes routine repairs and maintenance.
- 5.2. The calculation is done mechanistically and does not cater for engineering judgement. The information gained from the municipality's asset register and the correctness thereof will impact on the accuracy of future replacement- costs and dates. The asset register provided by the municipality included many assets lacking essential data to enable an accurate projection of future replacement cost. For these assets, we had to make calculated assumptions of acquisition cost and -dates as well as remaining useful life. Some assets were also not classified (categorised) and we added a "Not Classified" category. The model calculates the Replacement Cost (in nominal terms) of assets for the Planning Period, i.e., up to and including 2031/32. Some asset classes were not reviewed for replacement, viz. "Investment Property", "Land" and "Heritage Assets".
- 5.3. The outcome of this analysis and the Annual Replacement Cost ("ARC") is presented in Annexure 4: Assets Earmarked for Replacement.
- 5.4. According to a mechanistic calculation, the nominal replacement cost for the period from 2022/23 (and replacement not done before) to 2031/32 amounts to R 12 617 million. Of this amount an amount of R 7 712 million or 61% consist of assets that should already have been replaced in the past, based on their remaining useful life. The replacement of assets in the Water Infrastructure category amounts to 34%, followed by Roads infrastructure with 32% and Electricity and Stormwater with 11% each. The estimated current replacement cost ("CRC") of only those assets that were assessed, amounts to R 20 billion compared to the carrying value of PPE assets of approximately R 1.2 billion recorded in the municipality's annual financial statement for the period ending 30 June 2022.
- 5.5. We have amended the estimated replacement costs. This was achieved by:
  - Assuming that the actual remaining life of some assets will exceed the life recorded in the asset register
  - Assuming that only a percentage of assets will be replaced when their estimated useful life expires (e.g. in the case of buildings, it is doubtful whether the whole structure will have to be replaced, possibly only certain fittings, roof, finishes, etc.)
  - Spreading replacement not done in the past over several future years, and
  - Smoothing the constant 2022 value over the Planning Period and reverting these back to nominal values

- 5.6. Following the above procedure resulted in the total asset replacement cost, for the period 2022/23 to 2031/32 reducing from the original R 12 617 million to R 10 424 million.
- 5.7. The graph below compares the Replacement Cost as determined from the asset register and the smoothed Replacement cost after adjustment as described above:



5.8. The high amounts estimated for 2030 and 2031 are due to an extent, but not exclusively, to the replacement of:

#### 2030

Several water infrastructure assets, e.g. Off channel dam / water resource Water pipe wrp-17905 Water pipe wrp-18860 Water pipe wrp-21475 Water pipe wrp-42286 Water pipe wrp-42290

# 2031

Several water infrastructure assets, e.g. New Horizon reservoir cwt no1 Keurboomstrand reservoir Several Stormwater infrastructure assets Plettenberg Bay stormwater pipe ret-117 Plettenberg Bay stormwater pipe ret-126

It is worthwhile to assess the condition of the assets as accurately as possible and apply engineering judgment to determine when the asset components need to be replaced.

5.9. The smoothed Annual Replacement Cost ("ARC") curve ranges from R 754 million to R 1 387 million p.a. for the period 2022/23 to 2031/32. A future smoothed asset replacement programme of this nature would be advisable to avoid the spikes as illustrated above. The quantum may however not be affordable considering that the

investment in PPE of the municipality in 2021/22 was only R 78 million, which included investment in new as well as replacement assets.

- 5.10. In addition to asset replacement the municipality has the need to create new capital assets. However, in the light of the need for asset replacement this should not be neglected, and we propose that the municipality identify priority projects and implement a smooth asset replacement budget for future years.
- 5.11. In the light of the large demand for the replacement of assets that will be reaching the end of its useful life during the 10-year planning period, we propose that the municipality prioritises a cash backed Capital Replacement Reserve ("CRR") for this purpose. It would be prudent to transfer the full depreciation charge to the CRR once the cash balances are available. The CRR can then be used as a funding source for future capital expenditure. Furthermore, once the CRR has built up a significant balance the municipality should avoid depleting its CRR in any given financial year but use a percentage (say 50%) of the prior year balance for assets that require replacement. An asset replacement programme within the levels of available resources in the CRR will go a far way in quantifying the future replacement budget.

# 6. FINANCIAL MODEL

Future forecasts are based on the outcome of a financial model. Two basic scenarios are presented: First, the MTREF figures from the BLM Adjusted Budget FY2022/23-FY2024/25 were used unaltered. This scenario resulted in an unsustainable outcome, highlighted by a negative bank balance, poor liquidity and cash shortfalls on budgeted capital expenditure. Various adjustments were made to achieve a more sustainable outcome that is reflected in the Base Case. The **Base Case** assumptions of the model are listed in the table below:

#### ASSUMPTIONS OF BASE CASE VARIABLES

VARIABLE	Base Case Average for the 10 —year Planning Period
RSA consumer inflation rate (CPI)	5,3%
Population Growth Rate	1,9%
GVA Growth Rate	2,7%
Short term investment rate (Margin above CPI)	0,0%
Electricity Price Elasticity of Demand	-0,4
Water Price Elasticity of Demand	-0,2
Employee related cost escalation	6,4%
Bulk electricity cost escalation	8,9%
Collection Rate of customer billings	82,5%

#### The **Base Case** outcomes of the financial model is summarised below:

Outcome	10-Years up to 2032
Average annual % increase in Revenue	6,9%
Average annual % increase in Expenditure	4,6%
Accounting Surplus accumulated during Planning Period (Rm)	R 60
Operating Surplus accumulated during Planning Period (Rm)	-R 280
Cash generated by Operations during Planning Period (Rm)	R 508
Average annual increase in Gross Consumer Debtors	23,5%
Capital investment programme during Planning Period (Rm)	R 841
External Loan Financing during Planning Period (Rm)	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203
No of Months Cash Cover at the end of the Planning Period (Rm)	1,9
Liquidity Ratio at the end of the Planning Period	1:1
Gearing at the end of the Planning Period	14,9%
Debt Service to Total Expense Ratio at the end of the Planning Period	5,2%

#### BASE CASE OUTCOME

- 1.1. The proposals in this financial plan are based on the assumptions in the Base Case Financial Model. We are cognisant of the fact that future cash flows may be influenced by a variety of variables which limits the accuracy with which forecasts can be made.
- 1.2. The model framework is illustrated in the diagram below:





- 1.3. The output of the Base Case Model, particularly the graphs and tables are used throughout this report. The Projected Financial Statements are presented in Annexure 2, which may also serve as a guide to inform future budgets of the municipality. The Financial ratios are presented in Annexure 3 and summarised in TABLE 6 below.
- 1.4. The model forecasts the future revenue and expenditure by applying several independent variables. As an example, the future water services charges will in addition to the tariff charged be affected by future consumption as well as the addition of new users. Generic growth pursuant to the growth in population, households or economic output will be forecast.
- 1.5. To estimate the future revenue and expenditure, certain assumptions need to be made. These assumptions will serve as input to the model. For example, an assumption of future collection rates (payment ratios) is required to convert billings to actual cash receipts.
The average values for the 10-year planning period of those variables that were also changed for scenario testing are indicated in **TABLE 3** below:

VARIABLE	Base Case Average for the 10-year Planning Period
RSA consumer inflation rate (CPI)	5,3%
Population Growth Rate (% p.a.)	1,9%
GVA Growth Rate (% p.a.)	2,7%
Short term investment rate (Margin above CPI)	0,0%
Electricity Price Elasticity of Demand	-0,4
Water Price Elasticity of Demand	-0,2
Employee related cost escalation (p.a.)	6,4%
Bulk electricity cost escalation	8,9%
Collection Rate of customer billings	82,5%

#### TABLE 3: ASSUMPTIONS OF BASE CASE VARIABLES

- 1.6. The average economic growth rate, as measured by the percentage GVA p.a. is currently 2.70%. Positive to note is that the forecasted GVA growth rate exceeds the forecasted population growth rate. Employee related expenses are expected to be higher than CPI and increase by 6.4% p.a. The collection rate of customer billings is assumed to gradually improve to 85% over the 10-year forecast period from 2023 onward. The model allows for the decline of water consumption pursuant to price increases by applying a Price Elasticity of Demand ratio, estimated to be -0.2.
- 1.7. The historic financial assessment revealed Bitou's deteriorating liquidity position, largely as a result of declining collection rates, an unbalanced funding mix too reliant on capital grants and own cash resources as well as under-implementation of the capital expenditure budget. The objective of the assumptions in the model was to incorporate realistic assumptions to ensure future financial sustainability. The following factors represent the **most important assumptions** that were made in this regard. These assumptions will also have to be incorporated in the formulation of the municipality's long-term financial plan:
  - 1.7.1. The collection rate will gradually improve to 85% by the end of the forecast period. This is seen as realistic and achievable in light of the 8-year review period average of 84%.
  - 1.7.2. The Base Case Model incorporated all the increases in both expenditure and revenue items as announced by the BLM in the Adjusted Budget Report.
  - 1.7.3. Importantly, the Base Case Model incorporates a scenario in which the extent of the impact of the energy crisis and consequent Loadshedding on municipal revenues is modeled. This scenario assumes an average of Stage 4 Loadshedding for the next two years, which is expected to result in an annual

reduction of 22.6% of electricity consumption. Additionally, a permanent reduction of 5% of electricity sales was included to account for consumers moving to alternative power sources. Lastly, a permanent reduction of 5% of water sales was included to model the impact of Loadshedding on the water supply.

- 1.7.4. The NERSA tariff increases of 18.65% and 12.74% were incorporated into both the MTREF Case and Base Case, however the electricity tariffs that are passed onto the consumer were increased to 15.7% in FY2024 and 9.7% in FY2025, in only the Base Case.
- 1.7.5. Electricity losses were reduced to 15% over 7 years and water losses were reduced to 30% over 10 years.
- 1.7.6. The MTREF capital funding mix was altered to incorporate significantly increased borrowing, for a total increase of 85.3% over the MTREF period, after which it will grow at 10% p.a.
- 1.8. The Capital Budget was not amended, however the funding mix was optimized through utilising the scope for additional borrowing provided for by the affordability of the debt profile to significantly increase borrowing, as detailed above.
- 1.9. These adjustments result in a sustainable case which is referred to as the *Base Case* in this report. It must be emphasized that the achievement of this sustainable base case will require a long-term commitment to the parameters of the LTFP, financial discipline and improved revenue collection.
- 1.10. The impact of the Loadshedding Scenario is presented in TABLE 4 below. The impact of the 22.6% annual reduction in electricity consumption as a result of an average of Stage 4 Loadshedding for the next two years is significant. Further highlighting this impact, is the markedly reduced difference between the MTREF Case and Base Case revenues in 2025 & 2026 by which time Loadshedding has ceased.

