Overview of Municipal Service Delivery Mechanisms
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Preface

A local government restructuring initiative got underway in 2000 with the creation of different municipal categories, including metropolitan, district and local municipalities. A key outcome of this process was a clear shift in responsibility with local government obligated to deliver a range of services to the people it serves.

Despite structural changes, municipalities still face a major challenge in balancing the Constitutional imperatives of providing access to affordable basic services while also ensuring the optimal use and mobilisation of available skills, resources, capacity and assets.

Decision-making by municipalities is extremely regulated, particularly by local government legislation such as the Municipal Systems Act and the Municipal Finance Management Act. Implementing decisions is also a complex and often difficult process.

In evaluating municipal service delivery mechanisms, it is imperative that each be regarded as an ongoing process rather than a once-off or isolated solution. Service delivery is a long-term responsibility that requires continual improvements for the benefit of the community.

Municipalities are not obliged to provide municipal services themselves but may opt to appoint service providers to do so on their behalf, without limiting or compromising their autonomy or authority.

In 1997 the National Business Initiative, Standard Bank Corporate and Investment Banking (formerly Standard Corporate and Merchant Bank) and Rand Water established a partnership to empower and fund various initiatives regarding municipal service delivery. This included promoting the concept of public-public partnerships and public-private partnerships in respect of municipal service delivery options. This document is a product of this partnership.

Part A summarises the aims of the document. In Part B we contextualise the decision making process, commenting on a number of actions. Part C lists and sets out the objectives of legislation impacting on local government decision making. Part D explores the steps in the Section 78 process. Part E distinguishes internal and external mechanisms and raises practical issues for consideration. Part F and Annexure C set out different contract types and highlight legislative compliance issues. Part G focuses on Public Private Partnerships (PPPs). Finally, in Part H, other relevant issues such as procurement, employees, the finance cycle and asset issues are addressed.

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Disclaimer

This document aims to provide background and hopefully assist municipalities in selecting appropriate mechanisms for the provision of municipal services. Prevailing legislation must always be considered, including provisions of the Municipal Structures Act (1998), the Municipal Systems Act (2000), the Municipal Finance Management Act (2003) and sector-specific legislation such as the Water Services Act (1997).

While every effort has been made to ensure the accuracy and completeness of the information in this document, the National Business Initiative, Standard Bank Corporate and Investment Banking and Rand Water cannot be held liable for damages of any nature arising from reliance on this document.

Note also that this document is dated August 2006. By the very nature of the dynamic political and regulatory environment local government finds itself in, the legislation and interpretation thereof with reference to case studies and case law will change over time.
Part A: Introduction

1. Aims of document

This document aims to provide:

- A general overview of the context in which decisions are made regarding municipal service delivery.
- Details of the legislative framework and other matters that need to be considered when selecting appropriate service delivery mechanisms. These mechanisms need to provide sustainable, effective and affordable municipal services.
- Background to the types of municipal service delivery mechanisms listed in the legislation.
- Other relevant matters such as contract types, procurement issues and financing options.
- This document focuses primarily on the relevant provisions of the Municipal Systems Act and the Municipal Finance Management Act.

A key objective of this document is to encourage municipalities to adopt a fresh and creative approach to developing infrastructure and to delivering services to achieve growth targets.

This document does not aim to address in great detail all matters relating to, or impacting on, service delivery mechanisms. It does, however, provide a holistic overview of these matters, enabling municipalities to access information and resources and to take informed decisions regarding appropriate service delivery mechanisms.

2. An ongoing process

Basic municipal service delivery is imperative in South Africa. Despite its complexities, prevailing legislation regarding service delivery must be seen to assist municipalities to make informed and considered decisions. These laws and processes ultimately serve and protect the people who benefit from the delivery of municipal services.

Because local governments respond to unique needs within the areas they serve, there is no generic model or step-by-step guide that can be rolled out across the board to all municipalities. An effective project plan – developed by a municipality before embarking on any decision-making process – is thus critical. This is where specific compliance issues must be identified, with a sequence of events structured to ensure an effective overall process.

Decision-making is an ongoing process for local government and should not be regarded as a once-off activity. The diagram in Part B highlights the need for ongoing planning, identification and change management to deliver efficient and affordable services.

This document focuses on various available options concerning municipal service delivery and the processes involved in the respective selection processes.

“Section 78” is a buzzword with many municipalities and councillors intent on “completing” this process. Section 78 of the Municipal Systems Act is basically a process that regulates how municipalities can opt to deliver services. It distinguishes between the following:

- Internal mechanisms, where a municipality decides to provide a service itself.
- External mechanisms, where a municipality appoints an external entity to provide a service (this includes other municipalities, a municipal or state entity, a community-based organisation (CBO) a non-governmental organisation (NGO) or a private sector party).

Implementation of the outcome of Section 78 processes must comply with prevailing legislation impacting municipal decision-making processes, such as the Municipal Finance Management Act.

Currently, attention concerning Section 78 is focused mainly on the provision of water, sanitation services and electricity. This relates to national government’s restructuring initiatives within the electricity distribution industry as well as the authority afforded to some local municipalities to provide water and sanitation services. In response, several national sector departments have launched support initiatives for municipalities. These include the Department of Water Affairs and Forestry’s (DWAF) participation in a “Joint Response Team” and EDI Holdings (Pty) Ltd issuing a “‘tool kit for S78s”.

Section 78 is simply a regulated decision-making process that must be followed in certain cases. Similarly, compliance with Section 120 of the Municipal Finance Management Act is necessary in cases where a transaction will result in a public-private partnership.

Municipalities should note that not all decisions taken in relation to service delivery are necessarily about mechanisms (how service delivery happens). Rather, these may include decisions taken in the ordinary course of running the business of a municipality, such as:

- The procurement of goods and services in the ordinary course of the municipality’s business (equipment leasing arrangements, financing arrangements, professional service providers such as IT, lawyers and auditors).
- The procurement of construction contracts for infrastructure development (turnkey projects that do not involve transfer of operational risk).
- The procurement of support services to assist the municipality to deliver services.

Although this document focuses mainly on legislation governing the delivery of municipal services according to a Section 78 process, not all decisions necessarily follow the same process. General supply chain management policies and procedures will apply to most decisions.

Sometimes, PPP regulations issued under the Municipal Finance Management Act will apply should the transaction involve the transfer of technical, operational and financial risk to the private sector. Typically, we see Section 78 processes applying for basic municipal services such as waste management and the supply of electricity, water and sanitation services.
Part B: Process summary

Find out whether it is a decision about:

<table>
<thead>
<tr>
<th>How a municipal service is delivered to the community and whether there is a S77 trigger</th>
<th>Support to the municipality to deliver municipal services directly to the community</th>
<th>Infrastructure development</th>
<th>or Procurement of goods and services</th>
</tr>
</thead>
<tbody>
<tr>
<td>- electricity</td>
<td>- IT systems</td>
<td>Building or construction, with no transfer of ongoing operational responsibility</td>
<td>- stationery</td>
</tr>
<tr>
<td>- water</td>
<td>- revenue management systems</td>
<td></td>
<td>- photocopier machines</td>
</tr>
<tr>
<td>- waste</td>
<td>- fleet management</td>
<td></td>
<td>- finance arrangements</td>
</tr>
</tbody>
</table>

If it is a requirement to comply with section 78 then consider the following (in addition to the legislation and the rest of the details in this document). For the other decisions – follow Supply Chain Management Policy (discussed in Part H, clause 19). The mechanism options are explored in more detail in Part E.

<table>
<thead>
<tr>
<th>Internal mechanism</th>
<th>External mechanism</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Public sector</strong></td>
<td><strong>Private sector</strong></td>
</tr>
<tr>
<td><strong>What</strong></td>
<td><strong>What</strong></td>
</tr>
<tr>
<td>- Department</td>
<td>- CBO/NGO</td>
</tr>
<tr>
<td>- Business unit</td>
<td>- Private sector</td>
</tr>
<tr>
<td>- Other</td>
<td>Note:</td>
</tr>
<tr>
<td>Note:</td>
<td>- S78(3) feasibility study required.</td>
</tr>
<tr>
<td>- Can stop after S78(2) internal assessment</td>
<td>- PPP feasibility required.</td>
</tr>
<tr>
<td>- Must implement decision.</td>
<td>- Competitive procurement required which has the benefit of comparing value for money.</td>
</tr>
<tr>
<td>- Must allocate sufficient human, financial and other resources necessary for the proper provision of the service and transform the service in accordance with the requirements of the Systems Act.</td>
<td>- Service delivery agreement required with strict KPAs and KPIs addressing what was tendered and issues such as risk transfer and payment mechanisms, section 80 of the Systems Act, Regulation 309 under S120 of the Municipal Finance Management Act and relevant sector legislation such as Section 19 of the Water Services Act and the Regulations.</td>
</tr>
<tr>
<td>- Should assess if support contract is necessary to address short-term gaps with internal mechanism for example, – to build capacity</td>
<td>- Municipality is constitutionally obliged to ensure service delivery – and so must monitor and enforce performance of service provider and also its own performance around authority responsibilities such as:</td>
</tr>
<tr>
<td></td>
<td>– Supporting enforcement of policies by-laws.</td>
</tr>
<tr>
<td></td>
<td>– Funding budgets by setting proper tariffs and accessing grant funding.</td>
</tr>
<tr>
<td></td>
<td>– Aligning political promises to proper planning and realistic capacity constraints.</td>
</tr>
<tr>
<td></td>
<td>– Managing inter-governmental issues arising.</td>
</tr>
<tr>
<td>- Another municipality (for example local municipality where district municipality is the authority)</td>
<td>- No competitive procurement necessary although it can be done to get value for money even if invitation is only extended to specific public entities.</td>
</tr>
<tr>
<td>- Municipal entity: can take one of three forms: (Pty) Ltd established under Companies Act with one or more shareholders as long as municipality has effective control; Service Utility established by by-law of the municipality in which only the municipality can participate; or Multi-Jurisdictional Service Utility established by agreement between more than one municipality.</td>
<td>- Still need to enter into a service delivery agreement which must comply with legislation.</td>
</tr>
<tr>
<td>- Public entity: entities established by national or provincial government and regulated by the Public Finance Management Act, for example, water boards, Eskom and Transnet.</td>
<td>- No need to comply with PPP Regulations because it is a public sector entity.</td>
</tr>
<tr>
<td>Note:</td>
<td>- If contract term is for longer than three years have to comply with S33 of MFMA.</td>
</tr>
<tr>
<td>- No competitive procurement necessary although it can be done to get value for money even if invitation is only extended to specific public entities.</td>
<td>- Public entities have to comply with the Public Finance Management Act.</td>
</tr>
<tr>
<td>- Still need to enter into a service delivery agreement which must comply with legislation.</td>
<td>- Establishment of municipal entities have to comply with Systems Act and S84 of the MFMA.</td>
</tr>
<tr>
<td>- No need to comply with PPP Regulations because it is a public sector entity.</td>
<td>- Both parties have obligation to avoid fruitless and wasteful expenditure.</td>
</tr>
<tr>
<td>- If contract term is for longer than three years have to comply with S33 of MFMA.</td>
<td>- If it is appointment of another municipality, the other municipality who will be the service provider and has to do its own feasibility study in terms of Section 80(3) of the Systems Act.</td>
</tr>
<tr>
<td>- Public entities have to comply with the Public Finance Management Act.</td>
<td>- Managing inter-governmental issues arising.</td>
</tr>
<tr>
<td>- Establishment of municipal entities have to comply with Systems Act and S84 of the MFMA.</td>
<td></td>
</tr>
</tbody>
</table>
Section 78 is not a once-off or isolated activity. In the interests of efficient and affordable service delivery, the process of planning, identifying the need for, and implementation of improvement or change, must be ongoing.
The following table explains the key components of the activities identified in the previous diagram in Part B. Practically, it shows what is required at each stage of the ongoing planning process and highlights key questions that need to be addressed.