Electricity Revenue	2023	2024	2025	2026
MTREF Case (Rm)	207 720	237 855	272 381	311 908
Base Case (Rm)	159 676	184 595	262 860	292 972
Difference (%)	30.1%	28.85%	3.6%	6.4%

1.11. The outcomes of the Base Case are presented in TABLE 5 below:

Outcome	10-Years up to 2032
Average annual % increase in Revenue	6,9%
Average annual % increase in Expenditure	4,6%
Accounting Surplus accumulated during Planning Period (Rm)	R 60
Operating Surplus accumulated during Planning Period (Rm)	-R 280
Cash generated by Operations during Planning Period (Rm)	R 508
Average annual increase in Gross Consumer Debtors	23,5%
Capital investment programme during Planning Period (Rm)	R 841
External Loan Financing during Planning Period (Rm)	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203
No of Months Cash Cover at the end of the Planning Period (Rm)	1,9
Liquidity Ratio at the end of the Planning Period	1:1
Gearing at the end of the Planning Period	14,9%
Debt Service to Total Expense Ratio at the end of the Planning Period	5,2%

#### TABLE 5: BASE CASE FINANCIAL OUTCOMES

- 1.12. The Base Case reflects Accounting and Operating Deficits until FY2027/28 and FY2029/30 respectively, after which surpluses will be realised for the remainder of the forecast period. Cash will be generated from operations throughout the forecast period, for a total of R 508 million, with a cash balance of R 203 million at the end of the planning period (FY2031/32). The total capital investment programme of R 841 million is funded through external financing (56%), capital grants (40%) and own cash (4%).
- 1.13. The aforementioned increase in borrowing remains affordable, as indicated by the forecast period-end gearing and debt service to total expense ratios presented in <u>TABLE</u> <u>5</u> above.
- 1.14. The summarized projected financial statements for the Base Case are presented in Annexure 2: Base Case Summary Projected Financial Statements.
- 1.15. A selection of ratios is summarised in **TABLE 6** below. A complete list of ratios is presented in Annexure 3. These ratios are the outcome of the financial model.
- 1.16. Bitou is heavily reliant on Property Rates and Electricity Services to generate income, with 45% of revenue generated between these two sources. The Cash Generated by Operations / Own Source Revenue Ratio fluctuates between 6.3% and 11.6% throughout the planning period. The liquidity ratio remains below the NT norm of 1.5:1 for the duration of the review period, with a modest increase from 0.9:1 in FY2022/23 to 1:1 in FY2031/32. The above two metrics will improve as the municipality improves its long-term financial and operational management. The year-end Cash balance remains positive throughout the forecast period, but the Cash Shortfall on the Minimum Required Liquidity Level will worsen until FY2026/27, before improving to a

Cash Surplus of R 44 million by the end of the forecast period. The debt profile remains sustainable throughout the forecast period with a peak gearing ratio of 21% in FY2024/25, which will then gradually reduce to 15% by the end of the forecast period. Bitou's reliance on fiscus will gradually reduce over the forecast period but will remain reasonably high.

YEAR		1	3	5	7	9	10
RATIOS	Norm	2022/23	2024/25	2026/27	2028/29	2030/31	2031/32
Cash Generated by Operations / Own Revenue		11.6%	9.1%	6.3%	8.5%	10.6%	11.6%
Liquidity Ratio (Current Assets: Current Liabilities)	1:1.5 - 1:2.0	0.9:1	0.8 : 1	0.7 : 1	0.7 : 1	0.9 : 1	1:1
Cash Surplus / Shortfall on Minimum Liquidity Requirements		-R 55.6 m	-R 66.7 m	-R 100.8 m	-R 88.7 m	-R 16.3 m	R 44.2 m
Capital Expenditure / Total Expenditure	10% - 20%	11.4%	7.2%	5.7%	5.6%	5.5%	5.4%
Gearing = Total Debt (Borrowings) / Operating Revenue	45%	16.7%	21.1%	19.2%	17.5%	16.0%	14.9%
Debt Service Cover Ratio (Cash Generated by Operations / Debt Service)	Min 1.3:1	1.9:1	1.3 : 1	1:1	1.4 : 1	1.7 : 1	1.9 : 1
Total Grants / Total Revenue		25.8%	22.7%	21.9%	21.0%	20.2%	19.8%

GRAPH 4: BASE CASE: BANK BALANCE IN RELATION TO MINIMUM REQUIRED LIQUIDITY LEVEL







GRAPH 6: BASE CASE: FUNDING MIX



# 7. FUTURE MUNICIPAL REVENUE

In constant monetary terms (2015) the municipal revenue per capita in 2032 is estimated to be R 5 363 p.a., this is lower than the R 5 408 p.a. real per capita revenue generated in 2022. This is a key indicator for the municipality's ability to obtain revenue from residents as pointed out in **Section 3** above when presenting the MRRI model.

• The estimated future 10-year annual average growth in revenue is 6.9% p.a.

Revenue Item	Average Billings Growth % p.a.
Rates	5.9
Water	15.1
Electricity	10.1
Operating Transfers	5.0
Sanitation	6.0
Refuse	6.0

AVERAGE ANNUAL 10-YEAR GROWTH OF MAJOR REVENUE ITEMS

- 7.1. The forecast of future revenue in the financial model is based in part on historical trends as well as an estimate of future revenue (Revenue = Quantity x Price), where "Quantity" is a function of independent variables (such households, population and GVA) and "Price" a function of policy choices such as tariff increases.
- 7.2. The future Gross Value Add ("GVA") of BLM was estimated based on a view of the future economic growth of the region as well as an estimate of future population in the municipal area. <u>GRAPH 7</u> below illustrates the Base Case GVA and GVA growth rates used in IPM's model. Notwithstanding the significant economic recovery of 4.7% experienced in 2021, this remains lower than the drastic contraction of -5.8% in 2020 as a consequence of the pandemic. The average annual economic growth rate for the planning period is positive at 2.7% p.a., while there has been average economic growth of 1.0% p.a. since 2011.



7.3. The estimated future revenue was informed by the municipality's forecast of future revenue in its MTREF. The estimated Total Income and Expenditure during the planning period for BLM is illustrated in **GRAPH 8**:



GRAPH 8: BASE CASE: INCOME & EXPENDITURE

7.4. The number of households is expected to grow at an average rate of 1.3% p.a., slightly lower than the assumed population growth rate of 1.9% p.a. The proportion of indigent households will continue to increase to 60% over the forecast period, due to increasing unemployment driven by a harsh economic environment as well as to the increasing trend of urbanisation.

7.5. The 10-year growth in billings of the major revenue items is illustrated in the **TABLE 7** below.

	Average Billings
Revenue Item	Growth % p.a.
Rates	5.6
Water	7.5
Electricity	10.9
Operating Transfers	6.9
Sanitation	7.0
Refuse	7.0

TABLE 7: FORECAST AVERAGE ANNUAL GROWTH OF REVENUE ITEMS

- 7.6. GRAPH 8 above illustrates the increasing trend in profitability throughout the forecast period. While this is positive to note, the municipality will continue to realise Operating Deficits until FY2029/30. The total grants to revenue ratio reflects a decreasing trend (see TABLE 6 above), however the municipality will remain reasonably reliant on grant funding. It is strongly recommended that the municipality maximises its own revenue and implements measures to improve revenue collection as a priority.
- 7.7. The increasing number of indigent households provides limited opportunities for higher tariff increases, though according to the percentage of households above the equitable share bracket vs the households receiving RDP lever services or higher, there remains scope to increase revenue through billings. This is however influenced by the number of illegal connections, damage to infrastructure and resulting increased repair cost.
- 7.8. Electricity remains the predominant revenue item, with an average of 24% p.a. of Operating Revenue emanating from this source over the 8-year review period. The price of electricity is highly regulated. The average electricity gross surplus margin for the forecast period is 19.2% p.a., exceeding the NT norm of 15%. The municipality is urged to implement measures to curtail the negative influence of the number of illegal connections, damage to infrastructure and resultant increased repair costs. This will greatly assist in the municipality's revenue generation efforts.
- 7.9. IPM's model forecasts that the real GVA per capita in 2032 will be R 76 904, 8.26% higher in real terms than the GVA per capita of R 71 039 in 2022, largely due to forecasted economic growth. By comparison, the municipal real revenue per capita (excluding grants) in 2032 is forecast to amount to R 5 363 p.a., a decrease of 0.83% from the 2022 total of R 5 408 p.a. We are comfortable that the Real Revenue per Capita for 2032 as forecast by IPM's model is reasonable. Considering the current demographic and socio-economic environment, these projections raise concerns as to the affordability of the municipal bill.

# 8. FUTURE OPERATIONAL EXPENDITURE

Employee Related Expenses and Electricity Bulk Purchases are the two largest Operational Expenditure items. To remain sustainable the municipality should maximize its productivity by:

- Optimising the use of employees and contractors.
- Reviewing debt collection procedures to improve the collection rate and reduce debt impairment.
- Ensuring that the full cost of service delivery is covered by tariffs.
- Safeguarding infrastructure and reducing distribution losses and for water and electricity.
- Implementing procedures to reduce the Creditors payment period.
- Account for the impact of Loadshedding on municipal revenues and expenditure.
- 8.1. Aligning the expenditure budget with the forecast revenues and collections remains a key component of the municipality's budgeting process. It is important for the municipality to ensure that future expenditure is budgeted in accordance with the expected revenues and cash collection to ensure that accounting and operating surpluses are realised.
- 8.2. Any significant increase in costs will have a negative impact on the municipality's financial performance, an example of this is revealed upon comparison of Electricity Bulk Purchases in the Adjusted Budget and in the Financial Model. NERSA's tariff increases are modelled in the LTFM and the impact of this is clear in the realisation of Operating Deficits over the MTREF period, which are not present in the Adjusted Budget. This highlights the vulnerability of the municipality's operational performance to substantial increases in costs. Therefore, careful management and planning of Operational Expenditure is required to ensure that expenditure is efficient, targeted and prioritized.
- 8.3. The largest expenditure item, Employee Related Expenses, will amount to an average of 32.5% of Total Expenditure over the forecast period. While this ratio is within the NT benchmark of 25%-40%, it must be considered in conjunction with Contracted Services, which are in some instances an alternative to Employee Related Expenses. Contracted Services will amount to a further 10.4% of Total Expenditure over the forecast period, bringing the combined average contribution to 42.9% of Total Expenditure, thus exceeding the NT benchmark. The forecast increases in these expenditure items are modelled in accordance with the budgeted amounts. Stringent management of these expenditure items is required, with the current forecast, along with expected increases in Electricity Bulk Purchases, providing a threat to financial sustainability.



**GRAPH 10: BASE CASE: REPAIRS & MAINTENANCE EXPENDITURE** 



- Repairs and Maintenance Expenditure amounted to an average of just 3% of PPE and 8.4. Investment Property over the review period, well below the NT recommended norm of 8%. Considering the municipality's weak liquidity position, the FY2021/22 ratio of approximately 4% is forecast to remain in place for the 10-year forecast period. Ideally, this ratio should be increased to reduce the likelihood of future impairment of assets.
- 8.5. The financial model has assumed cost increases as per the figures contained in the MTREF for the first three years but uses various independent variables to calculate expenses in future and, where applicable, accounts for losses to calculate bulk purchases and services sold.

# 9. AFFORDABILITY OF FUTURE CAPITAL EXPENDITURE

The total affordable capex for the period FY2022/2023 to FY2031/32 amounts to R 841 million. The historic level of annual capital spending was an annual average of R 83.8 million. The model builds on this and accelerates capital expenditure over the 10-year period by 6% annually. The accelerated capex is predominantly funded through borrowings and capital grants, with a small percentage funded through own cash.

- 9.1. It was assumed that the capital expenditure budget presented in the MTREF for the period up to FY2024/25 will be implemented, while escalating at a rate of 6% p.a. beyond the MTREF period. The long-term financial model calculates the future capex that the municipality can afford for the period up to FY2031/32 and increases the expenditure annually within the affordability limits. Over the 10-year period, average capital expenditure amounts to R 84.0 million per year, essentially on par with the historic average annual capex.
- 9.2. The MTREF Case capital expenditure forecasts cash shortfalls on budgeted capex throughout the forecast period. As a result, the Base Case funding mix was altered to incorporate significantly increased borrowings, to alleviate reliance on own cash as a funding source. The more highly leveraged debt profile is affordable, as indicated by the gearing and debt service to total expense ratios which remain well below the NT maximum norms. It must be noted that the utilisation of cash to fund capex cannot come at the expense of the servicing of the minimum liquidity reserves.
- 9.3. The affordability of the debt profile, as previously mentioned, will allow the municipality to fund its budgeted capital investment programme through accelerated borrowing, whilst maintaining a financially sustainable position. Improvements in operational performance will in theory unlock the acceleration of the capital investment programme, through catering for accelerated affordable borrowing while preserving cash resources and maintaining prudent financial management.



GRAPH 11: BASE CASE: CAPITAL AFFORDABILITY, RM P.A.





# **10.FUNDING OF FUTURE CAPITAL EXPENSES**

NDING FUTURE AFFORDABLE CAPITAL EXPI	NDITURE	
Source of Funds	Amount Rm	%
Public & Developers' Contributions	-	-
Capital Grants	340	40 %
Financing	470	56 %
Cash Reserves and Funds	31	4 %
Cash Shortfall	-	-
TOTAL	841	100 %

10.1. The funding mix to fund the future affordable capex is determined by the model by ensuring that the available cash is either invested to cover the minimum liquidity requirements and fund a capital replacement reserve or invested in capital assets. In accordance with the model the capex may be funded as follows:

Year	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2030</u>	<u>2031</u>	<u>2032</u>
Public & Developers' Contributions	0	0	0	0	0	0	0	0	0	0
Capital Grants	47	35	36	34	32	32	31	31	31	31
Financing	60	84	41	30	33	36	40	44	48	53
Cash Reserves and Funds	0	1	0	0	2	4	5	6	6	7
Capital Expenditure	107	120	77	64	67	72	76	81	85	91

#### TABLE 8: ESTIMATED 10-YEAR CAPITAL INVESTMENT & FUNDING

10.2. Important to note is the lower degree of reliance on grant funding, with a higher portion of roughly 56% of the capital investment programme being funded through external borrowing. Just 4% of the 10-year funding mix consists of own cash, this in theory will allow for the minimum liquidity requirement to be serviced before allocating cash to fund capital investment. The debt indicators, remaining well within their NT maximum limits, highlights the affordability of the debt profile.



GRAPH 13: BASE CASE: FUNDING OF FUTURE CAPITAL INVESTMENT, RM P.A.

10.4. The amount of Grant funding was informed by historical trends and the Adjusted Budget figures. As illustrated in **GRAPH 13** above, the future amounts of Grant funding are expected to marginally decline over the forecast period. Reliance on grant funding will need to be reduced, with increased impetus being placed on alternative funding sources such as external financing or own cash to fund the forecasted capital investment programme. In light of the municipality's current and forecast liquidity position, external financing will need to become the main source of capital funding. As such, the Base Case Model caters for this scenario and **GRAPH 14** and **GRAPH 15** below illustrate the affordability of the forecast funding mix.



**GRAPH 14: BASE CASE: GEARING** 



GRAPH 15: BASE CASE: DEBT SERVICE TO TOTAL EXPENSE RATIO

- 10.5. The debt indicators remain well within their respective NT benchmarks throughout the entirety of the forecast period. In theory, this allows for the borrowing programme to be further accelerated, without increasing pressure on the municipality's own cash reserves.
- 10.6. The model proceeds from the premise that the minimum required liquidity must preferably be held in reserve before cash may be spent on capex. The "Liquidity Reserve" is the amount of cash equivalents held to cover the amounts of statutory reserve requirements, unspent conditional grants, short term provisions and at least one month's operational expenditure.
- 10.7. As indicated, the Base Case significantly increases the level of external borrowing. The municipality has not undertaken borrowing since FY2018 and as such the current debt profile is under-leveraged, meaning there is scope to increase borrowing in an affordable manner. It is important to note that regular access to the debt market can aid the municipality in obtaining competitive lending rates in future. This requires consistent servicing of debt obligations as scheduled. If this is achieved the risk view of the municipality will improve and thus lead to a reduction in the overall cost of funding.
- 10.8. It is important for the municipality to develop a long-term capital investment programme that is targeted, prioritized and affordable. Consideration should be given to increased private sector participation in the rehabilitation and maintenance of the municipality's asset base. The municipality is advised to prioritise asset renewal and replacement, with a focus on increasing expenditure on repairs and maintenance, as this will avoid any deterioration in the quality of the asset base.

# **11.ALTERNATIVE SCENARIOS**

Five scenarios were analyzed and compared to the Base Case. The rationale for this section is to identify key variables and demonstrate the impact on the long-term financial position of the municipality by adjusting only one variable at a time. This helps to focus future policy interventions.

- Improved collection rate to 90% over a period of 3 years.
- Consumer tariff increases.
- Reduced Operating Expenditure: 2% reduction.
- Extension of average loan tenor.
- Reduced Loadshedding impact compared to Base Case Loadshedding scenario.

Environmental factors outside the control of the municipality (e.g. economic growth and regulated prices) as well as policy choices by the municipality (e.g. rates and tariff increases) have a significant impact on future financial viability.

#### **Scenario: Collection Rate Improvement**

- 11.1. The unpredictable and harsh environment that Bitou LM operates in, driven by external factors such as the energy crisis and high inflation, creates uncertainty as to local GVA projections and economic growth prospects. This increases pressure on households to service their municipal bills and as such it is feasible to expect a reduced rate of revenue collection. It is important for the municipality to implement measures to avoid the above scenario. With the municipality's current liquidity position, it cannot afford further drops in the collection rate. Additionally, the benefits derived from an improvement in the collection rate are extensive as will be highlighted below.
- 11.2. To illustrate this sensitivity and to highlight the importance of credit control, the outcomes of collection scenarios are tabled below:

|--|

Outcome	Base Case	Improved collection rate
Average annual % increase in Revenue	6.9%	7.1%
Average annual % increase in Expenditure	4.6%	4.2%
Accounting Surplus accumulated during Planning Period (Rm)	R 60	R 727
Operating Surplus accumulated during Planning Period (Rm)	-R 280	R 387
Cash generated by Operations during Planning Period (Rm)	R 508	R 1 175
Average annual increase in Gross Consumer Debtors	23.5%	18.0%
Capital investment programme during Planning Period (Rm)	R 841	R 841
External Loan Financing during Planning Period (Rm)	R 470	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203	R 934
No of Months Cash Cover at the end of the Planning Period (Rm)	2	9
Liquidity Ratio at the end of the Planning Period	1:1	3.3: 1

Gearing at the end of the Planning Period	14.9%	18.4%
Debt Service to Total Expense Ratio at the end of the Planning Period	5.2%	4.9%

The Base Case estimates a collection rate that will rise to 85% by the end of the forecast period. The sensitivity analysis presents a scenario in which the collection rate is increased to **90%** over the first **three years** of the forecast period, i.e., by FYE2024/25 which will then be maintained for the remainder. Based on the historical analysis, in which the municipality twice achieved a collection rate in excess of 90%, this scenario is seen as achievable. The outcomes of this scenario are reflected in **TABLE 9** above and the graphs below.



GRAPH 16: SCENARIO: COLLECTION RATE IMPROVEMENT: BANK BALANCE





- 11.3. The improved collection rate has a substantial impact on the liquidity and cash position of the municipality, as illustrated in **GRAPH 16** above. The minimum required liquidity level is exceeded in FY2024/25, after which the bank balance continues to soar. The liquidity ratio is boosted to an impressive 3.3:1 by the end of the planning period, providing a healthy buffer against any unforeseen financial shocks. These improved positions not only put the municipality in a sustainable financial position but will also facilitate significantly accelerated capital investment that in turn will contribute to further growth and development of the municipality.
- 11.4. Financial performance will see a marked improvement as illustrated in GRAPH 17 above.
  Operating Surpluses are forecast to be realised from FY2024/25 and for the remainder of the forecast period, highlighting significantly reduced reliance on grant funding.
- 11.5. The benefits that will be derived from a significant increase in the collection rate are extensive. This should provide the municipality with ample cause and motivation to make a concerted effort to improve the efficiency and effectiveness of revenue collection procedures.

## Scenario: Increased Tariffs levied on the Consumer

- 11.6. This scenario builds on the base case scenario. From the Base Case Model, which already includes increased electricity tariffs, the following increases were incorporated into the tariffs passed onto the consumer:
  - Tariff increases for property rates, water services, sanitation services, refuse removal services and other services were increased to 7% p.a. from FY2023/24 until FY2025/26.
  - The corresponding tariff increases for the above services in the **Base Case Model** are as follows:
    - o FY2023/24: 4.4%
    - FY2024/25: 4.5%
    - FY2025/26: 4.5%
  - After the MTREF period, the long-term escalation is expected to be 1% above the inflation rate for the remainder of the forecast period for the above-mentioned services. This is unchanged from the Base Case Model.