<table>
<thead>
<tr>
<th>Action</th>
<th>Issues to bear in mind</th>
</tr>
</thead>
</table>
| **Planning** | - Planning is an authority function - a municipality cannot delegate this function or outsource it.  
- An integrated development plan (IDP) and a budget are key tools to analyse current service delivery.  
- An IDP is a prerequisite in terms of the Municipal Systems Act; it must include the following:  
  - An assessment of existing service levels  
  - Council’s development priorities  
  - Council’s development strategies  
  - A spatial development framework  
  - Council’s operational strategies (key performance indicators (KPIs) and performance targets)  
  - Sector-specific plans  
- The Municipal Finance Management Act stipulates budget requirements:  
  - The budget is a financial expression of the priorities of a municipality and the culmination of the planning process.  
  - The budget must indicate the allocation of available resources between competing needs.  
- Budget implementation and an IDP are cyclical factors that impact each other. |
| Identify a trigger for change | - Various factors may trigger a change. These include:  
  - Political imperatives  
  - Operational issues, for example, need for rapid expansion to address backlog  
  - Boundary changes, for example, re-demarcation  
  - Contractual issues, for example, expiry or termination of existing service delivery agreement  
  - A national government imperative, for example, EDI restructuring policy  
- Determine whether it is a Section 77 trigger and if Section 78 applies. |
| Analyse service delivery needs | - What is the service for? For example, is it a full municipal service or a support service?  
- How is the service currently being delivered? What mechanisms are in place?  
- What needs to be done and achieved regarding the service in the short, medium and long term?  
- Determine the challenges facing the mechanism regarding the service delivery needs. Assess whether a minor change to the existing mechanism would be sufficient or whether there is a need to change it to address any gaps or shortfalls. Also gauge whether the matter can actually be resolved by a restructured mechanism. |
| Assess options to develop feasible and affordable solutions going forward | Develop a project management plan highlighting compliance hurdles in sequence.  
Take into consideration both practical and legislative requirements, such as:  
- Mandating a task team and, if necessary, identifying and clarifying the key responsibilities of the project officer.  
- Mapping out, broadly, the legislative framework regulating the process, highlighting key decisions and consultation requirements with external stakeholders.  
- Developing a project plan for the task team to perform and report against.  
- Appointing advisers, consultants, transaction advisers, where appropriate, to assist the task team.  
- Establish realistic timelines and allocation of resources relative to the nature of the project.  
Take into account the National Treasury’s Project Development Fund, which assists PPPs.  
Also remember that national and provincial government have an obligation to support municipalities, both generally and specifically, in relation to feasibility studies.  
- Avoiding an unnecessarily over-complicated decision-making process that is unrealistic and impossible to implement.  
- Identifying the appropriate decision-maker. |
| Ensure process compliance | - Consider whether Section 78 is applicable (is it a municipal service and is there a trigger?)  
- Establish whether Section 120 is applicable – it’s probably then a PPP.  
- If there is more than a three-year financial commitment, Section 33 of the Municipal Finance Management Act is applicable. Ensure timeous consultation with relevant stakeholders, such as labour, the local community and external parties.  
- Ensure that due process has been followed and that views and recommendations received have been adequately addressed and considered.  
- Record in a transparent fashion the information and professional opinion relied on to reach the conclusion and recommendation.  
- Justify the conclusion and recommendation. |
<p>| Decide | - The decision must be reasonable and justifiable. The decision-makers will reach their decision independently but will rely on the report and recommendations put forward by the mandated task team. |</p>
<table>
<thead>
<tr>
<th>Action</th>
<th>Issues to bear in mind</th>
</tr>
</thead>
</table>
| Procure | • The appropriate decision-maker must be identified. Note that a council may not delegate the decision to enter into a contract with an external service delivery mechanism.  
• In some cases the Municipal Finance Management Act stipulates that the council must be the ultimate decision-maker. This applies in cases such as the establishment of a municipal entity and when approving a contract that has a future financial commitment.  
• Usually, the Executive Mayor or the Executive Committee will have authority to make decisions in implementation-related issues or the accounting officer may be the decision-maker.  
• The decision may result only in internal change, in which case procurement is not necessary.  
• The procurement process must be appropriately designed in accordance with supply chain management policies and other legislation and regulations. These include the Preferential Procurement Policy Framework Act, the Broad Based Black Economic Empowerment Act and PPP regulations.  
• If necessary, procurement can be a two-stage process where bidders are 1) pre-qualified in response to an expression of interest, and, 2) subsequently required to respond to a detailed terms of reference.  
• The terms of reference should ideally detail specific parameters. This will assist bidders to respond accurately. Greater clarity will ensure less risk and more certainty, keeping prices down and making contractual negotiations easier.  
• A draft contract attached to the request for proposal (RFP) can help speed up the process.  
• Note that in the case of a public sector service provider, a competitive procurement process is not compulsory. This type of process does, however, assist municipalities to derive greater value for their money. |
| Negotiate and finalise the contract | • The negotiation process is an important step in clarifying roles, responsibilities and expectations.  
• The Municipal Systems Act leaves room for negotiation but municipalities should avoid changing fundamental, underlying principles. In such cases, the municipality concerned may be challenged by unsuccessful bidders.  
• Contracts may be standardised to some extent but should ideally address the specific needs identified in assessments, feasibility studies and procurement processes.  
• The contracts must be appropriate for the type of transaction they govern. They must also be realistic in terms of risk allocation.  
• If it is an internal restructuring, the contracts will be performance contracts with the municipal employees or inter-departmental service level undertakings. |
| Implement | • The cost and stamina required to implement changes should not be underestimated. Unless municipal staff have experienced change and/or driven a change management processes previously, they may not be expecting a reluctance to change. This is why National Treasury requires a project officer with a performance contract to be dedicated to a PPP project. A dedicated and motivated person still needs to push for the changes to be implemented.  
• Very often, for the service provider to deliver on its contractual obligations, the municipality needs to participate and assist where necessary.  
• Implementation may also require change management strategies, especially where employees are affected.  
• An implementation plan is essential in driving change. |
| Contract management | • Once the contract is signed, there is an ongoing obligation on the part of the municipality to perform.  
• Effective contract management ensures that all parties meet their respective obligations and deliver the objectives required from the contract. Contract management requires a good working relationship and a proactive approach to react appropriately when problems arise and to anticipate future needs.  
• The central aim of contract management is to achieve a continuous improvement in performance and to obtain the services specified in the contract. Other aims include the following:  
  − Ensure ongoing affordability, value for money and appropriate risk transfer.  
  − Optimise efficiencies, effectiveness and achieve economies of scale.  
  − Balance costs against risks. |
| Plan | • Good planning involves an ongoing obligation to address changing needs and to identify new opportunities for improved service delivery.  
• The process starts again. |

Overview of Municipal Service Delivery Mechanisms
Part C: The legislative framework

3. Relevant legislation

Part C provides a brief description of the objectives of legislation impacting on local government decision-making. It also distinguishes the types of decisions that an authority, as distinguished from a provider, is obliged to make.

Part D focuses on the detailed legislative requirements of a Section 78 process and also refers to Section 120 PPP requirements of the Municipal Finance Management Act.


There are three primary spheres of government, namely local, provincial and national.

The Constitution outlines the functional areas of each sphere. The powers and functions of local government are detailed in Annexure A.

Local government must ensure that communities have access to sustainable services. National and provincial government are obliged to support local government and regulate its performance.

3.2. Local Government: Demarcation Act (Act 27 of 1998)

This Act was the first step in transforming local government. It created the framework for the re-demarcation of municipal boundaries by the Demarcation Board. It reduced the number of municipalities from 843 to 284, including:

- Six metropolitan municipalities
- 231 local municipalities


The Municipal Structures Act establishes municipalities and creates their internal structures. The Act deals with the division of powers and functions between district and local municipalities.

“Functions” refer to local government functions, according to Part B of Schedule 4 and Part B of Schedule 5 of the Constitution (attached as Annexure A: Municipal Powers and Functions).

“Powers” refer to the legislative and executive authority associated with each of function. Legislative authority concerns the power to make by-laws and executive authority’s ability to make decisions in relation to these functions.

The Act allocates a broad range of powers and functions to district municipalities. These functions include water, sanitation, municipal health and electricity services.

While the Act allocates these four functions to district municipalities, it also makes provision for the Minister of Provincial and Local Government to authorise a local municipality to exercise these powers and functions in its area of jurisdiction instead of the district municipality. The Minister has effectively done this since July 2003.

The Act is largely static. It lists municipal structures and describes how to create them but doesn’t specify what these structures do (the Systems Act does this).


The Systems Act focuses on municipalities’ internal systems and administration. The Act provides basic elements of public accountability, the constitutional requirement for public involvement, policies and decision-making structures. As such, it focuses on “developmental local government”. It also distinguishes the responsibility of a service authority versus a service provider; it sets out the roles of officials and councillors and provides for a range of requirements, including IDPs, performance management and tariff setting.

The Act, together with the Municipal Finance Management Act, is the primary legislation that regulates municipal service delivery. The Act provides a comprehensive range of service delivery mechanisms through which municipalities may provide municipal services. It explains the process to be applied and the criteria to be considered in reviewing and selecting municipal service delivery mechanisms.


The Municipal Finance Management Act regulates the financial affairs of municipalities and municipal entities. It establishes treasury norms and standards for budgets, reporting and financial controls. This Act applies to all municipalities, all municipal entities and national and provisional organs of state that have financial dealings with municipalities. The Act aims to ensure transparency, accountability, and appropriate lines of responsibility. It focuses on appropriate management of revenues, expenditure, assets and liabilities and the management of financial dealings.

The Act regulates certain aspects of municipal service delivery mechanisms and the process of implementing such mechanisms. Matters addressed include the establishment of municipal entities, public-private partnerships, supply chain management and municipal budgets.

This Act also obligates municipalities to practice supply chain management. This is a holistic approach to procuring goods and services used by local government (see clause 19 for more details).

3.6. Sector legislation

Sector legislation regulates the provision of specific municipal services. Any municipality that provides municipal services needs to comply with it.
Overview of Municipal Service Delivery Mechanisms

3.7. Provincial legislation

There are still several provincial laws in force. These are being repealed gradually, particularly by local government legislation. However, during the project planning stage, it is important to check what laws apply. This document does not identify such legislation.

3.8. Other relevant legislation

Promotion of Access to Information Act (Act 2 of 2000)

This Act gives effect to the constitutional right of access to any information held by municipalities.

Promotion of Administrative Justice Act (Act 3 of 2000)

The Act applies to all administrative actions and reinforces the need for municipalities to apply their minds to every aspect of the decision-making process and to ensure that deliberations consider every relevant aspect.

Preferential Procurement Policy Framework Act (Act 5 of 2000)

The provisions of this Act may be applicable depending on the service delivery mechanism selected by a municipality and must be reflected in the Supply Chain Management Policy of a municipality. The regulations under this Act set out the 80/20 or 90/10 price/preference point system, depending on the value of the contract. It allows for points to be allocated for functionality (that is skills and experience), which is generally important in service delivery contracts.

Broad Based Black Economic Empowerment Act (Act 53 of 2003)

This Act establishes a legislative framework for the promotion of black economic empowerment. It also empowers the Minister of Trade and Industry to issue codes of good practice and to publish transformation charters. No relevant code has been issued under this Act and municipalities must still comply with the Preferential Procurement Policy Framework Act and regulations. It is worth noting that National Treasury has issued a PPP balanced scorecard in its National and Provincial PPP guidelines, which is a useful reference tool.

4. The authority/provider distinction

Local government is obliged to ensure service delivery. It need not actually provide the service itself but can appoint a service provider to do certain things. An interpretation of relevant legislation draws a clear distinction between the powers, obligations and functions that a municipality must perform, that is cannot assign, delegate or contract to another institution and those that a municipality may have another organisation perform on its behalf, for example:

<table>
<thead>
<tr>
<th>Authority function which cannot be delegated or contracted out</th>
<th>Provider function which can be undertaken internally or by way of an external mechanism</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance/supervision</td>
<td>Provision/implementation</td>
</tr>
<tr>
<td>• Ensuring access</td>
<td>• Management</td>
</tr>
<tr>
<td>• Planning</td>
<td>• Operations and maintenance</td>
</tr>
<tr>
<td>• Policy and legislation</td>
<td>• Service provision</td>
</tr>
<tr>
<td>• Tariffs</td>
<td>• Compliance</td>
</tr>
<tr>
<td>• Monitoring</td>
<td>• Business planning</td>
</tr>
<tr>
<td>• Accountability</td>
<td>• Providing information</td>
</tr>
</tbody>
</table>

Only the municipal council may take the following decisions:

• Pass by-laws
• Approve budgets
• Raise loans
• Set tariffs and impose rates
• Enter into contracts with external mechanisms
• Approve or amend IDPs.

5. Definition of a municipal service

It is important to know whether the subject of review and assessment is a “municipal service” as the obligation to comply with Section 78 applies only to municipal services (unlike compliance with the PPP regulations, which have a broader definition – see paragraphs 6 and 18 of this document).

The Municipal Systems Act defines a municipal service as one that a municipality, in terms of its powers and functions, provides or may provide to or for the benefit of the local community, irrespective of whether the municipality provides the service itself, or engages an external mechanism, or whether fees, charges or tariffs are levied in respect of the service, or not.

The administrative activity undertaken by the municipality in support of a specific municipal service is typically also undertaken in support of other municipal services and in support of municipal activities having no relationship to service provision.

Note that the distinction between what is a municipal service and what is a support service is not always clear. Municipalities must consider this aspect carefully during their process planning phase, with reference to the specific details of the project.

There is a view that support services, such as revenue management, are not regarded as municipal services as this is specifically addressed in a separate chapter of the
Municipal Systems Act and not under the chapter dealing with municipal services. For example, the City of Johannesburg did not follow a Section 78 process when considering establishing a revenue management service utility. Procurement of support services would nonetheless be regulated by the Supply Chain Management Policy, but not to the extent of having to comply with Section 78 of the Systems Act and Section 120 of the Municipal Finance Management Act.

6. Definition of a public private partnership (PPP)

PPPs are defined as a commercial transaction between a municipality and a private party in terms of which the private party:

- Performs a municipal function for or on behalf of the municipality
- Assumes substantial financial, technical and operational risks in connection with the performance of the function and/or use or management of municipal property
- Receives a benefit from performing the municipal function, by way of compensation from a revenue fund, charges or fees collected by the private party from users or customers of a service provided to them, or a combination of such compensation and such charges or fees.

It is important to know what a PPP is because of the procedural requirements of Section 120 and its Regulation 309. These place obligations on the municipality at a very early stage of assessment, such as notifying National Treasury. If it is a municipal service, Section 78(1) must first be complied with – that is an internal assessment must be done before a PPP can be considered. If it is not a municipal service, but for example, office accommodation and/or development, then Section 78 need not be complied with. If Section 78 and Section 120 both be complied with, this can be done in a parallel process. PPPs are further discussed in Part G.

Part D: The Section 78 process

7. The trigger

Section 77 of the Municipal Systems Act prescribes the circumstances under which a municipality must review and decide on an appropriate mechanism to provide a municipal service in the municipality or a part of the municipality, being:

- Where the municipal service is provided through an internal mechanism when:
  - An existing municipal service is to be significantly upgraded, extended or improved
  - A performance evaluation in terms of Chapter 6 of the Systems Act requires a review of the mechanism
  - The municipality is restructured or reorganised in terms of the Municipal Structures Act

- Where the municipal service is provided through an external mechanism when:
  - A performance evaluation in terms of Chapter 6 of the Systems Act requires a review of the mechanism
  - The service delivery agreement is likely to expire or be terminated within the next 12 months
  - An existing municipal service, or part of it, is to be significantly upgraded, extended or improved and such upgrade, extension or improvement is not addressed in the service delivery agreement

At this stage, the most common triggers include the expiry of existing service delivery mechanisms and the consequences of the Minister’s authorisations under Section 84 of the Municipal Structures Act (that is namely a shift in powers and functions between local and district municipalities).

8. Legislative process and criteria for Section 78 Mechanism Assessment

Section 78 of the Municipal Systems Act sets out the following process and criteria to be considered by municipalities in reviewing municipal service delivery mechanisms. Reference is also made to the process and criteria required in terms of Section 84 of the Municipal Finance Management Act that are relevant when considering whether to establish a municipal entity.
8.1. The Section 78 criteria

Step 1: Assess and review

A municipality must assess the following in respect of providing a municipal service through an internal service delivery mechanism:

• The direct and indirect costs and benefits, the expected effect on the environment and on human health, well-being and safety.
• Its capacity and potential future capacity to furnish the necessary skills, expertise and resources for the provision of the service through an internal mechanism.
• The extent to which the reorganisation of its administration and the development of the human resource capacity within its administration could be used to provide the service through an internal mechanism.
• The likely impact on development, job creation and employment patterns in the municipality.
• The views of organised labour.

The municipality may take into account any developing trends in the sustainable provision of municipal services generally.

Step 2: Decision

When a municipality has completed Step 1 it may:

• Decide on an appropriate internal mechanism to provide the service.

or

• Before it takes a decision on an appropriate mechanism, explore the possibility of providing the service through an external mechanism.

Step 3: Implement internal mechanism

If a municipality decides to provide the service through an internal mechanism, it must:

• Allocate sufficient human, financial and other resources necessary for the proper provision of the service.
• Transform the provision of that service in accordance with the requirements of the Municipal Systems Act.

or

Step 3: Exploring external mechanisms

If a municipality decides to explore the possibility of providing the service through an external mechanism, it must:

• Notify the local community of this intention
• Assess the different external service delivery options, taking into account:
  • The direct and indirect costs and benefits, the expected effect on the environment and on human health, well-being and safety.
  • The capacity and potential future capacity of prospective service providers to furnish the skills, expertise and resources necessary for the provision of the service.
  • The views of the local community
• The likely impact on development and employment patterns in the municipality; and
• The views of organised labour.

• Conduct or commission a feasibility study, which must be taken into account and which must include:
  • A clear identification of the municipal service for which the municipality intends to consider an external mechanism
  • An indication of the number of years for which the provision of the municipal service through an external mechanism might be considered
  • The projected outputs which the provisions of the municipal service – through an external mechanism – might be expected to produce
  • An assessment regarding the extent to which the provision of the municipal service through an external mechanism will:
    • Provide value for money.
    • Address the needs of the poor.
    • Be affordable for the municipality and residents.
    • Transfer appropriate technical, operational and financial risk.
• The projected impact on the municipality’s staff, assets and liabilities.
• The projected impact on the municipality’s integrated development plan.
• The projected impact on the municipality’s budgets for the period for which the external mechanism might be used, including effect on revenue, expenditure, borrowing, debt and tariffs.
• Any other matter that may be prescribed by regulations.

If a municipality decides to explore the possibility of providing the service through an external mechanism in the form of a municipal entity it must also, in terms of Section 84 of the Municipal Finance Management Act:

• Determine precisely the service that such entity would perform on behalf of the municipality.
• Assess the impact of shifting that service to the entity on the municipality’s staff, assets and liabilities, including an assessment of:
  • The number of municipal staff to be transferred to the entity.
  • The number of municipal staff that would become redundant as a result of shifting the function or service.
  • The cost to the municipality of any staff retrenchments or the retention of redundant staff.
  • Any municipality assets to be transferred to the entity.
  • Any municipality assets that would become obsolete because of shifting the service.
  • Any municipality liabilities to be ceded to the entity.
  • Any municipality debt attributed to that service which it would retain.
• A municipality may establish or participate in a municipal entity only if, prior to the council meeting to approve this, it has:
  • Made a public information statement setting out
its plans for the municipal entity, together with the assessment which it must conduct.

- Invited the local community, organised labour and other interested persons to submit comments or representations in respect of the proposed entity.

- Solicited the views and recommendations of the National Treasury, relevant provincial Treasury, Department of Provincial and Local Government and the MEC for local government in the province, and

- Taken into account:
  - The impact assessment.
  - Any comments or representations on the matter received from the local community, organised labour and other interested persons.
  - Any written views and recommendations on the matter received from the National Treasury, the relevant provincial Treasury, Department of Local and Provincial Government and the MEC for local government in the province.

**Step 4: Decision**

When a municipality has completed Step 3, it may decide on an appropriate internal or external mechanism to provide the service, taking into account its duty to give effect to the following in achieving the best outcome:

- Ensuring that the service is equitable and accessible.
- Ensuring that the service is provided in a manner that uses available resources economically, efficiently, effectively and prudently.
- Ensuring that the quality of the service improves over time.
- Ensuring that the service is financially sustainable.

### 8.2. The desired extent and scope of assessments

Apart from the factors discussed above, the Municipal Systems Act provides no guidance in respect of the extent and/or scope of the required assessments. It thus falls within the discretion of the municipality undertaking the assessments.

A municipality must take well-informed decisions and be able to justify these transparently. The decision must also be lawful.

Regarding the extent of the assessments, we suggest that the following be considered by the municipality:

- Urgency.
- Importance of the service.
- Scale of expenditure.
- Level of risk.
- Potential for community and labour uncertainty.

### 8.3. Views of organised labour and the local community

The municipality is required to assess the views of organised labour during both the internal and external assessment stages (unlike the local community, which is only required if an external assessment is done).

At a national level, organised labour is ideologically opposed to external mechanisms and this influences its participation in any process.

The legislation requires assessment of views only, not negotiation. Procedurally, it has been recommended to raise the issues through the local labour forum, although some municipalities have included labour representation on the task team to facilitate communication and transparency, especially where large change is anticipated.

Organised labour should be notified of the process and its views sought regarding the needs and challenges of service delivery, as well as on how restructuring can be improved. The Section 78 report should then demonstrate that any views received have been assessed by the municipality.

The Municipal Systems Act defines local community or community as “that body of persons comprising:

- The residents of the municipality.
- The ratepayers of the municipality.
- Any civic organisations and non-governmental, private sector or labour organisations or bodies which are involved in local affairs within the municipality.
- Visitors and other people residing outside the municipality who, because of their presence in the municipality, make use of services or facilities provided by the municipality.

It also includes, more specifically, the poor and other disadvantaged sections of such body of persons.”

Section 78 specifically requires interaction with the community, especially where the municipality is considering external mechanisms. In particular:

- If the municipality has, following an assessment of providing services by way of an internal mechanism, decided to explore the possibility of providing services by way of an external mechanism before taking a final decision, it must give notice to the community of its intention to do so.
- The legislation further requires that when assessing the different external options, the municipality must take into account the views of the local community.
- Before a municipality enters into a service delivery agreement with an external service provider, it must establish a programme for community consultation and information dissemination regarding the appointment of the external service provider and the contents of the service delivery agreement. The contents of the service delivery agreement must be communicated to the media through the local community.