The comparison of outcomes can be seen on the table below:

Outcome	Base Case	Increased Tariffs Scenario
Average annual % increase in Revenue	6.9%	7.3%
Average annual % increase in Expenditure	4.6%	4.6%
Accounting Surplus accumulated during Planning Period (Rm)	R 60	R 388
Operating Surplus accumulated during Planning Period (Rm)	-R 280	R 48
Cash generated by Operations during Planning Period (Rm)	R 508	R 836
Average annual increase in Gross Consumer Debtors	23.5%	24.0%
Capital investment programme during Planning Period (Rm)	R 841	R 841
External Loan Financing during Planning Period (Rm)	R 470	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203	R 531
No of Months Cash Cover at the end of the Planning Period (Rm)	2	5
Liquidity Ratio at the end of the Planning Period	1:1	2: 1
Gearing at the end of the Planning Period	14.9%	14.3%
Debt Service to Total Expense Ratio at the end of the Planning Period	5.2%	5.2%

#### TABLE 10: SCENARIO: INCREASED TARIFFS: OUTCOMES

- 11.7. An increase in the level of tariffs passed onto the consumer by the municipality will result in considerable benefits for the municipality. This is most evident in the increased levels of profitability, evidenced best by the movement from an accumulated operating deficit to a surplus over the planning period. Cash generation is also significantly improved. The liquidity ratio improves to 2:1 which is a healthy, sustainable liquidity position.
- 11.8. Improvements such as the above, create scope for increased external financing in an affordable manner, which consequently paves the way for accelerated capital investment. The municipality will be able to invest in capital projects that aim to stimulate economic growth as well as reduce the level of backlogs, both of which will contribute to the betterment of the lives of the municipality's inhabitants as well as provide a return on their investment.
- 11.9. It must be noted that in light of Bitou receiving a "High" rating on IPM's Municipal Revenue Risk Indicator (MRRI) with already declining collection rates, the extent to which households can be levied is limited. Thus, careful consideration must be given to the extent to which the municipality can increase tariffs. There must be a balancing act between increasing tariffs and ensuring that consumers do not lose the ability to foot their municipal bills.
- 11.10.The graphical representation below illustrates the positive impact the increase in service charges tariffs will have on the municipality's financial performance sustainability prospects.



GRAPH 18: SCENARIO: INCREASED TARIFFS: BANK BALANCE









# Scenario: Improved Financial Performance through reduced Operating Expenditure

- 11.11. This scenario once again builds on the Base Case Model, by modelling an improvement in financial performance through a 2% reduction of Operating Expenditure.
- 11.12. The outcomes of this scenario are tabled below.

Outcome	Base Case	Opex -2% Scenario
Average annual % increase in Revenue	6.9%	7.0%
Average annual % increase in Expenditure	4.6%	4.4%
Accounting Surplus accumulated during Planning Period (Rm)	R 60	R 290
Operating Surplus accumulated during Planning Period (Rm)	-R 280	-R 50
Cash generated by Operations during Planning Period (Rm)	R 508	R 736
Average annual increase in Gross Consumer Debtors	23.5%	23.5%
Capital investment programme during Planning Period (Rm)	R 841	R 841
External Loan Financing during Planning Period (Rm)	R 470	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203	R 431
No of Months Cash Cover at the end of the Planning Period (Rm)	2	4
Liquidity Ratio at the end of the Planning Period	1:1	1.7: 1
Gearing at the end of the Planning Period	14.9%	14.8%
Debt Service to Total Expense Ratio at the end of the Planning Period	5.2%	5.3%

11.13. As presented in **TABLE 11**, BLM's financial performance is significantly improved through improvements in its operational performance. Highlighted by substantially improved profitability and liquidity.

11.14. Considering the limited opportunity for diversification of municipal revenue sources, as well as the fact that the municipality exerts an element of control over its Operating expenditure, the importance of Operating Expenditure management to the sustainability of the municipality cannot be understated.



GRAPH 21: SCENARIO: REDUCED OPEX: BANK BALANCE







GRAPH 23: SCENARIO: REDUCED OPEX: REVENUE & EXPENDITURE

- 11.15.It is imperative that the municipality conducts regular analyses of its Operating Expenditure, to ensure that expenditure is targeted, efficient and prioritized. An area in which the municipality may be able to reduce its Operating Expenditure is through the reduction of its Contracted Services bill. Analysis must be conducted to assess whether deviating from a strategy of outsourcing certain services and rather moving those services in-house would be of financial benefit to the municipality.
- 11.16. The improved financial performance as a result of the above will leave the municipality in a sustainable financial position, able to absorb potential financial shocks whilst simultaneously unlocking opportunities for further growth and development.

#### SCENARIO: EXTENDED AVERAGE LOAN TENOR

- 11.17. This scenario tests the impact of extending the Base Case Model average loan tenor of 10 years, to an average of 13 years.
- 11.18. The extension of the average loan tenor will have the effect of reducing annual debt servicing charges, while extending the period of time for which the debt will need to be serviced, which may result in increased finance charges.
- 11.19. As stated, the increased finance charges may negatively impact profitability and this has proven to be the case, with a modestly reduced accumulated accounting surplus and increased accumulated operating deficit over the planning period. A similar effect is had on cash generation due to the cash nature of finance costs payments.
- 11.20. This scenario will, however, have positive effects on the municipality's liquidity position as evidenced by the outcomes presented in **TABLE 12** below.

|--|

Outcome	Base Case	Extended Loan Tenor
Average annual % increase in Revenue	6.9%	6.9%
Average annual % increase in Expenditure	4.6%	4.6%
Accounting Surplus accumulated during Planning Period (Rm)	R 60	R 41
Operating Surplus accumulated during Planning Period (Rm)	-R 280	-R 298
Cash generated by Operations during Planning Period (Rm)	R 508	R 490
Average annual increase in Gross Consumer Debtors	23.5%	23.5%
Capital investment programme during Planning Period (Rm)	R 841	R 841
External Loan Financing during Planning Period (Rm)	R 470	R 470
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203	R 272
No of Months Cash Cover at the end of the Planning Period (Rm)	2	3
Liquidity Ratio at the end of the Planning Period	1:1	1.3: 1
Gearing at the end of the Planning Period	14.9%	20.3%
Debt Service to Total Expense Ratio at the end of the Planning Period	5.2%	4.6%

11.21. Notwithstanding the modest negative impact on long-term profitability, it is recommended that the municipality considers the implementation of an increased loan tenor strategy should it decide to approach the external market for financing. It is our view that the positive impact on liquidity and the municipality's cash position outweighs the slight reduction in profitability.





#### **GRAPH 25: SCENARIO: EXTENDED LOAN TENOR: GEARING**



#### SCENARIO: REDUCED LOADSHEDDING IMPACT

- 11.22. This scenario builds on the Base Case Model's Loadshedding scenario in which the following assumptions are made:
  - An average of Stage 4 Loadshedding for the next two years, resulting in a reduction of 22.6% of electricity consumption.
  - A permanent reduction of 5% of electricity sales as a result of consumers utilising alternative power sources.
  - A permanent reduction of 5% of water sales due to the impact of Loadshedding on the water supply, as a result of pumps that do not fill reservoirs for example.
- 11.23.To model a reduced loadshedding impact, the following adjustments were made to the Base Case Loadshedding Scenario:
  - An average of Stage 2 Loadshedding for the next two years, resulting in a reduction of 11.9% of electricity consumption.
  - No permanent reductions in water or electricity sales.
- 11.24. The outcomes of this scenario are reflected in the table below.

#### TABLE 13: SCENARIO: REDUCED LOADSHEDDING: OUTCOMES

Outcome	Base Case	Reduced Loadshedding	
Average annual % increase in Revenue	6.9%	7.1%	
Average annual % increase in Expenditure	4.6%	4.7%	
Accounting Surplus accumulated during Planning Period (Rm)	R 60	R 80	
Operating Surplus accumulated during Planning Period (Rm)	-R 280	-R 260	
Cash generated by Operations during Planning Period (Rm)	R 508	R 535	
Average annual increase in Gross Consumer Debtors	23.5%	23.8%	
Capital investment programme during Planning Period (Rm)	R 841	R 841	
External Loan Financing during Planning Period (Rm)	R 470	R 470	
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 203	R 229	
No of Months Cash Cover at the end of the Planning Period (Rm)	2	2	
Liquidity Ratio at the end of the Planning Period	1:1	1.1: 1	
Gearing at the end of the Planning Period	14.9%	14.6%	
Debt Service to Total Expense Ratio at the end of the Planning Period	5.2%	5.1%	

- 11.25. Interestingly, the impact of the above reduction is moderate. Profitability is slightly improved with a R20 million improvement in both the accumulated accounting surplus and accumulated operating deficit over the planning period. Cash generation experiences a modest improvement, with a R26 million increase in cash and cash equivalents at the end of the planning period.
- 11.26. With electricity services accounting for 25% of Bitou's FY2022 revenue, the potential impact of sustained Loadshedding on municipal revenues and expenditure may be extensive. As a result of this, it is recommended that the municipality carefully and stringently manages its operating expenditure reducing it where possible, as well as makes a concerted effort to improve its collection rate, as this will greatly assist in mitigating the potential impact of Loadshedding.
- 11.27.It must be mentioned that although we are comfortable that the model gives a fair indication of the estimated impact on municipal revenues, the recent nature of the severe impact of Loadshedding and consequent lack of data makes giving an accurate reflection a challenging endeavour.

#### GRAPH 26: SCENARIO: REDUCED LOADSHEDDING: BANK BALANCE







## **12.RECOMMENDATIONS**

We recommend the following, subject to discussions with Executive Management and Council of the Municipality, to be adopted for inclusion in a long-term financial plan.

The recommendations are based on the findings of the Independent Financial Assessment, which concluded that Bitou LM's financial position is deteriorating, liquidity levels are poor, there are consistent cash shortfalls on liquidity requirements as well as recent operational deficits. It is recommended that the municipality makes a concerted effort to improve its liquidity position through improving the collection rate and preserving cash resources. This must take priority over the acceleration of the capital investment programme, while the current capital funding mix should be altered to incorporate prudent use of debt funding to allow for cash reserves to be bolstered.

#### 12.1. OPERATIONS FRAMEWORK

Whereas some of the Base Case Outcomes do not yet comply with benchmark norms it is essential that the municipality institutionalises a financial plan that aims to achieve the norms of the following parameters (detail and definitions are provided in **ANNEXURE 3: RATIO ANALYSIS** and **ANNEXURE 4: VIABILITY FRAMEWORK**):

		<u>MFMA</u> <u>Norm</u>	<u>Minimum</u>	<u>Healthy</u>	<u>Base Case</u> <u>10-Year</u> Average	
FINANCIAL POSITION						
ASSE	TMANAGEMENT					
	Capital Expenditure / Total Expenditure	10% - 20%	10%	20%	6.9%	
	Repairs and Maintenance as % of PPE and Investment Property	8%	n.a.	6%	4.0%	
DEBT	ORS MANAGEMENT					
	Gross Consumer Debtors Growth	n.a.	n.a.	0%	25,4%	
	Payment Ratio / Collection Rate	95%	90%	95%+	83.0 %	
	Net Debtors Days	30	60	30	35	
LIQUIDITY MANAGEMENT						
	Minimum Liquidity Level	1 – 3 months	1 months	3 months	1 month	
	Liquidity Ratio (Current Assets: Current Liabilities)	1.5:1 – 2.:1	1:1	2 : 1	0.8 : 1	
	Debt Service as % of Total Operating Expenditure	6% - 8%	n.a.	8.0%	5.0%	
	Total Debt (Borrowings) / Operating Revenue	45%	40%	35%	18.0%	