**Section 5 of the Municipal Systems Act states the rights and duties of members of the local community and Chapter 4 deals with community participation.**
Part E: The mechanism options

Section 76 of the Municipal Systems Act provides that a municipality may provide a municipal service in its area or a part of its area through an internal or external mechanism.

An internal mechanism may be:

- A department or other administrative unit within its administration.
- Any business unit devised by the municipality, provided it operates within the municipality’s administration and under the control of the council in accordance with operational and performance criteria determined by the council.
- Any other component of its administration.

An external mechanism may be:

- A municipal entity with which the municipality has concluded a service delivery agreement.
- Another municipal entity with which the municipality has concluded a service delivery agreement.
- An organ of state entity with which the municipality has concluded a service delivery agreement.
- A community-based organisation or other non-governmental organisation competent to enter into such a service delivery agreement.
- Any other institution, entity or person legally competent to operate a business activity with which the municipality has concluded a service delivery agreement.

9. Internal delivery mechanisms

9.1. Department or other administrative unit

Description

This mechanism is currently the most commonly used by municipalities to provide municipal services. Most municipalities have departments that are responsible for the provision of water, sanitation, electricity and other services. The departments or administrative units usually take responsibility for the technical aspects of delivering a municipal service. Other departments or administrative units take responsibility for the other aspects of the services, such as financial, legal and social factors. There are no specific legislative provisions that regulate the establishment of departments or administrative units.

Certain legislation may, however, impact indirectly on the establishment of a department or administrative unit, such as labour legislation (see the Labour Relations Act, 1995 and the Basic Conditions of Employment Act, 1997).

Matters for consideration

- From a customer’s perspective, the municipal services are rendered in a fragmented manner.
- The real cost of providing a specific municipal service is difficult to determine.
- Cross-subsidisation to or from other municipal services is difficult to determine.
- Duplication of functions is avoided, that is all financial matters are dealt with by one department or administrative unit (credit control for all municipal services rendered is undertaken by one department or administrative unit).

Example

The Water Department of a municipality provides water services to customers (end users). It is responsible for the day-to-day operation and maintenance of water purification plants and reticulation systems. The Treasury department of a municipality is responsible for credit control and debt collection, that is billing and collections. When a customer fails to pay for water services provided, the legal department of the municipality will be responsible for taking legal action for the recovery of arrears from the customer.

9.2. Business unit

Description

A business unit is similar to a department or administrative unit as it is an integral part of a municipality and does not have a separate legal personality. A business unit is responsible for all aspects of a service, including its technical, financial and legal aspects. This is often referred to as ring-fencing, which implies that once its budget is approved by Council, its income and expenditure is ring-fenced (kept separate) and surpluses remain with the unit for the benefit of that service. The unit makes decisions for and performs all aspects of the service. The Municipal Systems Act requires a business unit to operate within a municipality’s administration and under the control of the council in accordance with operational and performance criteria determined by the council. (See section 76 (a) (iii))

Matters for consideration

- A municipal service can easily be managed and accounted for separately, that is the costs of providing the service are known, the level of cross-subsidisation to, or from, other municipal services is known.
- A duplication of functions may occur, that is a situation may arise where both the electricity and water services business units have a credit control department.
- Holistically focused on effective delivery of a service.

Case study: eThekwini Metropolitan Municipality

The eThekwini Metropolitan Municipality created a business unit for the provision of water and sanitation services. At that stage, the unit functioned independently from other departments and it was responsible for all aspects of water and sanitation provision, i.e. technical, financial, legal, customer services, credit control, infrastructure development and the like. The business unit issued a separate account for water services rendered and conducted credit control and
debt collection in respect thereof. The unit is, however, not a separate legal entity. The unit has since been restructured as a department relying on support functions from other departments of the eThekwini Metropolitan Municipality.

Summary

10. External delivery mechanisms

10.1. A municipal entity

Description

The Municipal Systems Act recognises the following kinds of municipal entities:

- A private company, as referred to in the Companies Act, 1973, established by one or more municipalities, or in which one or more municipalities have acquired or hold an interest.
- A service utility established by a municipality.
- A multi-jurisdictional service utility established by two or more municipalities.

The Municipal Systems Act provides that, other than the acquisition by a municipality of securities in a company listed on the JSE Ltd, for investment purposes, a municipality may only participate in the establishment of or acquire or hold an interest in a corporate body, including a trust, where the corporate body is a private company, service utility, multi-jurisdictional service utility, or a pension or medical aid scheme for the benefit of its employees.

10.1.1. Types

There are three types of municipal entities described in the Municipal Systems Act. The Municipal Finance Management Act sets out the procedure to be followed if a municipality wants to establish or participate in a municipal entity.

10.1.1.1. Private company municipal entity

A municipality may only acquire or hold full ownership of a private company. It may also acquire or hold a lesser interest in a private company, but only if all the other interests are already held by that municipality, or are held by one or more other municipalities.

A private company will only qualify as a municipal entity if one or more municipalities have effective control of the private company.

What does “effective control” mean?

It means the power which a shareholder in the private company may have to:

- appoint or remove at least the majority of the board of directors of the private company.
- control at least the majority of the voting rights at a general meeting of the private company in the case of a company, co-operative or other body having members.

A private company that is a municipal entity must restrict its activities to purposes for which it is to be used by its parent municipality and has no competence to perform any activity which falls outside of the municipality’s functions and powers.

A municipality may only establish or acquire an interest in a private company:

- For the purpose of using the company as a mechanism to assist it in the performance of its functions or powers.
- It can demonstrate that there is a need to perform that function or power in accordance with business practices in order to achieve the strategic objectives of the municipality more effectively and the company would benefit the local community.
- If all prescribed conditions have been complied with.

10.1.1.2. Service utility

A service utility is created by a municipal by-law. It states the purpose for which the utility is established, confers powers, imposes the duties of the service utility, and provides for the functioning and control and budgetary and funding arrangements of that utility. It is a separate juristic person and can thus sue and be sued in its own name and is under the sole control of the municipality that established it. It is thus a statutory organisation similar to a water board, which is established and regulated in terms of the Water Services Act or Eskom (prior to its conversion). It must restrict its activities to the purpose for which it was established and has no competence to act outside of its powers and functions in terms of a by-law.

10.1.1.3. Multi-jurisdictional service utility

A multi-jurisdictional service utility may be established by written agreement between two or more municipalities to perform their powers or functions within their municipal areas (or designated parts thereof).

A separate juristic person can sue and be sued in its own name and is under the sole control of the municipalities that established it. It must restrict its activities to the purpose for which it was established and has no competence to act outside of its powers and functions in terms of the agreement by which it was established.

If municipalities receive a request from the national minister of local government to establish a multi-jurisdictional service utility, they must – within two months of receiving the request – decide whether to accede and convey their decision to the minister.
Section 89 of the Municipal Systems Act indicates what the contents of an agreement establishing a multi-jurisdictional service utility must be. It must describe the rights, obligations and responsibilities of the parent municipalities and various other matters, including:

• Determine the boundaries of the area for which the multi-jurisdictional service utility is established.
• Identify the municipal service to be provided.
• Determine budgetary and funding arrangements for implementing the agreement.
• Regulate the appointment and functions of the board of directors of the multi-jurisdictional service utility.
• Regulate the acquisition of assets and staff.
• Determine conditions for the amendment, termination and withdrawal from the agreement.
• Provide for the governing and the reporting responsibilities of the multi-jurisdictional service utility.

10.1.2. Matters for consideration

• More popularly known as corporatisation, this mechanism is aimed at creating an independent, separate legal entity which operates in the same way as a private company but which remains either fully owned by the municipality or which is under the ownership or control of the municipality. As with any company, management presents its business plan to the board of directors, in this case the municipality or its nominated representatives, and is then required to perform against the approved plan.
• Parts 5 and 6 of Chapter 8A of the Municipal Systems Act provide detailed provisions regarding the duties and responsibilities of parent municipalities of municipal entities. They also detail governance requirements pertaining to municipal entities.
• Chapter 10 of the Municipal Finance Management Act regulates the functioning of municipal entities in respect of financial governance, financial accountability and reporting and reportable matters.

10.1.3. Municipal Finance Management Act requirements

If a municipality decides to explore the possibility of providing the service through an external mechanism in the form of a multi-jurisdictional service utility, it must also, in terms of section 84 of the Municipal Finance Management Act:

• Determine precisely the service that the entity would perform on behalf of the municipality.
• Assess the impact of shifting that service to the entity on the municipality’s staff, assets and liabilities, including an assessment of:
  – The number of municipal staff to be transferred to the entity.
  – The number of municipal staff that would become redundant as a result of shifting the function or service.
  – The cost to the municipality of any staff retrenchments or the retention of redundant staff.
  – Any assets of the municipality to be transferred to the entity.
  – Any assets of the municipality that would become obsolete because of shifting the service.

• Any liabilities of the municipality to be ceded to the entity.
• Any debt of the municipality attributed to that service which it would retain.

• A municipality may establish or participate in a multi-jurisdictional service utility only if, prior to the council meeting to approve this, it has:
  – Made a public information statement setting out the municipality’s plans for the municipal entity, together with the assessment which the municipality must conduct.
  – Invited the local community, organised labour and other interested persons to submit comments or representations in respect of the proposed entity.
  – Solicited the views and recommendations of the National Treasury, the relevant provincial Treasury, the department of provincial and local government and the MEC for local government in the province.
  – Taking into account:
    – The impact assessment.
    – Any comments or representations on the matter received from the local community, organised labour and other interested persons.
    – Any written views and recommendations on the matter received from the National Treasury, the relevant provincial Treasury, the Department of Provincial and Local Government and the MEC for local government in the province.

10.1.4. Appropriate agreements

All the traditional forms of contract as well as variations thereof can be a service delivery agreement between a municipality and its municipal entity.

**Case study: Johannesburg Water**

The City of Johannesburg created a company that provides water and sanitation services to end users, namely Johannesburg Water. The company is under the ownership control of the City and is thus a municipal entity. The company entered into a management agreement with a private company, Johannesburg Water Management, in terms of which the latter company would provide the services to the municipality. Johannesburg Water, the municipal entity, entered into a management agreement with the City for the provision of water and sanitation services on behalf of the City.

See also the National Business Initiative (NBI) website for the NBI/Infrastructure Finance Corporation of South Africa (INCA) case study on this mechanism (www.nbi.org.za).

10.2. Another municipality

**Description**

Two municipalities can enter into a service delivery agreement whereby the one provides a municipal service to the other.

**Matters for consideration**

• Adjacent municipalities could combine to use their...
resources and available expertise on a more efficient basis, thus benefiting from their combined abilities to provide the service and the synergy effect of developing a critical mass.

- Additional capacity or existing capacity in a municipality could benefit another.
- Where a municipality decides to enter into a service delivery agreement with another municipality, the other municipality must conduct a feasibility study in terms of section 80 (3) (a) of the Municipal Systems Act.
- The feasibility study must be taken into account before the service delivery agreement is entered into. It must include an assessment of:
  - The impact on its budget, assets, liabilities and staff expenditure of the other municipality, for each financial year that it intends to serve as an external service provider.
  - Whether it will be necessary to increase the number of staff to enable it to be an external service provider, and whether it will be necessary to transfer or second any staff.
  - Its ability to absorb any commitments, liabilities or employees involved, if and when the appointment as external service provider ends.

Note that another municipality (particularly a local municipality where the district municipality is both the water services authority (WSA) and the water services provider (WSP)) can provide support to the WSP by undertaking support functions (not operational functions) such as billing, IT support and office space. This would require a service level agreement and not a service delivery agreement and need not follow a Section 78 process prior to conclusion.