#### TABLE 14: OPERATIONS FRAMEWORK

		<u>MFMA</u> <u>Norm</u>	<u>Minimum</u>	<u>Healthy</u>	<u>Base Case</u> <u>10-Year</u> <u>Average</u>
	Debt Service Cover Ratio (Cash Generated by Operations / Debt Service)	n.a.	1.3	1.5	1.4
SUST	AINABILITY				
	Net Financial Liabilities Ratio	n.a.	n.a.	< 60%	37.3%
	Operating Surplus Ratio	n.a.	n.a.	0% - 10%	-3.1%
	Asset Sustainability Ratio	n.a.	n.a.	> 90%	7.0%
<u>FINAN</u>	CIAL PERFORMANCE				
EFFIC	IENCY				
	Accounting Surplus R'000	Break even or >0	Break even	> 0	R 60
	Cash Operating Surplus R'000	n.a.	Break even	> 0	-R 280
	Net Operating Surplus / Total Operating Revenue	>= 0%	Break even	> 0%	-3.1%
	Electricity Surplus / Total Electricity Revenue	0% - 15%	> 0%	> 15%	19.2%
	Water Surplus / Total Water Revenue	>= 0%	= 0%	> 0%	99.3%
	% Increase in Billed Income p.a.	CPI	n.a	n.a	8.0%
	Operating Revenue Growth %	CPI	n.a	n.a	7.4%
	Annual Increase per Income Source: Equitable Share	n.a	n.a	n.a	8.6%
	Annual Increase per Income Source: Property Rates	n.a	n.a	n.a	5.6%
	Annual Increase per Income Source: Electricity Services	n.a	n.a	n.a	10.9%
	Annual Increase per Income Source: Water Services	n.a	n.a	n.a	7.5%
	Creditors Payment Period	30	30	30	194
	Contribution per Expenditure Item: Staff Cost (Salaries, Wages and Allowances)	25% - 40%	25% - 30%	25%	32.0%
	Contribution per Expenditure Item: Contracted Services	2% - 5%	2% - 5%	< 5%	9.9%
GRANT DEPENDENCY					
	Total Grants / Total Revenue	n.a.	n.a.	n.a.	22.2%
	Own Source Revenue to Total Operating Revenue	n.a.	n.a.	n.a.	80.2%
	Capital Grants to Total Capital Expenditure	n.a.	n.a.	n.a.	41.4%

12.2. PLANNING STRATEGIES



The municipality must analyse and ensure the viability of its long-term planning processes, with the objective of financial sustainability and resilience at the core of each decision.

#### 12.3. ORGANISATIONAL STRATEGIES

We recommend that BLM implement a formalized performance management programme throughout the organization, with clear, consequent management where lapses in outcomes occur. Ensuring accountability must be at the forefront of such a strategy.

#### 12.4. REVENUE RAISING STRATEGIES

The municipality will continue to work on diversifying and ensuring growth of its revenue base. The following revenue streams need to be maximised:

- Revenue from service charges
- Agency fees and fines
- Grants
- Donor funding
- Public Benefit Contributions to assist with the rehabilitation and maintenance of infrastructure, particularly where the municipality may lack the expertise to do so effectively itself.

#### 12.4.1. Debtors Collection Action Plan

Analysis of the municipality's current collection procedures must be conducted in order to ensure improvements are realised. Once shortcomings are identified, a strategy to address and improve on said shortcomings must be implemented as a **priority**. Ensuring that all applicable consumers are billed at the correct amounts is a good starting point. The Base Case presents a scenario in which the current collection rate is assumed to rise to 85% by the end of the forecast period. A scenario is run to show the potential benefits to be derived from a concerted effort to improve the collection rate.

#### 12.4.2. Service Charges Margins

The municipality is advised to safeguard its margins on its service charges from potential decline. The sharp Eskom tariff increases will impact bulk purchases expenditure, while a comparable increase in consumer tariffs is not possible resulting in expected reductions in surplus margins. The Base Case assumes electricity tariffs will increase at a rate of roughly 3% below the associated bulk purchases tariffs throughout the MTREF period. Additionally, a scenario was run to model the impact of increased service charges tariffs on municipal revenues.

#### 12.4.3. Enhance Potential Revenue

We recommend that:

- All consumers are captured, data is verified, billing is correct and monies due are collected.
- Large consumers are billed correctly for all services used and payments made are correct.
- BLM ensures payments are made timeously.
- Tariffs are cost reflective.
- Indigent support cases are verified independently.
- Maintain indigent support levels at the minimum levels as funded by fiscal transfers.
- Fines revenue collections are maximised.

#### 12.5. COST SAVING STRATEGIES

The municipality must compile the expenditure budget in accordance with anticipated revenue growth, as well as to anticipated cash collections to generate cash surpluses. Stringent expenditure management is critical, as is ensuring the expenditure budget is efficient, targeted and prioritized.

#### 12.5.1. Productivity

Employee related expenses are forecast to contribute an average of 32.5% over the forecast period, this in itself is not excessive. When contracted services, with a forecast average contribution of 10.4%, are considered, the combined contribution exceeds the NT benchmark. This will provide a threat to financial sustainability and thus a more efficient approach is required.

It is recommended that the municipality:

- Limits employee related expenditure where possible through reviewing discretionary aspects of salaries and overtime policies.
- Conducts wider organisational review to ensure the municipality is not unnecessarily overstaffed and its organogram is efficiently organized.

#### 12.6. FINANCIAL MANAGEMENT STRATEGIES

The sustainability and financial wellbeing of the municipality is linked directly to sound financial management. In this regard, it is recommended that the municipality continuously:

- Ensures that it complies with GRAP standards.
- Reviews and updates all policies and procedures annually.

- Automates National Treasury reporting templates to ensure proper reporting.
- Trains and develops staff to minimize the use of consultants.
- Maintains an effective system of expenditure control, including procedures for approval authorization, withdrawal and payment of funds.
- Prepares annual financial statements timeously and review performance and achievements.
- Prioritizes and diversifies its investment portfolio to maximize returns.
- Ensures that multi-year forecasts are sustainable.
- Maintains financial procedures and discipline to achieve and maintain unqualified audit history, and addressing the audit findings which were as and when they are raised.

#### 12.7. ASSET MANAGEMENT STRATEGIES

The Municipality must ensure that its assets are properly accounted for and safeguarded. Leveraging on the municipal assets will drive the economic growth and sustainable development of the Municipality. In particular:

#### 12.7.1. Integrated Asset Management

Integrated asset management aims to deliver a required level of service, while being cost-effective through the management of assets for current and future customers. This entails utlising an integrated approach to asset management and performance, through monitoring, operating, maintaining, upgrading and disposing of assets in the most cost-effective manner. The creation and monitoring of a maintenance programme with the philosophy of proactive rather than reactive maintenance is critical and will contribute significantly to the saving of costs in future. A formalized, systematic approach must be used in the monitoring of the ageing of municipal assets,

#### 12.7.2. Repairs and Maintenance

The Base Case forecasts repairs and maintenance expenditure to remain roughly around 4% of the carrying value of PPE. This is half of the recommended benchmark of 8% and ideally must be increased over the forecast period to safeguard against the deterioration of the municipal asset base.

#### 12.7.3. Water and electricity losses

The FY2021/22 distribution losses for electricity and water of 18.8% and 37.7% respectively, both exceeded their respective NT norms. Electricity losses have been reduced to 15% over a period of 7 years, while water losses have been reduced to 30% over a period of 10 years in the **Base Case Model**.

Illegal activity is rife, and this plays a significant role in the extent of the distribution losses in Bitou. It is thus recommended that the municipality, along with the provincial and national law enforcement agencies, coordinate and combine resources to combat this issue.

It is further recommended that the municipality implements a focussed and prioritized approach to ensuring that non-technical losses outside of theft or meter tampering are limited through ensuring that consumers are billed correctly, and these revenues are collected.

#### 12.7.4. Infrastructure planning

It is **recommended** that this LTFP and a consolidated infrastructure investment plan be used as the basis for annual budgeting and updated when required. Furthermore, and to ensure political buy-in, that the LTFP be submitted to Council for approval as part of the normal budget cycle.

It is **recommended** that the BLM implements a formalized system to track and manage the condition and ageing of infrastructure, to serve as input to the development of maintenance schedules as well as rehabilitation / renewal timelines.

#### 12.8. CAPITAL FINANCING STRATEGIES

The municipality is encouraged to incorporate a significantly increased level of borrowing to fund capital investment. In light of the current liquidity position, the municipality is advised to avoid the use of its own cash reserves to fund capital expenditure. The debt indicators allow for affordable borrowing and the municipality's IPM Shadow Credit Rating should mean reasonably competitive lending rates should be obtained.

Furthermore, it is recommended that the municipality implements an integrated plan which preserves cash reserves and improves the collection rate. When this is achieved, the capital investment programme can be accelerated through making use of a strategically designed funding mix which incorporates significantly increased external financing. The municipality is encouraged to explore the option of utilizing longer loan tenors to further assist with the municipality's liquidity position, as presented in a scenario on **Page 47** of this report.

#### 12.8.1. Fund a Capital Replacement Reserve ("CRR")



We recommend that once liquidity improves, a CRR is cash backed and that tariffs are progressively increased to include a depreciation charge that can be used to fund a cash backed CRR which in turn can be applied towards the funding of the replacement of ageing infrastructure.

#### 10.8.2. Tariff Model

IPM is currently developing a tariff model, however its institutionalization has not yet come to pass at the time of writing of this report. Therefore, tariffs are currently calculated based on an ad-hoc basis, considering the cost of providing the service from which the tariff is determined accordingly. The perception of the tariff setting process being somewhat arbitrary contributes to the reluctance of the public to pay municipal bills. As part of the longer-term process to improve revenue collection and accuracy / credibility of household bills, a tariff model will be a useful tool.

It is **recommended** that BLM consider the implementation of a more robust and accurate formal tariff modelling system to determine tariffs and as a basis to guide tariff policy in future.

#### 12.9. OPERATIONAL FINANCING STRATEGIES

Operational efficiency will be maintained by ensuring the targeted collection rates are achieved and BLM is managing the underlying items of current assets and current liabilities optimally.

ANNEXURE 1: INDEPENDENT FINANCIAL ASSESSMENT AGAINST THE BACKGROUND OF BITOU LOCAL MUNICIPALITY'S DEMOGRAPHIC, ECONOMIC & HOUSEHOLD INFRASTRUCTURE SITUATION

# [SEE SEPARATE DOCUMENT]

#### **ANNEXURE 2: BASE CASE SUMMARY PROJECTED FINANCIAL STATEMENTS**

#### Municipal Financial Model - Bitou Local Municipality Statement of Financial Position

Model year 0 2 3 4 5 6 7 8 9 10 1 2027 2028 2031 Financial year (30 June) 2022 2023 2024 2025 2026 2029 2030 2032 R thousands 1 218 624 1 448 797 1 474 619 1 503 403 Non-current assets: 1 290 582 1 370 507 1 405 092 1 425 661 1 535 429 1 570 976 1 610 329 1 196 038 1 264 884 1 344 809 1 379 394 1 399 963 1 423 099 1 448 921 1 477 705 1 509 731 1 545 278 1 584 631 Property, plant and equipment Intangible assets \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ Investment properties 12 692 25 663 25 663 25 663 25 663 25 663 25 663 25 663 25 663 25 663 25 663 9 857 Investments \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ Long-term receivables 1 \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ Other non-current assets 35 35 35 35 35 35 35 35 35 35 35 155 916 166 138 173 172 182 577 166 449 160 105 165 973 188 017 226 588 280 502 352 713 Current assets: 32 020 39 260 54 214 Inventories 23 298 34 063 36 628 37 204 41 600 44 243 47 230 50 548 83 990 95 526 95 526 95 526 95 526 95 526 95 526 95 526 95 526 95 526 95 526 Trade and other receivables Cash & Short term investments 48 627 38 592 43 583 50 423 33 7 1 9 25 3 19 28 848 48 248 83 832 134 427 202 973 TOTAL ASSETS 1 374 540 1 456 720 1 543 679 1 587 669 1 592 110 1 608 902 1 640 592 1 691 420 1 762 016 1 851 478 1 963 042 **Municipal Funds:** 1 073 498 1 055 425 1 036 034 1 025 151 1 007 469 997 100 996 098 1 007 010 1 031 357 1 072 212 1 133 273 Housing development fund & Other Cash Backed Reserves \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ Reserves (Not Cash Backed) 18 550 126 077 134 049 140 617 140 617 140 617 140 617 140 617 140 617 140 617 140 617 Accumulated surplus 1 054 948 929 348 901 985 884 534 866 852 856 483 855 481 866 393 890 740 931 595 992 656 368 270 388 561 412 514 436 477 459 785 Non-current liabilities: 160 322 225 754 306 065 342 291 353 322 492 657 186 442 Long-term liabilities (Interest Bearing) 88 704 103 756 160 222 173 514 174 046 176 179 180 887 189 151 188 332 194 233 121 998 145 843 192 091 Non-current provisions 71 618 168 777 179 276 207 674 226 072 247 326 271 454 298 424 243 531 255 934 **Current liabilities:** 140 720 175 541 201 580 220 226 231 318 271 896 294 183 319 481 337 112 9 848 10 598 11 294 11 900 12 365 12 990 13 646 14 355 15 166 17 040 Consumer deposits 16 055 31 678 58 916 58 916 Provisions 49 889 56 164 58 916 58 916 58 916 58 916 58 916 58 916 99 194 90 320 106 589 121 703 130 570 140 758 151 779 164 251 178 886 195 375 213 910 Trade and other pavables Bank overdraft \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ \_ Current portion of interest bearing liabilities 24 734 27 534 27 708 29 468 30 867 31 593 34 374 41 214 49 135 47 246 \_ TOTAL MUNICIPAL FUNDS AND LIABILTIES 1 374 540 1 456 721 1 543 679 1 587 669 1 592 110 1 608 902 1 640 592 1 691 420 1 762 017 1 851 478 1 963 042
#### Municipal Financial Model - Bitou Local Municipality Statement of Financial Performance

Model year	0	1	2	3	4	5	6	7	8	9	10
Financial year (30 June)	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2030</u>	<u>2031</u>	<u>2032</u>
R thousands											
Revenue											
Property rates	157 194	159 655	167 532	175 522	183 333	194 183	206 462	220 267	235 784	252 951	271 832
Service Charges	413 479	379 798	418 535	516 199	561 083	609 292	661 681	720 842	787 811	862 920	946 952
Service charges - electricity	202 469	159 676	184 595	262 860	292 972	322 162	352 945	387 865	427 633	472 504	523 045
Service charges - water	85 578	86 174	91 812	102 828	109 298	117 248	126 452	136 826	148 460	161 445	175 874
Service charges - sanitation	88 009	93 875	99 608	105 483	111 301	119 059	127 750	137 469	148 379	160 470	173 830
Service charges - refuse	37 424	40 073	42 520	45 028	47 512	50 823	54 533	58 682	63 339	68 500	74 203
Service charges - other		0	0	0	0	0	0	1 0 0	0	0	0
Rental of facilities and equipment	1 200	1 193	1 230	1 291	1 302	1 457	1 203	1 682	1010	1 903	2 12/
Interest earned - external investments	3 747	3 900	2 249	2 093	2 193	F 610	6 4 2 0	7 201	2700	4 000	10.261
Dividends received	14 ///	14 572	10 104	10 0 10	4 029	5010	0 429	7 301	0 233	9 220	10 201
Fines, penalties and forfeits	54 430	35.870	37 423	39 108	41 265	44 141	47 364	50 967	55 012	59 495	64 448
Licences and permits	-	1 002	1 046	1 094	1 164	1 259	1 375	1 510	1 668	1 848	2 051
Agency services	2 423	2 414	2 521	2 634	2 779	2 973	3 190	3 433	3 705	4 007	4 341
Transfers and subsidies (operating)	137 299	163 835	197 799	188 392	198 770	210 997	224 683	239 949	257 011	275 827	296 496
Other revenue	11 994	7 875	7 981	8 464	8 931	9 553	10 251	11 031	11 906	12 876	13 948
Gain on disposal of PPE	_	_	_	_	_	_	_	_	_	_	_
Revaluation of assets gain / (loss)	_	-	-	-	-	-	-	-	-	-	-
Total revenue before Capital Grants	796 598	770 114	852 506	952 815	1 005 710	1 081 087	1 164 319	1 258 570	1 365 680	1 485 963	1 620 373
Capital Grants	50 997	47 441	35 097	35 734	33 753	32 412	31 558	31 064	30 846	30 798	30 850
Public & developers contributions	-	0	-	-	-	-	-	-	-	-	-
Total Revenue after Capital Grants	847 595	817 555	887 603	988 549	1 039 462	1 113 500	1 195 877	1 289 635	1 396 525	1 516 760	1 651 223
Operating expenditure											
Employee related costs	278 100	308 082	309 490	327 129	345 978	367 302	391 200	417 773	447 117	479 320	514 449
Remuneration of councillors	6 198	6 944	7 239	7 539	7 861	8 227	8 639	9 0 9 6	9 599	10 146	10 737
Debt impairment	346 676	135 570	142 812	160 816	168 278	176 835	185 964	196 048	207 191	219 271	232 277
Depreciation and asset impairment	36 223	38 865	40 435	42 415	43 231	44 491	45 864	47 202	48 520	49 831	51 149
Finance charges	11 102	16 646	24 650	26 414	26 497	27 032	27 828	28 932	30 461	32 243	33 855
Bulk purchases	159 802	125 439	148 017	215 595	236 468	260 012	284 829	312 967	346 667	384 829	427 977
Inventory Consumed	15 399	18 137	17 382	17 499	17 493	18 276	19 279	20 505	21 967	23 661	25 589
Repairs and maintenance	_	-	-	-	-	-	-	-	-	-	-
Contracted services	102 726	99 439	127 734	104 907	112 398	117 101	122 364	128 238	134 810	142 065	150 045
Transfers and subsidies	4 527	4 750	350	350	368	390	415	442	473	507	544
Other expenditure	57 505	81 756	88 884	96 767	98 572	104 202	110 499	117 519	125 375	134 033	143 540
Loss on disposal of PPE	-	-	-	-	-	-	-	-	-	-	-
Total Expenditure	1 018 259	835 628	906 994	999 432	1 057 144	1 123 868	1 196 880	1 278 723	1 372 179	1 475 905	1 590 161
Suplus/ (Shortfall) for the year	(170 664)	(18 073)	(19 391)	(10 883)	(17 682)	(10 369)	(1 003)	10 912	24 347	40 855	61 062

# Municipal Financial Model - Bitou Local Municipality Cash Flow Statement

Model year Financial year (30 June) <i>R thousands</i>	0 <u>2022</u>	1 <b>2023</b>	2 <b>2024</b>	3 <b>2025</b>	4 <u>2026</u>	5 <b>2027</b>	6 <u>2028</u>	7 <b>2029</b>	8 <u>2030</u>	9 <u>2031</u>	10 <u>2032</u>
Cash flows from Operating Activities											
Suplus/Deficit for the year <u>including</u> Capital Grants	(170 664)	(18 073)	(19 391)	(10 883)	(17 682)	(10 369)	(1 003)	10 912	24 347	40 855	61 062
Suplus/Dencit for the year <u>excluding</u> Capital Grants & Contributions Capital Grants & Contributions		(65 514) 47 441	(54 488) 35 097	(46 617) 35 734	(51 435) 33 753	(42 781) 32 412	(32 561) 31 558	(20 152) 31 064	(6 499) 30 846	10 057 30 798	30 212 30 850
Adjustments for non-cash items:	20.000	20.005	40.405	10 115	10.001	44.404	45.004	47.000	40 500	40.004	54.440
Depreciation, amortisation and impairment loss Revaluation on investment property (gain) / loss	36 223	38 865	40 435	42 415	43 231	44 491	45 864	47 202	48 520	49 831	51 149
Increase / (Release from) current provisions & non-interest bearing liabilities	-	18 211	6 275	2 752	-	-	-	-	-	-	-
Increase / (Release from) other non-current provisions & non-interest bearing liabilities	-	50 380	23 845	22 934	10 499	12 815	15 583	18 398	21 254	24 128	26 970
(increase) / Release from non-current interest bearing assets Capitalised interest	-	9 857	_	_	_	_	_	_	_	_	_
· · · · · · · · · · · · · · · · · · ·											
Operating surplus before working capital changes:	(134 441)	99 241	51 164	57 218	36 049	46 937	60 445	76 512	94 121	114 814	139 181
Change in W/C Investment	-	(29 132)	14 225	12 550	8 290	8 133	8 681	9 829	11 648	13 171	14 870
(Increase)/decrease in inventories	-	(8 722)	(2 043)	(2 564)	(576)	(2 056)	(2 340)	(2 643)	(2 987)	(3 318)	(3 665)
Increase/(decrease) in trade payables	_	(11 330) (8 874)	 16 268	 15 114	8 867	10 189	 11 021	12 472	14 635	16 489	
Net cash flow from Operating activities	(134 441)	70 109	65 390	69 768	44 339	55 070	69 126	86 341	105 769	127 984	154 050
Cash flows from Investing Activities											
Capital expenditure	-	(107 711)	(120 360)	(77 000)	(63 800)	(67 628)	(71 686)	(75 987)	(80 546)	(85 379)	(90 502)
Decrease/(Increase) in non-current receivables	-	(12 071)	-	-	-	-	-	-	-	-	-
(Additions) / Disposals of investment property	-	(12 97 1)	-	-	-	-	-	-	-	-	-
Net cash flow from Investing activities	-	(120 681)	(120 360)	(77 000)	(63 800)	(67 628)	(71 686)	(75 987)	(80 546)	(85 379)	(90 502)
Cash flows from Financing Activities											
New loans raised	-	60 000	84 000	41 000	30 000	33 000	36 300	39 930	43 923	48 315	53 147
Loans repaid	-	(20 214)	(24 734)	(27 534)	(27 708)	(29 468)	(30 867)	(31 593)	(34 374)	(41 214)	(49 135)
(Decrease) / Increase in consumer deposits	-	750	696	606	465	625	656	709	812	889	985
Net cash flow from Financing activities	-	40 536	59 961	14 073	2 757	4 157	6 089	9 046	10 360	7 990	4 997
Change in Cash	(134 441)	(10 036)	4 991	6 840	(16 704)	(8 400)	3 529	19 400	35 584	50 595	68 546
Cash/(Overdraft), Beginning		48 627	38 592	43 583	50 423	33 719	25 319	28 848	48 248	83 832	134 427
Cash/(Overdraft), Ending	48 627	38 592	43 583	50 423	33 719	25 319	28 848	48 248	83 832	134 427	202 973