Appropriate agreements

All the traditional forms of contract as well as variations thereof can be a service delivery agreement between a municipality and an organ of state. Risk transfer between the parties needs careful consideration.

Case study: Maluti-a-Phofung Municipality

Rand Water was providing water services on behalf of the Maluti-a-Phofung Local Municipality in terms of a three-year management contract at cost. The purpose of the contract is to improve service delivery and to enhance the capacity of the municipality to provide services effectively on termination of the management contract.

A number of water boards have been created around the country to support municipalities rendering water services, specifically in respect of bulk water supply.

10.3. An organ of state

Description

The Constitution defines an organ of state as any department of state or administration in the national, provincial or local sphere of government, or any other functionary or institution exercising a public power or performing a public function in terms of any legislation (but does not include a court or judicial officer).

An example of an organ of state that often acts as a service provider on behalf of municipalities is a water board and Eskom.

Matters for consideration

- Organs of state are subject to the Public Finance Management Act (Act 1 of 1999) and must inform National Treasury in writing and obtain approval from the Minister of Water Affairs and Forestry before entering into a service delivery agreement with a municipality.
- In terms of Section 80 of the Municipal Systems Act, if a municipality decides to provide a municipal service through a service delivery agreement with a national or provincial organ of state, it does not need to comply with the competitive bidding requirements of the Municipal Systems Act, but service delivery agreements must be entered into.

Appropriate agreements

All the traditional forms of contract as well as variations thereof can be a service delivery agreement between a municipality and an organ of state. Risk transfer between the parties needs careful consideration.

10.4. A community-based organisation (CBO)

Description

Community-based service providers should not be confused with small, medium and micro enterprises (SMMEs). The following is the most recent definition of a CBO service provider:

“Community-based organisation” means a not-for-profit organisation situated within a defined community that is mandated by that community to provide a specific municipal service to that community on behalf of the municipality, provided that:

a) All members of the governing body of the organisation are nominated members of the community and are permanently resident within the community.

b) All employees of the organisation are members of the community and are permanently resident within the community.

c) The area constituting the community is defined by the municipality.

The only legal requirement laid down by the Municipal Systems Act is that CBOs must be legally competent to enter into service delivery agreements. This implies that CBOs must at least have a written constitution giving them independent legal status and mandating them to enter into service delivery agreements.
Matters for consideration

- Use of this mechanism generally requires clearly defined communities of a size where communication and consensus can be readily achieved.
- It is particularly appropriate for more isolated communities where they have their own supply system, such as a borehole, and where they can control the service provision with some technical support from the authority or its overall service provider.
- Use of this mechanism may assist the community in creating an income base, which can be used to fund other needs, and ensures that as much of the money as possible goes back into the community.
- This mechanism does not facilitate access to funding for capital expenditure.

Appropriate agreements

Service or management contracts or variations on these are the most suited for this mechanism.

In terms of Section 80 of the Municipal Systems Act, if a municipality decides to provide a municipal service through a service delivery agreement with a community-based organisation, it must comply with the competitive bidding requirements of the Municipal Systems Act (and by implication also with the provisions of Chapter 11 of the Municipal Finance Management Act).

Case study: Alfred Nzo Municipality

The Alfred Nzo District Municipality has entered into service contracts with CBOs in respect of water services provision in its rural areas. As a rule, a CBO is established for each village served by a stand-alone scheme or for a group of villages served by a more regional scheme.

10.5. A non-governmental organisation (NGO)

Description

An NGO is a not-for-profit organisation that focuses on supporting communities and/or municipalities to provide effective municipal services.

The only legal requirement laid down by the Municipal Systems Act is that NGOs must be legally competent to enter into service delivery agreements. This implies that they must at least have a written constitution giving them independent legal status and mandating them to enter into service delivery agreements.

Matters for consideration

- NGOs usually have specialised developmental capacity and provide support to service provision rather than acting as service providers to municipalities.
- This mechanism does not facilitate the accessing of funding for capital expenditure.

Appropriate agreements

All the traditional forms of service contract as well as variations thereof can be an agreement between a municipality and an NGO.

10.6. Any other institution

Description

This mechanism is a general category. The only requirement is that these institutions must be legally competent to operate a business activity. Private sector providers fall into this category.

Matters for consideration

- The requirements of the contract have to be clearly defined. Changes to these requirements can lead to a renegotiation of the contract after notice and representations from the local community (See section 81 (4) of the Municipal Systems Act).
- Private sector institutions can bring flexibility to the approach of service provision. They will normally be able to achieve higher efficiencies and can generally access operating and investment capital.

Appropriate agreements

All the traditional forms of contract as well as variations thereof can be a service delivery agreement between a municipality and a private sector institution.

In terms of Section 80 of the Municipal Systems Act, if a municipality decides to provide a municipal service through a service delivery agreement with a provider that falls into the category of “other institution”, it is required to comply with the competitive bidding requirements of the Municipal Systems Act (and by implication also with the provisions of Chapter 11 of the Municipal Finance Management Act).

Case study: Mbombela Municipality

The Mbombela Local Municipality entered into a concession agreement with a private company, backed by BEE and technical and financial expertise. In terms of the agreement, the concessionaire needs to improve service delivery and make a substantial capital investment in infrastructure within the municipality’s area.
11. Internal municipal service districts

**Description**

A municipality may establish an internal municipal service district in a part of the municipality to facilitate the delivery of a municipal service in that area. The establishment of this type of district must be done in accordance with a policy framework developed by the municipality for the establishment, regulation and management of such districts and as set out in Section 85 (3) of the Municipal Systems Act.

The policy framework referred to above must reflect at least the following:

- The development needs and priorities of designated parts of the municipality, which must be balanced against that of the municipality as a whole.
- The extent to which the establishment of one or more internal municipal service districts will promote the total economic development of the municipality as a whole, will contribute to enhancing the social, economic and spatial integration of the municipality and may not entrench or contribute to further disparities in service provision.

Before establishing an internal municipal service district, the municipality must:

- Consult the local community on the proposed boundaries of the service district, the proposed nature of the municipal service that is to be provided, the proposed method of financing the municipal service and the proposed mechanism for the provision of the service.
- Obtain consent from the majority of the members of the local community in the proposed service district that will be required to contribute to the provision of the municipal service.

**Matters for consideration**

- This is not a mechanism, but rather a scoping of the area within the jurisdiction of a municipality to which a mechanism will be specifically focused. The option of ring-fencing an internal municipal service district must be considered at the project planning stage as it will affect the scope of the mechanism assessment.
- The requirement for consent of a majority of the members of the local community in the proposed district may dissuade the establishment of such districts.

**Part F: Service delivery agreements**

12. Types of agreements

A generic categorisation of contracts is set out in Annexure C. Contract types. The categorisation of contracts is undertaken basically with reference to operational and financial risk transfer. It is important to note that each and every agreement will be different due to prevailing circumstances and needs specific to each municipality or part of the municipality. Although precedents and guidelines issued in support of standardisation are useful, it is important not to be limited by the traditional forms of contracts referred to. Combinations of the contracts or the combination of certain elements of the generic forms of contract are possible to cater for specific circumstances and local needs. See Annexure C for further information.

13. Legal contracting requirements

13.1. General

**Municipal Systems Act**

The Act defines a service delivery agreement as an agreement between a municipality and an institution or person in terms of which a municipal service is provided by that institution or person, either for its own account or on behalf of the municipality.

Section 80 (2) of the Municipal Systems Act provides that before a municipality enters into a service delivery agreement with an external service provider, it must establish a programme for community consultation and information dissemination regarding the appointment of the external service provider and the contents of the service delivery agreement. The contents of the service delivery agreement must be communicated to the local community through the media.

Section 81 of the Act provides that if a municipal service is provided through a service delivery agreement, the municipality is still responsible for ensuring that the service is provided to the local community in terms of the provisions of the Act, and accordingly must:

- Regulate the provision of the service, in accordance with a performance management system.
- Monitor and assess the implementation of the agreement, including the performance of the service provider in accordance with a performance management system.
- Perform its functions and exercise its powers in terms of Chapters 5 (development planning) and 6 (performance management) if the municipal service in question falls within a development priority or objective in terms of the municipality’s integrated development plan.
- Within a tariff policy determined by the municipal council, control the setting and adjustment of tariffs by the service provider for the municipal service in question.
- Generally exercise its service authority so as to ensure uninterrupted delivery of the service in the best interest of the local community.

A municipality may assign the following responsibilities to a service provider:

- Developing and implementing detailed service delivery plans within the framework of the municipality’s integrated development plan.
- The operational planning, management and provision of the municipal service.
- Undertaking social and economic development that is directly related to the provision of the service.
• Customer management.
• Managing its own accounting, financial management, budgeting. Investment and borrowing activities within a framework of transparency, accountability, reporting and financial control determined by the municipality, subject to the Municipal Finance Management Act.
• The collection of service fees for its own account from users of services in accordance with the municipal council’s tariff policy in accordance with the credit control measures established.

A municipality may further, through a service delivery agreement:
• Pass onto the service provider, through a transparent system that must be subject to performance monitoring and audit, funds for the subsidisation of services to the poor.
• In accordance with applicable labour legislation transfer or second any of its staff members to the service provider, with the agreement of the staff member concerned.

A municipality is obliged to ensure continuity of the service if the service provider is placed under judicial management, becomes insolvent, is liquidated or is for any reason unable to continue performing its functions in terms of the service delivery agreement and where applicable, take over the municipal service, including all assets, when the service delivery agreement expires or is terminated.

The municipal council has the right to set, review or adjust the tariffs within its tariff policy. The service delivery agreement may provide for the adjustment of tariffs by the service provider within the limits set by the municipal council.

A service delivery agreement may be amended by agreement between the parties, except where it has been concluded following a competitive bidding process, in which case an amendment can only be made after the local community has been given reasonable notice of the intention to amend the agreement and the reasons for the proposed amendment; and sufficient opportunity to make representations to the municipality. Notification must also be given to the National Treasury if it is a PPP.

No councillor or staff member of a municipality may share in any profits or improperly receive any benefits from a service provider providing a municipal service in terms of a service delivery agreement.

When a municipality has entered into a service delivery agreement it must:
• Make copies of the agreement available at its offices for public inspection during office hours.
• Give notice in the media of:
  – particulars of the service that will be provided under the agreement.
  – The name of the selected service provider.

  – The place where and the period for which copies of the agreement are available for public inspection.

13.2. Future budgetary implications

Municipal Finance Management Act

If an agreement will impose a financial obligation on a municipality beyond three years, it must comply with the provisions of Section 33 of the Municipal Finance Management Act.

Section 33 requires that the municipality must have:
• Prior to the meeting of the council at which the contract is to be approved:
  – Made public the draft contract and information statement summarising the municipality’s obligations.
  – Invited the local community and other interested persons to submit comments or representations in respect of the proposed contract.
  – Solicited the views and recommendations of the National Treasury, the relevant provincial Treasury, and Department of Provincial and Local Government and, if the agreement involves service delivery, the responsible national department.
• … and taken into account:
  – The municipality’s projected financial obligations in terms of the proposed contract for each financial year covered by the contract.
  – The impact of those financial obligations on the municipality’s future municipal tariffs and revenue.
  – Any comments or representations on the proposed contract received from the local community and other interested persons.
  – Any written views and recommendations on the proposed contract by the National Treasury, relevant provincial Treasury, Department of Provincial and Local Government and, if the agreement involves service delivery, the responsible national department.

13.3. Competitive bidding and tendering

Municipal Systems Act

Section 83 of the Municipal Systems Act states that where a municipality decides to provide a service through a service delivery agreement with a municipal entity, another municipality or a national or provincial organ of state, it may negotiate and enter into this agreement without applying competitive bidding processes.