## **ANNEXURE 3: RATIO ANALYSIS**

YEAR			2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
FINANCIAL I	POSITION											
ASSET MAN	AGEMENT											
R29	Capital Expenditure / Total Expenditure	10% - 20%	11,4%	11,7%	7,2%	5,7%	5,7%	5,7%	5,6%	5,5%	5,5%	5,4%
R27	Repairs and Maintenance as % of PPE and Investment Property	8%	3,9%	4,2%	4,0%	4,0%	4,0%	4,0%	4,0%	3,9%	3,9%	3,9%
DEBTORS M	ANAGEMENT											
R4	Gross Consumer Debtors Growth		89,3%	43,2%	31,6%	22,0%	16,7%	13,4%	11,3%	9,8%	8,8%	8,0%
R5	Payment Ratio / Collection Rate	95%	80,0%	80,6%	81,1%	81,7%	82,2%	82,8%	83,4%	83,9%	84,5%	85,0%
	Net Debtors Days	30	46	48	44	38	35	32	30	28	25	23
	IANAGEMENT											
R49	Cash Coverage Ratio (excl. Working Capital)		1:1	1:1	1:1	0,7:1	0,5 : 1	0,6 : 1	1:1	1,7 : 1	2,7 : 1	4,1:1
R50	Cash Coverage Ratio (incl. Working Capital)		0,4 : 1	0,4 : 1	0,4 : 1	0,3 : 1	0,2 : 1	0,2 : 1	0,4 : 1	0,6 : 1	0,9 : 1	1,3 : 1
R51	Cash Surplus / Shortfall on Minimum Liquidity Requirements		-R 55,6 m	-R 61,5 m	-R 66,7 m	-R 87,6 m	-R 100,8 m	-R 102,4 m	-R 88,7 m	-R 59,6 m	-R 16,3 m	R 44,2 m
R1	Liquidity Ratio (Current Assets : Current Liabilities)	1:1.5 - 1:2.1	0,9 : 1	0,9 : 1	0,8:1	0,7 : 1	0,7 : 1	0,6 : 1	0,7 : 1	0,8 : 1	0,9 : 1	1:1
LIABILITY M	ANAGEMENT											
R45	Debt Service as % of Total Operating Expenditure	6% - 8%	4,4%	5,4%	5,4%	5,1%	5,0%	4,9%	4,7%	4,7%	5,0%	5,2%

YEAR			2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
R6	Total Debt (Borrowings) / Operating Revenue	45%	16,7%	22,0%	21,1%	20,2%	19,2%	18,2%	17,5%	16,9%	16,0%	14,9%
R7	Repayment Capacity Ratio		2,40	4,61	4,64	11,41	7,38	5,15	3,85	3,06	2,48	2,01
R46	Debt Service Cover Ratio (Cash Generated by Operations / Debt Service)		1,9 : 1	1,3 : 1	1,3 : 1	0,8:1	1:1	1,2 : 1	1,4 : 1	1,6 : 1	1,7 : 1	1,9 : 1
SUSTAINAB	ILITY											
	Net Financial Liabilities Ratio	< 60%	30,5%	39,2%	39,9%	41,6%	41,8%	41,1%	39,4%	36,9%	33,6%	29,4%
	Operating Surplus Ratio	0% - 10%	-8,5%	-6,4%	-4,9%	-5,1%	-4,0%	-2,8%	-1,6%	-0,5%	0,7%	1,9%
	Asset Sustainability Ratio	> 90%	16,8%	13,4%	4,4%	4,6%	4,8%	4,9%	5,0%	5,2%	5,4%	5,5%

### FINANCIAL PERFORMANCE

EFFICIENCY		-	-			_	-	-			_	-
R42	Net Operating Surplus / Total Operating Revenue	>= 0%	-8,5%	-6,4%	-4,9%	-5,1%	-4,0%	-2,8%	-1,6%	-0,5%	0,7%	1,9%
R43	Electricity Surplus / Total Electricity Revenue	0% - 15%	21,4%	19,8%	18,0%	19,3%	19,3%	19,3%	19,3%	18,9%	18,6%	18,2%
R44	Water Surplus / Total Water Revenue	>= 0%	99,4%	99,3%	99,3%	99,3%	99,3%	99,3%	99,3%	99,3%	99,3%	99,3%
REVENUE MANAGEMENT												
R8	Increase in Billed Income p.a. (R'm)		-R 31,3 m	R 46,7 m	R 105,7 m	R 52,8 m	R 59,2 m	R 64,8 m	R 73,1 m	R 82,6 m	R 92,4 m	R 103,1 m
R9	% Increase in Billed Income p.a.	CPI	-5,5%	8,6%	18,0%	7,6%	7,9%	8,0%	8,4%	8,8%	9,0%	9,2%
R12	Operating Revenue Growth %	CPI	-3,3%	10,7%	11,8%	5,6%	7,5%	7,7%	8,1%	8,5%	8,8%	9,0%
R14	Contribution per Income Source: Equitable Share		16,8%	16,8%	16,7%	16,7%	16,5%	16,4%	16,2%	16,1%	15,9%	15,7%

YEAR			2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
R15	Contribution per Income Source: Conditional Operating Grants		4,5%	6,4%	3,1%	3,1%	3,0%	2,9%	2,8%	2,7%	2,7%	2,6%
R16	Contribution per Income Source: Property Rates		20,7%	19,7%	18,4%	18,2%	18,0%	17,7%	17,5%	17,3%	17,0%	16,8%
R17	Contribution per Income Source: Electricity Services		20,7%	21,7%	27,6%	29,1%	29,8%	30,3%	30,8%	31,3%	31,8%	32,3%
R18	Contribution per Income Source: Water Services		11,2%	10,8%	10,8%	10,9%	10,8%	10,9%	10,9%	10,9%	10,9%	10,9%
R19	Contribution per Income Source: Interest on Investments		0,5%	0,3%	0,2%	0,2%	0,2%	0,1%	0,1%	0,2%	0,3%	0,5%
R20	Annual Increase per Income Source: Equitable Share		15,2%	10,9%	11,1%	5,7%	6,4%	6,8%	7,1%	7,4%	7,6%	7,8%
R21	Annual Increase per Income Source: Property Rates		1,6%	4,9%	4,8%	4,4%	5,9%	6,3%	6,7%	7,0%	7,3%	7,5%
R22	Annual Increase per Income Source: Electricity Services		-21,1%	15,6%	42,4%	11,5%	10,0%	9,6%	9,9%	10,3%	10,5%	10,7%
R23	Annual Increase per Income Source: Water Services		0,7%	6,5%	12,0%	6,3%	7,3%	7,9%	8,2%	8,5%	8,7%	8,9%
R24	Annual Increase per Income Source: Interest on Investments		4,1%	-42,3%	-6,9%	4,8%	-26,0%	-18,4%	20,1%	72,1%	77,6%	63,1%
R47	Cash Generated by Operations / Own Revenue		11,6%	10,0%	9,1%	5,5%	6,3%	7,4%	8,5%	9,5%	10,6%	11,6%
R48	Cash Generated by Operations / Total Operating Revenue		9,1%	7,7%	7,3%	4,4%	5,1%	5,9%	6,9%	7,7%	8,6%	9,5%
EXPENDITU	RE MANAGEMENT											
	Creditors Payment Period	30	82	99	126	159	187	216	243	264	278	286
R30	Contribution per Expenditure Item: Staff Cost (Salaries, Wages and Allowances)	25% - 40%	33,4%	30,8%	31,1%	31,6%	31,5%	31,5%	31,5%	31,4%	31,4%	31,2%
	Contribution per Expenditure Item: Contracted Services	2% - 5%	10,5%	12,4%	9,7%	10,0%	9,8%	9,6%	9,5%	9,3%	9,1%	8,9%
R31	Contribution per Expenditure Item: Electricity Services		13,3%	14,4%	20,0%	21,1%	21,8%	22,5%	23,1%	23,9%	24,6%	25,5%

YEAR		2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
R32	Contribution per Expenditure Item: Water Services	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%	0,1%
R33	Contribution per Expenditure Item: Repairs & Maintenance	5,3%	5,6%	5,2%	5,0%	4,8%	4,6%	4,4%	4,2%	4,0%	3,8%
R34	Contribution per Expenditure Item: Depreciation and Asset Impairment	4,1%	3,9%	3,9%	3,9%	3,7%	3,6%	3,5%	3,3%	3,2%	3,0%
R35	Contribution per Expenditure Item: External Interest Charged	1,8%	2,4%	2,5%	2,4%	2,3%	2,2%	2,1%	2,1%	2,1%	2,0%
R36	Annual Increase per Expenditure Item: Staff Cost (Salaries, Wages and Allowances)	10,8%	0,5%	5,7%	5,7%	6,1%	6,5%	6,8%	7,0%	7,2%	7,3%
R37	Annual Increase per Expenditure Item: Electricity Services	-21,5%	18,0%	45,7%	9,7%	10,0%	9,5%	9,9%	10,8%	11,0%	11,2%
R38	Annual Increase per Expenditure Item: Water Services	3,2%	8,8%	13,2%	7,0%	7,2%	7,7%	8,1%	8,4%	8,6%	8,8%
R39	Annual Increase per Expenditure Item: Repairs & Maintenance	3,8%	15,6%	-3,0%	1,3%	1,5%	1,6%	1,8%	2,0%	2,2%	2,4%
R40	Annual Increase per Expenditure Item: Depreciation	7,3%	4,0%	4,9%	1,9%	2,9%	3,1%	2,9%	2,8%	2,7%	2,6%
R41	Annual Increase per Expenditure Item: External Interest Charged	49,9%	48,1%	7,2%	0,3%	2,0%	2,9%	4,0%	5,3%	5,9%	5,0%
GRANT DEP	ENDENCY										
R10	Total Grants / Total Revenue	25,8%	26,2%	22,7%	22,4%	21,9%	21,4%	21,0%	20,6%	20,2%	19,8%
R11	Own Source Revenue to Total Operating Revenue	78,7%	76,8%	80,2%	80,2%	80,5%	80,7%	80,9%	81,2%	81,4%	81,7%
	Capital Grants to Total Capital Expenditure	44,0%	29,2%	46,4%	52,9%	47,9%	44,0%	40,9%	38,3%	36,1%	34,1%

These ratios are calculated from the output of the model and can at best only approximate the calculation based on actual accounts.