If a municipality decides to provide a service with a service delivery agreement with any other institution, it must apply competitive bidding processes.

The selection processes must:
• Allow all prospective service providers to have equal and simultaneous access to information relevant to the bidding process.
• Minimise the possibility of fraud and corruption.
• Make the municipality accountable to the local community about progress with selecting a service provider, and the reasons for any decision in this regard.
Take into account the need to promote the empowerment of small and emerging enterprises.

May be provided for in other national legislation.

A municipality may determine a preference for categories of service providers to advance the interest of persons disadvantaged by unfair discrimination. This is fine as long as the manner in which this preference is exercised does not compromise or limit the quality, coverage, cost and developmental impact of the services.

The provisions of the Preferential Procurement Policy Framework Act (2000) regulate how such preferences may be determined and applied. Due consideration must also be given to the Broad Based Black Economic Empowerment Act and the Supply Chain Management policy of the municipality.

After a prospective service provider has been selected, the municipality must, on the basis of the bidding documents and any addenda, amendments or variations thereto that were provided to all the bidders, negotiate the final terms and conditions of the service delivery agreement with the preferred service provider and if successful, enter into an agreement with the selected service provider.

The agreement must be consistent with the terms and conditions specified in the bidding documents but may be modified or supplemented during negotiations provided that these changes do not materially affect the bid in a manner which compromises the integrity of the bidding process.

If a municipality and the selected service provider fail to reach agreement within a reasonable time allowed by the municipality for negotiations, the municipality may negotiate with the next-ranked prospective service provider.

Municipal Finance Management Act

Section 116 of the Municipal Finance Management Act provides that an agreement procured through the supply chain management system of a municipality must:

- Be in writing
- Stipulate the terms and conditions of the contract that must include provisions providing for:
  - The termination of the contract in the case of non- or under-performance.
  - Dispute resolution mechanisms.
  - A periodic review of the contract, at least every three years.

(See also the discussion under clause 19 below.)

The municipal accounting officer must also take reasonable steps to ensure that the contract is properly enforced. They must also monitor the performance of the service provider on a monthly basis and manage capacity within the municipality’s administration for this purpose. They must also oversee the day-to-day management of the contract and keep council up to date regarding the monitoring and performance of the contracted provider.

A contract procured through a municipality’s supply chain management policy may only be amended after the reasons for the proposed amendment have been tabled in council and the local community has been given reasonable notice of the intention to amend and has been invited to submit representations to the municipality.

Both the Municipal Systems Act and the Water Services Act create a preference for public sector providers. The Municipal Systems Act does not require competitive bidding prior to entering into a service delivery agreement with an organ of state. The Water Services Act requires municipalities to consider all known public sector providers that are willing and able to provide the service prior to entering into a service delivery agreement with a private sector provider.

Case study: City of Johannesburg

The City of Johannesburg created a municipal entity for the provision of water services on its behalf, namely Johannesburg Water. The City wanted to put a management contract in place to provide support to the municipal entity. The criteria set by the City for qualification to submit a bid for the management contract was such that only international companies or South African companies in a consortium with international companies could submit bids. The criteria related, among others, to international experience and a predetermined minimum annual turnover in rands.

14. Contract management

The success of every contract depends on the municipality’s ability and capacity to monitor and regulate the performance of its service provider effectively, in accordance with the provisions of the service delivery agreement.

The three main functions of contract management can be broadly described as follows:
• Partnership management is concerned with structures of accountability and how the municipality and the service provider relate to each other.
• Service delivery management can be described as the systems and procedures designed to manage risk and performance.
• Contract administration relates to the administrative processes required to ensure that all the procedures contained in the contract and all the documents relating to the contract are effectively managed.

Each stage of contract management can be generally defined in the following terms:
• The procurement stage covers the period from the initiation of a project up until the signing of the contract.
• The development stage begins from the signing of the contract and lasts until the commencement of service delivery.
• The delivery stage refers to the period when services are provided and used.
• The exit stage is the phase towards the end of the life of the project – whether the project ends through expiry or termination – during which activities are wound up and the municipality makes new financial and contractual arrangements for continued service delivery.

Change management relates to the creation of mechanisms to address any aspect of change that could occur in relation to the project.

The table below includes a summary of some of the most important tasks to be carried out during each contract management stage.

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<th>Critical stages of contract management</th>
<th>Key functions of contract management</th>
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<td>Contract administration</td>
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<td><strong>Procurement</strong></td>
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<td>• Prepare the contract management plan</td>
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<td><strong>Development</strong></td>
<td>• Establish risk control procedures</td>
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<td>• Establish performance management systems</td>
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<td></td>
<td>• Monitor the development of the service towards the commencement date</td>
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<td><strong>Delivery</strong></td>
<td>• Review and revise the partnership as necessary</td>
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<tr>
<td></td>
<td>• Review and revise the contract management plan</td>
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<td></td>
<td>• Commission independent reviews</td>
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<tr>
<td><strong>Exit</strong></td>
<td>• Organise closure event</td>
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<td></td>
<td>• Integrate lessons of the partnership into the work of the municipality</td>
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Change management
Any agreement requires monitoring to confirm that the appointed contractor conforms to all requirements. Allowance must be made to identify a person or persons who will undertake this task on their behalf. This agreement should include a mechanism for the necessary costs of the monitoring process to be paid to or by the municipality. This would normally be dealt with as a monthly management or a contract fee payable by the contractor to or by the municipality.

The municipality has several options to ensure effective monitoring and regulation. It may appoint consultants to review the performance of the service provider at regular intervals or it can allocate adequate internal resources to undertake this task. Irrespective of what it chooses to do, it is critical that persons with sufficient capacity, experience and expertise are appointed to carry out this function.

15. Employees

Two possibilities exist in addressing personnel where a municipal service will be provided through an external mechanism. The type and duration of the service delivery agreement will determine which possibility will be the most appropriate. Employees can be seconded or transferred to the service provider.

15.1. Secondment

Employees seconded to the service provider for the duration of the service delivery agreement remain employees of the municipality.

The service delivery agreement will usually state:
- That the seconded employees will continue to enjoy their rights and benefits, provided that the service provider is entitled to restructure a seconded employee’s duties and responsibilities after consultation with them and provided that there is no extra cost to seconded employees in fulfilling restructured duties and obligations.
- During the term of the contract, the seconded employees will be subject to the control, supervision and management of the service provider and will be obliged to obey any instructions and orders which do not conflict with the service delivery agreement or their contract of employment with the municipality.
- The service provider will have the authority to take disciplinary action against seconded employees in terms of any existing conditions of employment of such personnel without reference to the municipality. For purposes of disciplining the seconded employees, the service provider is appointed as the authorised representative of the municipal manager and/or any head of a department in respect of the basic conditions of employment of seconded employees.
- If a seconded employee is found guilty of an offence that justifies dismissal, the service provider will have the right and authority to refer such person back to the municipality which will be obliged to terminate the secondment agreement with the service provider.
- Recognised unions will continue to represent and remain responsible for bargaining on behalf of their members.
- If a seconded employee reasonably wants to terminate their secondment agreement, the municipality and the service provider will do their best to accommodate the employee.
- The salaries and disbursements to be paid to seconded employees will be the salaries agreed to by the municipality and the seconded employee (or their duly authorised representative) at the South African Local Government Bargaining Council.

15.2. Transfer

Employees to be transferred to the service provider will become employees of the service provider. Section 197 of the Labour Relations Act, 1995 (Act 66 of 1995) provides that a contract of employment may not be transferred from one employer (referred to as “the old employer”) to another employer (referred to as “the new employer”) without the employee’s consent, unless the whole or any part of a business, trade or undertaking is transferred by the old employer as a going concern.

The Municipal Systems Act, in section 81 (2) (c), provides that a municipality through a service delivery agreement may in accordance with applicable labour relations legislation transfer or second any of its staff members to the service provider, with the agreement of the staff member concerned. The agreement of employees transferred or seconded by a municipality to a service provider will accordingly always be required, even if such transfer or secondment forms part of the transfer of whole or any part of a business, trade or undertaking as a going concern.

Unless otherwise agreed:
- The new employer is automatically substituted in the place of the old employer in respect of all contracts of employment in existence immediately before the date of transfer.
- All the rights and obligations between the old employer and an employee at the time of the transfer continue to be in force as if they had been the rights and obligations between the new employer and the employee.
- Anything done before the transfer by or in relation to the old employer, including the dismissal of an employee or the commission of an unfair labour practice or act of unfair discrimination, is considered to have been done by or in relation to the new employer.
- The transfer does not interrupt an employee’s continuity of employment, and an employee’s contract of employment continues with the new employer as if with the old employer.

The new employer will comply with the above if the employer employs transferred employees on terms and conditions that are on the whole not less favourable to the employees than those on which they were employed by the old employer, unless the terms and conditions of employment
of the transferred employees are determined by a collective agreement, in which case the collective agreement continues to apply. This does not prevent an employee from being transferred to a pension, provident, retirement or similar fund other than the fund to which they belonged prior to the transfer, if the criteria in section 14 (1) (c) of the Pension Funds Act, 1956 (Act 24 of 1956), are satisfied.

Collective agreements and arbitration awards bound the old employer in respect of the employees to be transferred, immediately before the date of transfer.

The new employer is bound by any arbitration award made in terms of the Act, the common law or any other law and any collective agreement.

The old employer must:

• Agree with the new employer to a valuation as at the date of transfer of:
  – The leave pay accrued to the transferred employees.
  – The severance pay that would have been payable to the transferred employee.
  – Any other payments that have accrued to the transferred employees but have not been paid to employees of the old employer.
• Conclude a written agreement that specifies:
  – Which employer is liable for paying any amount referred to above and in the case of the apportionment of liability between them, the terms of that apportionment.
  – What provision has been made for any payment contemplated above if an employee becomes entitled to receive it.
• Disclose the terms of the agreement to each employee who after the transfer becomes employed by the new employer.
• Take any other measure that may be reasonable in the circumstances to ensure that adequate provision is made for any obligation on the new employer that may arise.

For 12 months after the date of the transfer, the old employer is jointly and severally liable with the new employer to any employee who becomes entitled to receive a payment as a result of the employee’s dismissal for a reason relating to the employer’s operational requirements or liquidation or sequestration, unless the old employer is able to show that it has complied with the provisions of this section.

The old and new employer are jointly and severally liable in respect of any claim concerning any term or condition of employment that arose prior to the transfer.

16. Risks

All contractual relationships, especially long-term, involve risks. Some of these risks can be reduced through careful drafting of contractual provisions, while others should be allocated as far as possible to the party best able to handle the risks.

The following list contains a short description of risks relating to municipal services to be considered in respect of a service delivery agreement with a service provider of any type. The appropriate allocation and mitigation of risks is critical to the success of the agreement.

The risks listed are not intended to be exhaustive, but highlight key risks.

Availability risk

This is the risk that a service provider will render services that are less than those required by the agreement.

Design and development risk

This is the risk that the design specifications or the actual design of infrastructure may be inappropriate.

Completion risk

This is the risk that the project will not be completed within the specified time and cost specifications.

Non-performance risk

This is the risk that those to whom services are provided (whether it be customer or the municipality) do not pay for them or that inappropriate tariffs are set. The key revenue risk is that the municipality will not have sufficient revenue to pay for services provided.

Insurance risk

This is the risk that losses and damages that may occur are not insured adequately or at all.

Political risk

This risk includes expropriation, nationalisation, war, currency availability and inconvertibility and changes in government policy.

It also includes the risk of ministerial limitations on tariff increases that may result in payment obligations to the service provider not being met.

Currency risk

The risk that exchange rate movements will negatively affect a service provider’s ability to make payments, where the debt is not in South African currency or where goods and services are imported.

Legal, regulatory and policy risk

The risk of substantial changes within the legal system, legislation, regulation and policy, particularly with respect to labour, tax and environmental issues.

Unforeseen circumstances risk (Force Majeure)

This is the risk that unexpected and uncontrollable natural or human made conditions such as earthquakes, floods or war may occur that will negatively impact the project.

Inflation risk

This risk represents the possibility that the actual inflation rate will exceed the projected rate.
Demand and affordability risk
The risk that the demand for the services to be rendered as a result of the project may be less than projected. This may be affected by factors such as an increase in the cost of providing the service or by changing affordability levels within the communities served.

Operating risk
The risk that the service provider cannot provide a service to the required standard due to inadequate technical performance on the operator’s part.

Residual value risk
The risk that assets are returned to the municipality on completion of an agreement in a condition less than expected due to inadequate maintenance during the period of the agreement.

Resource risk
The risk that needed natural resources (such as water, waste water, electricity or waste) are not of the required quantity or quality.

Technology risk
The risk that the technology implemented by the service provider is inadequate or inappropriate to provide the services contracted for.

Environmental risk
The risk that an environmental incident may occur such as sewage spillages or ground water contamination from waste.

Part G: Public private partnerships (PPPs)

17. Legislative requirements

Municipal Finance Management Act
Section 120 of the Municipal Finance Management Act specifically provides for the conditions and process when a municipality wishes to enter into a public-private partnership (PPP). Municipalities may enter into PPP agreements, but only if they can demonstrate that the agreement will:

• Provide value for money to the municipality.
• Be affordable for the municipality.
• Transfer appropriate technical, operational and financial risk to the private party.

Before a PPP is concluded, the municipality must conduct a Feasibility Study in terms of section 120(4) of the Act that must:

• Explain the strategic and operational benefits of the PPP for the municipality in terms of its strategic objective.
• Take into account all relevant information.
• Describe in specific terms.

The nature of the private party’s role in the PPP.
The extent to which this role can be performed by a private party.
Describe in specific terms how the proposed agreement will:
- Provide value for money to the municipality.
- Be affordable for the municipality.
- Transfer appropriate technical, operational and financial risk to the private party.
- Impact on the municipality’s revenue flows and its current and future budgets.

The feasibility study must also motivate for the capacity of the municipality to effectively monitor, manage and enforce the agreement.

Before submitting the feasibility study report and other relevant documents to Council for an in principle decision, the municipality must:

• Make public the particulars of the proposed PPP including the Feasibility Study report.
• Invite the local community and other interested persons to submit comments or representations in respect of the proposed PPP.
• Solicit the views and recommendations of National Treasury, Department of Provincial and Local Government and responsible national department, if the PPP involves the provision of water, sanitation, electricity or other prescribed services.

Municipal PPP regulations issued in terms of the Municipal Finance Management Act on 1 April 2005

The Public-Private Partnership Regulations (PPP Regulations) issued in terms of the Municipal Finance Management Act require that before a municipality initiates a feasibility study in terms of section 120(4) of the Municipal Finance Management Act, the accounting officer of the municipality must notify National Treasury and the relevant provincial treasury in writing of the municipality’s intention, together with information on the expertise of the municipality, to comply with section 120(4). If requested to do so by National Treasury and/or the relevant provincial treasury, the municipality must appoint a transaction adviser to assist and advise it on the preparation and procurement of the PPP agreement.
The PPP Regulations also provide that a section 120 (4) Feasibility Study must address the following additional matters, unless they have been addressed in terms of a section 78(3)(b) and (c) Feasibility Study and these are submitted to council:

- Identify and define the activity the municipality intends to outsource.
- Assess the needs of the municipality in respect of the particular activity, including the various options available and the advantages and disadvantages of each. This assessment must show comparative projections of the full costs to the municipality if it does or does not outsource.
- Assess the projected impact of the outsourcing on staff, assets, liabilities and revenue of the municipality.
- Recommend an appropriate plan for procurement of the PPP.

### 18. PPP agreements

PPP agreements are further regulated by PPP regulations, as follows:

- A PPP agreement must:
  - Provide value for money and be affordable.
  - Describe the role of the private party in the PPP in specific terms.
  - Confer effective powers on the municipality to monitor, manage and enforce the agreement.
  - Impose financial management duties on the private party.
  - Provide for termination of the agreement if the private party fails to comply or provides incorrect or misleading information.
  - Restrain the private party from offering employment to municipal officials during the period of the agreement.
  - Restrain the private party from offering employment, either in the PPP or otherwise, to an employee of the municipality involved in the negotiation of the agreement for three years.

- Only the accounting officer of the municipality may sign a PPP agreement, and only if the provisions of Section 33 of the Municipal Finance Management Act have been complied with.

- As soon as a municipality initiates a project that may be a PPP a project manager must be appointed, either from within the municipality or from outside to manage the process. An assessment of potential external service delivery mechanisms in terms of section 78 (3) of the Municipal Systems Act is an example of a project that may result in a PPP. It would, however be advantageous to appoint a project manager prior to commencing with the section 78 (1) process.

- The accounting officer must solicit the views and recommendations of national and provincial Treasury on:
  - The reasons for amending a PPP agreement.
  - Proposed terms and conditions of a PPP agreement.
  - The municipality’s plan for effective management of the agreement.
  - The preferred bidder’s competency and capacity to enter into and comply with the agreement.

### Part H: Other relevant issues

#### 19. Procurement

Procurement forms part of supply chain management. Supply Chain Management (SCM) aims to achieve a holistic approach to procurement and comprises:

1. Demand management (adequate resources delivered at the correct time, right price and location)
2. Acquisition management
3. Logistics management (inventory levels, placing of orders, receipt and distribution of goods, transport and vendor management)
4. Disposal management (disposal or letting of assets no longer needed)
5. Risk management (identification of risks, allocation of risks and costing of risks) Performance management (internal monitoring system to determine whether SCM processes are being followed).

The Supply Chain Management Regulations issued under the Municipal Finance Management Act became effective on 1 July 2005. The regulations further deal with, among other things:

- Procurement thresholds.
- Supplier lists.
- Verbal and written quotations.
- Competitive bidding.
- Committee system for competitive bids.
- Procurement exemptions.
- Unsolicited bids.

All municipalities must have, implement and comply with, a supply chain management policy. The policy must be “fair, equitable, transparent, competitive and cost effective” and comply with the regulations.

- Issues to note are the following:
  - The Municipal Finance Management Act makes it clear that municipalities may entertain unsolicited bids. However, this may only occur in accordance with a prescribed framework. The framework in the Supply Chain Management Regulations are quite restrictive, and may only be considered if:
    - The product or service offered in terms of the bid is a demonstrably or proven unique innovative concept.
    - The product or service will be exceptionally beneficial to, or have exceptional cost advantages for, the municipality or municipal entity.
    - The person who made the bid is the sole provider of the product or service.
    - The reasons for not going through normal bidding processes are found to be sound by the accounting officer.

- Councillors are barred from adjudicating tenders and penalties are prescribed for interference by anyone in the supply chain management system.

- Special procurement requirements are established for PPPs in terms of section 120.
20. The finance cycle

20.1. Types

There are three primary sources of local government funding:

- Inter-governmental transfer (Equitable Share from the National Revenue Fund and Grant Funding).
- Own revenue (tariffs, user charges, conditional grants, and taxes, rates).
- Borrowing.

Public finance (national government)

This type of finance involves national government grants made available to municipalities. Equitable Share, allocated annually in the Division of Revenue Act (DORA), is the only unconditional grant.

A municipality must usually apply for other grants from various national government departments and these are usually made available subject to specific conditions being met by the municipality. The grants can be direct from a transferring department or indirect through an intermediary (for example, province). It can be cash for the municipality to spend or in kind where the money is administered by the transferring department. There are several conditional grants:

- Capital: The Municipal Infrastructure Grant (MIG), which comes from DPLG, is intended to consolidate all funds for municipal infrastructure. The intention is to use MIG systematically to eliminate backlogs in infrastructure.
- Capacity building and restructuring grants.
- Grants in kind: operational and capital from sector departments.

Public finance (municipality)

This type of finance is where the municipality borrows funds to finance an infrastructure project and provides a guarantee to lenders to repay all funds.

This type of finance affects a municipality’s balance sheet and therefore limits its ability to undertake other projects requiring the borrowing of funds.

What do lenders look for?

The lender would analyse a municipality’s total ability to raise funds through taxes and revenues, including additional revenue that may be raised through application of the funds. It would also consider outstanding or recurring obligations and the potential for ministerial interference with the municipality’s ability to raise tariffs to meet loan obligations.

Municipalities are accustomed to this type of lending. Generally, a municipality raises a loan facility, which is split internally between departments. This practice will change with the implementation of the MFMA provisions, which require the specific reason for the loan to be investigated.

Service provider finance

This type of finance is where a service provider will raise the funds using its own credit.

What do lenders look for?

The lender would consider the creditworthiness of the provider and municipality, parent company guarantees, the track record of the provider in respect of similar projects, the existing debt obligations of the provider and potential for ministerial interference that will affect the municipality’s ability to pay contract fees through tariffs or fee increases.

Project finance

This type of finance uses a project’s assets and future revenues as the basis for raising funds.

A separate legal entity (such as a company) is usually created and the company then borrows funds. Such an entity usually has a minimum equity requirement (investment by the municipality and/or other parties) needed to raise project finance debt.

What do lenders look for?

The lender would analyse the projected future revenue stream to be generated and the company’s assets to repay the loans. It would also consider the creditworthiness of the provider and municipality, parent company guarantees, the track record of the provider in respect of similar projects, the existing debt obligations of the provider and potential for ministerial interference that will affect the municipality’s ability to pay contract fees through tariffs or fee increases.

This type of lending is most relevant in concession-type agreements; however, because of the political risk associated with tariff setting and budget allocation done by Council on an annual basis, and collection risk from the community, project finance deals at local government level are not as common as at provincial and national government level.

20.2. Who could invest or provide finance?

Service providers

Service providers may be willing to invest, but only if they are quite certain about getting their money repaid through contractual certainty about revenue to be generated. They will consider factors such as the duration of the contract and what the potential return on investment may be.

Debt or equity funds

This may include locally registered unit trusts or foreign debt or equity funds. Most funds have an investment mandate or strategy that allows them to invest in certain industries (such as infrastructure), geographical locations (such as South Africa) or to promote certain social issues (such as black economic empowerment).

The primary interest of such funds is the prospect of earning dividends or appreciation on their investment.

Banks

Banks can be involved as short- or long-term lenders.
End user
Financing through end users can be achieved where customers pay for services to be rendered in advance or where they commit to the purchasing of a minimum amount of services over a specific period.

20.3. Loans – The Municipal Finance Management Act
A municipality may incur debt only in accordance with the provisions of the Municipal Finance Management Act. Section 46 of the Act provides that a municipality may only incur long-term debts for the following purposes:

- Capital expenditure (including costs) on property, plant or equipment to be used for the purpose of achieving the objects of local government as set in the Constitution.
- Re-financing existing long-term debt.

The accounting officer of a municipality must, at least 21 days prior to the council meeting at which debt is approved:

- Make public an information statement setting out particulars of the proposed debt, including the amount, purpose and details regarding security to be provided.
- Submit a copy of the information statement to council, together with repayment details, anticipated debts repayment schedule and the anticipated total cost in connection with the debts over the repayment period.
- Invite the public, National Treasury and relevant provincial treasury to submit written comments or representations to council regarding the proposed debt.