DEFINITIONS	
Liquidity Ratios	
Current Ratio	Current Assets / Current Liabilities
Quick Liquidity Ratio	(Current Assets - Debtors > 30 days) / Current Liabilities
Minimum Liquidity Level (or Cost Coverage)	((Cash and Cash Equivalents - Unspent Conditional Grants - Overdraft) + Short Term Investment) / Monthly Fixed Operational Expenditure excluding (Depreciation, Amortisation, Provision for Bad Debts, Impairment and Gain and Loss on Disposal of Assets)
Overdraft to Total Income	Overdraft / Total Operating Revenue
Operational Ratios	
Accounting Surplus	Total Operating Revenue + Conditional Grants - Total Operating Expenditure
Cash Operating Surplus	Total Operating Revenue - Total Operating Expenditure + Working Capital
Cash from Operations as a % of own Revenue	Operating Cash / Operating Revenue
Repairs and Maintenance to PPE	Total Repairs and Maintenance Expenditure / Carrying Value of PPE x 100
Debtors Payment Ratio	(Gross Debtors Closing Balance + Billed Revenue - Gross Debtors Opening Balance + Bad Debts Written Off) / Billed Revenue x 100
Staff Costs	Remuneration (Employee Related Costs and Councillors' Remuneration) / Total Operating Expenditure x 100
External Gearing Ratios	
External Loan Liability Paid Coverage Ratio	(Total Operating Revenue - Total Operating Expenditure (excluding non-cash items)) / Capital Cost (Interest Paid and Redemption)
External Interest and Capital Paid to Total Expenditure	Capital Cost (Interest Paid and Redemption) / Total Operating Expenditure x 100
External Gearing Ratio (or Debt as a % of Own Revenue)	(Overdraft + Current Finance Lease Obligation + Non-Finance Lease Obligation + Short Term Borrowings + Long Term Borrowings) / Total Operating Revenue
Other Ratios	
Level of Grant Dependency	(Total Grants) / (Total Operating Revenue)
Operating Surplus Ratio	(Operating Revenue - Operating Expenditure) / Operating Revenue
Net Financial Liabilities Ratio	(Total Liabilities - Current Assets) / Operating Revenue (excl Capital Grants)
Asset Sustainability Ratio	Capex for Replacement / Depreciation

### **ANNEXURE 4: VIABILITY FRAMEWORK**

- 1. A proposed framework is provided below, within which to manage liquidity, operational performance and external gearing and is aligned to MFMA Circular No. 71.
- 2. The municipality is advised to include these ratios in the relevant revised financial policies:

#### **Liquidity Ratios**

3. Standard Liquidity Ratio (The ability to fully provide for current liabilities with current assets.)

Minimum norm: 1:1 Healthy norm: 2:1 MFMA norm: 1.5 – 2:1

4. Quick Liquidity Ratio (The ability to provide for current liabilities with liquid current assets therefore current assets including only 30-day debtors.)

Minimum norm: 1:1 Healthy norm: 2:1 MFMA norm: None

5. Minimum Liquidity Level (Holding sufficient cash and investments to fully provide for the sum of unspent conditional grants, short term provisions, ceded investments, cash backed reserves and provisions and at least one month of operating expenditure (excluding non-cash expenses).

Minimum norm: 1:1 Healthy norm: 1:1 plus an additional month's operational expenditure MFMA norm: 1 – 3 months MFMA calculation excludes cash backed reserves and short-term provisions; however, an additional ratio is stipulated in Circular 71 regarding the Level of Cash Backed Reserves.

6. Overdraft to Total Income (Preferably a municipality should not have an overdraft facility at all at year end, however, should an overdraft facility be used it should not exceed 5% of Total Income.)

Maximum norm: 5% Healthy norm: 0% MFMA: None

7. Other ratios as stipulated below are to be managed at levels applicable to the Municipality and although industry benchmarks exist it is more prudent to set objectives given the current financial context of the Municipality. The following ratios are recommended for consideration, and it would be prudent to report hereon on a quarterly basis to the Finance Committee:

### **Operational Ratios**

8. Total Accounting Surplus (The ability to post an accounting operational surplus where Total Income exceeds Total Expenditure with a positive margin.)

Minimum norm: Break-even of the above calculation Healthy norm: Positive margin that is maintained MFMA norm: Break-even or >0

9. Cash Operating Surplus (The ability to generate surplus cash from operational performance therefore Total Income less conditional transfers less total expenditure excluding non-cash items adjusted for changes in working capital should be positive.)

Minimum norm: Break-even of the above calculation Healthy norm: Positive margin that is maintained

#### MFMA norm: None

10. Repairs and maintenance to Total Expenditure (The ability of the municipality to effectively maintain the infrastructure assets from which it derives its primary income.)

Minimum norm: 5% Healthy norm: 7% MFMA norm: 8%

MFMA calculation differs in using the Property, Plant and Equipment (carrying value) as the base of the ratio instead of Total Expenditure.

11. Consumer Collection Levels (For a municipality to maintain its viability it should maintain its collection levels at least above 90%. Growth in gross consumer debtors including debts written off in the financial year as a percentage of billed income including equitable share, will provide the non-collection level therefore the difference will indicate the consumer collection level.)

Minimum norm: 90% Healthy norm: 95%+ MFMA norm: 95%

12. Staff Costs, Allowances and Wages (The level of staff costs, allowances and wages to total operational expenditure needs to be effectively managed to ensure that costs aren't considered too high, but also that the municipality is not under capacitated and employment levels are too low.)

Minimum norm: 25% Healthy norm: 25% to 30% MFMA norm: 25% to 40%

**External Gearing Ratios** 

- 13. Proposed External Gearing ratios are subject to Liquidity ratios being within recommended levels.
- 14. External Loan Liability Paid Coverage Ratio (The ability to at least cover the External Interest and Capital Payable with the cash generated from operations before interest.)

Minimum norm: 1:1 Healthy norm: 2:1 MFMA norm: None

15. External Interest and Capital Paid to Total Expenditure (The percentage of Total Expenditure Utilized to service external loan repayments.)

Maximum norm: 10% Healthy norm: 7.5% MFMA norm: 6% - 8%

16. External Gearing Ratio (The level to which the municipality has geared itself is calculated as Total External Interest-Bearing Debt as a percentage of Total Income less conditional grant funding.)

Maximum: 40% Healthy norm: 35% MFMA norm: 45%

### **ANNEXURE 5: ASSETS EARMARKED FOR REPLACEMENT**

The asset register of the municipality was analysed mechanistically (without engineering judgement) and a replacement schedule of the Annual Replacement Cost ("ARC") of different asset classes was determined. This was done with reference to the information in the municipality's asset register. Asset categories such as "Investment Property", "Land" and "Heritage Assets" were excluded from the assessment. The values in the Tables below are in nominal Rand values, escalated to the date of replacement.

TABLE 5.1: BITOU LM: ESTIMATED ANNUAL REPLACEMENT COST AS EXTRACTED FROM THE ASSET REGISTERS (RM NOMINAL)

			2021/22	/			(		(		/		
#	DESCRIPTION	TOTAL	and before	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32
1	Construction work-in-progress	16.4	0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	16.1	0.0	0.0
2	Heritage assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
3	Intangible assets	0.6	0.4	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0
4	Investment property	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
5	PPE - Community assets	539.9	502.4	0.2	1.1	0.4	5.5	5.2	22.7	0.1	0.7	0.9	0.5
6	PPE - Computer equipment	55.7	13.7	3.4	1.1	3.9	1.0	0.0	0.0	19.6	5.3	1.7	6.0
7	PPE - Furniture and office equipment	42.9	15.6	2.1	1.5	0.5	0.5	2.9	1.1	11.0	2.9	2.3	2.5
8	PPE - Infrastructure: Electricity	1 385.6	159.8	15.3	210.2	98.0	536.6	8.6	0.0	105.4	97.1	104.7	49.8
9	PPE - Infrastructure: Network and Communication	0.7	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.5	0.1	0.0	0.0
10	PPE - Infrastructure: Roads, pavements, bridges	4 129.8	3 909.2	0.0	33.8	9.4	0.0	35.9	0.0	86.7	0.7	53.4	0.7
11	PPE - Infrastructure: Storm water	1 384.9	302.4	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	1 082.4	0.0
12	PPE - Infrastructure: Waste management	15.2	0.1	0.0	0.0	0.0	2.9	0.0	0.4	0.0	0.0	10.4	1.4
13	PPE - Infrastructure: Waste Water management	514.7	435.5	0.5	1.5	14.8	6.9	3.3	0.0	2.5	7.6	34.1	8.1
14	PPE - Infrastructure: Water	4 350.8	2 308.6	1.4	0.8	301.6	39.1	0.0	0.0	6.8	1 170.0	477.6	44.8
15	PPE - Land	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16	PPE - Libraries	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
17	PPE - Machinery and equipment	35.4	13.4	1.3	0.8	0.1	1.7	12.3	1.8	3.5	0.2	0.2	0.2
18	PPE - Other assets	7.0	2.3	0.2	0.0	0.1	0.3	0.7	1.3	0.9	0.1	0.0	1.2
19	PPE - Transport assets	102.6	12.8	13.6	3.4	4.0	2.5	2.7	6.4	18.0	13.9	6.3	18.9
20	Not Classified	35.2	35.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	TOTAL	12 617.2	7 711.8	38.0	254.2	432.8	597.1	71.9	33.7	255.1	1 314.6	1 773.9	134.1

We have amended the estimated replacement costs. This was achieved by:

- Assuming that the actual remaining life of assets will exceed the life recorded for some of the assets in the asset register,
- Assuming that only a percentage of assets will be replaced when their estimated useful life expires,
- Spreading replacement not done in the past over several future years, and
- Smoothing the constant 2022 value over the Planning Period and reverting these back to nominal values.

The outcome of this analysis is presented in the Table below:

#### TABLE 5.2: BITOU LM: SPREAD, REVISED, REDUCED AND SMOOTHED ESTIMATED ASSET REPLACEMENT COST (RM NOMINAL)

			1	2	3	4	5	6	7	8	9	10
	TOTAL	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
		and before										
ARC (Rm Nominal) Original	12 617.2	7 711.8	38.0	254.2	432.8	597.1	71.9	33.7	255.1	1 314.6	1 773.9	134.1
ARC (Rm Nominal) Revised & Spread	9 986.7		884.9	1 073.6	1 239.7	1 387.1	906.0	343.4	531.0	1 489.6	1 690.2	441.0
ARC (Rm Constant 2022)	7 051.0		827.0	937.7	1 012.0	1 058.2	646.0	228.8	330.7	866.9	919.4	224.2
ARC (Rm Constant)(Smoothed)	7 051.0		705.1	705.1	705.1	705.1	705.1	705.1	705.1	705.1	705.1	705.1
ARC (Rm Nominal)(Smoothed)	10 423.9		754.5	807.3	863.8	924.2	988.9	1 058.2	1 132.2	1 211.5	1 296.3	1 387.0