21. Immovable assets
A number of considerations need to be taken into account in respect of the transfer of assets from municipalities to service providers.

The Municipal Finance Management Act provides that a municipality may not transfer ownership, with or other transaction or otherwise permanently dispose of a capital asset needed to provide a minimum essential municipal service. A “basic municipal service” is defined as a service, which, if not provided, would pose a threat to public health or safety. Water services would be regarded as a basic municipal service.

In addition, the Framework for the Restructuring of municipal service provision, as signed by SALGA and COSATU on 11 December 1998, states that municipalities must retain ownership of infrastructure assets of core services and that infrastructure assets used by a private company during a contract will be transferred back to the municipality at the end of the contract.

The Framework does recognise that there will be instances where the municipalities can choose to sell or lease some of these assets. It further provides that measures must be put in place to allow for effective protection against asset stripping. When the service is transferred back to the municipality, it must be transferred as a going concern, with the assets in a state of good repair and maintenance, and at no cost to the municipality.

The regulations in terms of Section 19 of the Water Services Act, promulgated on 19 July 2002, provide that the maximum duration of a service delivery agreement may not exceed 30 years calculated from the date of signature of the contract. Notwithstanding the regulations, it is a generally accepted principle that all service delivery agreements must be for a fixed term and that although renegotiation and/or the extension of the agreements is possible, consideration should be given to the situation where a service delivery agreement terminates.

There is also the risk that the service provider may fail. In these circumstances, the municipality, being responsible for water services, would find itself in the position that all of its immovable property, servitudes and infrastructure were registered in the name of, or otherwise made over to the service provider.

In the event that all immovable assets, servitudes and infrastructure are transferred to a service provider and it was declared insolvent, the municipality would be a concurrent creditor having no claim in regard to the immovable assets, servitudes and infrastructure transferred by it to the service provider. The municipality would have to endeavour to re-acquire the immovable assets, servitudes and infrastructure as best it could.

The costs (legal fees, transfer duty and other charges) associated with the transfer of land and immovable assets or cession of servitudes should also be considered.

Part I: Conclusion
Although this document focuses predominantly on the legislative requirements of a Section 78 decision-making process, any process followed must be designed to allow the municipality to achieve the desired outcome.
Annexure A: Municipal powers and functions

Listing of local government functions in Schedules 4B and 5B of the Constitution

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<td>Municipal airports</td>
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<tr>
<td>Municipal planning</td>
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<tr>
<td>Municipal health services</td>
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<tr>
<td>Municipal public transport</td>
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<tr>
<td>Municipal public works (internal)</td>
</tr>
<tr>
<td>Pontoons, ferries, jetties, etc</td>
</tr>
<tr>
<td>Stormwater management</td>
</tr>
<tr>
<td>Trading regulations</td>
</tr>
<tr>
<td>Water and sanitation services</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Schedule 5 B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beaches and amusement facilities</td>
</tr>
<tr>
<td>Billboards and display advertisements</td>
</tr>
<tr>
<td>Cemeteries, funeral parlours and crematoria</td>
</tr>
<tr>
<td>Cleansing</td>
</tr>
<tr>
<td>Control of public nuisances</td>
</tr>
<tr>
<td>Control of undertakings that sell liquor</td>
</tr>
<tr>
<td>Facilities for animals</td>
</tr>
<tr>
<td>Fencing and fences</td>
</tr>
<tr>
<td>Licensing of dogs</td>
</tr>
<tr>
<td>Licensing and control of food undertakings</td>
</tr>
<tr>
<td>Local amenities</td>
</tr>
<tr>
<td>Local sports facilities</td>
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<tr>
<td>Markets</td>
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<tr>
<td>Municipal abattoirs</td>
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<tr>
<td>Municipal parks and recreation</td>
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<tr>
<td>Municipal roads</td>
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<tr>
<td>Noise pollution</td>
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<tr>
<td>Pounds</td>
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<tr>
<td>Public places</td>
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<tr>
<td>Refuse removal; solid waste disposal</td>
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<tr>
<td>Street trading</td>
</tr>
<tr>
<td>Street lighting</td>
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<tr>
<td>Traffic and parking</td>
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</table>
## Annexure B: Consultation requirements and notice periods

<table>
<thead>
<tr>
<th>Institution</th>
<th>MFMA: Section 33 – Contracts having future budgetary implications</th>
<th>MFMA: Section 84 – Financial implications of municipal entities for the Council</th>
<th>MFMA: Section 120 – PPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>60 days before the meeting at which the contract is to be approved. Make public the draft contract and an information statement summarising the municipality’s obligations in terms of the</td>
<td>90 days before the meeting of the municipal council at which the proposed establishment of the municipal entity is to be approved: Make public an information statement setting out the municipality’s plans for the municipal entity together with the assessment which the municipality must conduct</td>
<td>60 days prior to the meeting of the council at which the matter is to be considered: Make public particulars of the proposed PPP, including the report on the feasibility study</td>
<td></td>
</tr>
<tr>
<td>Required: Draft service delivery agreement between the municipality and the municipal entity</td>
<td>Required: assessment report required in terms of section 84(1)</td>
<td>Required: feasibility study in terms of section 120(4)</td>
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<tr>
<td>Solicit views and recommendations</td>
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<td>Solicit views and recommendations</td>
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<td>Solicit views and recommendations</td>
<td>Solicit views and recommendations</td>
<td>Solicit views and recommendations</td>
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</tr>
</tbody>
</table>

1. National Treasury: Solicit views and recommendations
2. DPLG: Solicit views and recommendations
3. Sector department: Solicit views and recommendations
4. Provincial Treasury: Solicit views and recommendations
5. Provincial department responsible for local government: Solicit views and recommendations
6. MEC for local government: Solicit views and recommendations
7. Community and other interested parties: Invite the local community and other interested parties to submit to the municipality comments or representations in respect of the proposed contract
8. Organised labour: Invite organised labour to submit to the municipality comments or representations in respect of the matter
Annexure C: Contract types

In the table below we set out the generally recognised “standard contract options”. Essentially the options are distinguished by the level of risk transferred (in particular operational and funding risk). The type of risk transfer influences the return that the service provider should make, and accordingly to make it affordable, the duration of the contract.

It should be noted that although there are “standard contract types”, ultimately any service delivery agreement that a municipality approves should be a negotiated position taking into consideration the particular needs of the municipality and the risk that a service provider will accept. It may be that following assessment of suitable options and procurement processes the ultimate contract structure will have characteristics of a combination of the generic contract options.

<table>
<thead>
<tr>
<th>Generic contract type</th>
<th>Brief description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service contract</td>
<td>A municipality pays a fee to a service provider to provide specific operational services such as meter reading, garbage collection or collection of certain revenues. Capital investment is not the responsibility of the contractor and the contractor takes no collection risk. Typical duration: one to three years</td>
</tr>
<tr>
<td>Management contract</td>
<td>A municipality pays a fee to a service provider to assume overall responsibility for operation and maintenance of a service delivery system, with the freedom to make day-to-day management decisions. Capital investment is usually not the responsibility of the contractor. The contract is an attractive option when fuller service provider participation is not an attractive option or where it is expected that a management contractor can help improve information about the enterprise and its market before further contracting. The downside of this is that the contractor’s superior information about the job and its market might deter other potential bidders in future, hindering open competition. Typical duration: five years.</td>
</tr>
<tr>
<td>Lease contract</td>
<td>A service provider rents facilities from a municipality and assumes responsibility for operation and maintenance. The lessee finances working capital and replacement of capital components with limited economic life, but usually not fixed assets, which remain the responsibility of the municipality. Typical duration: 10 years.</td>
</tr>
<tr>
<td>Concession</td>
<td>A service provider handles operations and maintenance and finances investments (fixed assets) in addition to working capital. Assets are usually owned by the municipality, but leased and managed by the concessionaire for the period of the concession. At the end of the contract the assets are returned to the municipality in specified condition. The project is designed to generate sufficient revenues to cover the concessionaire’s investment and operating costs, plus an acceptable rate of return. The municipality exercises a regulatory and oversight role and receives a concession fee for this arrangement. Concessions typically focus on operating and financing the expansion of existing system components. Typical duration: 15+ years</td>
</tr>
<tr>
<td>Build-operate-transfer</td>
<td>A form of concession, with an emphasis on construction of new, stand-alone systems. The municipality may or may not receive a fee or share of profits. Typical duration: 15+ years.</td>
</tr>
<tr>
<td>Privatisation</td>
<td>The assets are privately owned and the owner sells a service either through competition in the marketplace, or by competing for a contract to provide monopoly services for a defined period at an agreed price. Note that for municipal services, this is not an option as the municipality always retains the constitutional responsibility to ensure service delivery, and can never “sell-off” or contract out of its service authority responsibilities to the communities. It is legislatively precluded from divesting itself of assets used for basic service delivery. There are, however, activities of municipalities which are not municipal services and which can be privatised. An example is residential gas supply which the City of Johannesburg decided to privatise.</td>
</tr>
</tbody>
</table>
### Annexure D: Glossary of terms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>BEE</td>
<td>Black Economic Empowerment</td>
</tr>
<tr>
<td>CBO</td>
<td>Community-based organisation</td>
</tr>
<tr>
<td>COSATU</td>
<td>Congress of South African Trade Unions</td>
</tr>
<tr>
<td>DBSA</td>
<td>Development Bank of Southern Africa</td>
</tr>
<tr>
<td>DORA</td>
<td>Division of Revenue Act</td>
</tr>
<tr>
<td>DPLG</td>
<td>Department of Provincial and Local Government</td>
</tr>
<tr>
<td>DTI</td>
<td>Department of Trade and Industry</td>
</tr>
<tr>
<td>DWAF</td>
<td>Department of Water Affairs and Forestry</td>
</tr>
<tr>
<td>IDC</td>
<td>Industrial Development Corporation</td>
</tr>
<tr>
<td>IDP</td>
<td>Integrated Development Plan</td>
</tr>
<tr>
<td>INCA</td>
<td>Infrastructure Finance Corporation of SA Ltd</td>
</tr>
<tr>
<td>IT</td>
<td>Information Technology</td>
</tr>
<tr>
<td>KPA</td>
<td>Key Performance Area</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicator</td>
</tr>
<tr>
<td>MEC</td>
<td>Member of Executive Committee</td>
</tr>
<tr>
<td>MFMA</td>
<td>Local Government: Municipal Finance Management Act 56 of 2003</td>
</tr>
<tr>
<td>MIG</td>
<td>Municipal Infrastructure Grant</td>
</tr>
<tr>
<td>MSA</td>
<td>Local Government: Municipal Systems Act 32 of 2000</td>
</tr>
<tr>
<td>NBI</td>
<td>National Business Initiative</td>
</tr>
<tr>
<td>NGO</td>
<td>Non-Governmental Organisation</td>
</tr>
<tr>
<td>PFMA</td>
<td>Public Finance Management Act 1 of 1999</td>
</tr>
<tr>
<td>PPP</td>
<td>Public-Private Partnership</td>
</tr>
<tr>
<td>SALGA</td>
<td>South African Local Government Association</td>
</tr>
<tr>
<td>SCM</td>
<td>Supply Chain Management</td>
</tr>
<tr>
<td>Section 78</td>
<td>Section 78 of the Local Government: Municipal Systems Act 32 of 2000</td>
</tr>
<tr>
<td>SMMEs</td>
<td>Small, Medium and Micro Enterprises</td>
</tr>
<tr>
<td>WSA</td>
<td>Water Services Authority</td>
</tr>
<tr>
<td>WSP</td>
<td>Water Services Provider</td>
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</tbody>
</table>