Municipal rates policies and the urban poor

- How can municipal rates policies promote access by the poor to urban land markets?

October 2009

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Executive summary

Property rates policies are foremost an instrument created through the Municipal Property Rates Act (MPRA) of 2004 to provide a policy framework at municipal level within which a transparent and fair system of rating, exemptions, reductions and rebates can be implemented. However the MPRA explicitly incorporates a pro-poor objective alongside its fiscal goals. In urban areas, the poor struggle to access well-located land in cities and legal, institutional and procedural constraints impede secondary residential property markets from functioning effectively in black townships. The purpose of this paper is to examine how municipal property rates policies are, or could be, used as an instrument to promote access by the poor to urban land markets. Buffalo City Municipality and the City of Johannesburg are used as case studies to probe implementation issues and highlight some of the key trade-offs made and approaches taken by municipalities to balance municipal revenue concerns with pro-poor policy intentions.

There are two main avenues by which municipal rates policies could be designed to positively impact on the struggle by low-income households to gain access to urban land. First, by providing direct tax relief, municipal rates policies can impact the demand-side of the equation by making it more affordable to remain in one's current property or to move up the property ladder. Second, through indirect means, municipal rates policies can create incentives for property owners to make land use decisions which increase the supply of available well-located land and the stock of low-income housing.

Direct tax relief to improve affordability for poor households

Municipal rates policies include rebates, exemptions and reductions which are targeted at vulnerable groups for the purpose of eliminating or relieving their rates liability. An unaffordable property rates account could have the following effects on property owners: cause eviction or downward movement in the housing ladder; stop households from moving up the housing ladder due to fears of being unable to pay in the future; or simply reduce disposable income available for other household necessities. To the extent that ownership by the poor of formal housing is limited by affordability, direct tax relief can assist by putting more money in the pockets of low-income property owners or prospective property owners.

On aggregate, municipal accounts (property rates plus service charges) for 2009/10 average 12% of monthly household income for the metros, thus falling below the commonly accepted benchmark of 15% for affordable municipal tax burden. However many cities set the cut-off for indigent support at an income level equal to two social pensions. As a result, the group most adversely affected by property rates and service charges are therefore the poor and lower-income households whose income disqualifies them from benefits provided to those on the indigent register, and whose property values may exceed the residential exclusion. These households often pay over the 15% mark.

Mandated R15 000 residential exclusion

The residential exclusion is likely the most important instrument in the municipal rates policy for providing direct relief to the poor. Section 17(1)(h) of the MPRA mandates a

R15 000 residential property exclusion, although a number of municipalities raise this limit to as much as R150 000. Some municipalities simply adopted the R15 000 minimum stipulated in the MPRA (e.g. Buffalo City Municipality), while other municipalities utilised more complex rationales to derive their residential exclusion threshold.

At the time of the drafting of the MPRA, this R15 000 figure was chosen to reflect the perceived average market value of a government-subsidised RDP house. However since then, the amount of the subsidy has increased significantly as the specifications for the standard RDP house have improved. The mandated R15 000 residential exclusion has not kept pace with the input costs of a government subsidised house nor the estimated re-sale price of these houses through formal or informal transactions. As a consequence, the wide variation in residential exclusion thresholds means that RDP beneficiaries in some municipalities will be liable for rates while beneficiaries in neighbouring municipalities may be exempt.

Johannesburg and eThekwini have the highest residential exclusion rate of R150 000. In the current housing bond market, a municipality which has a R150 000 residential exclusion is subsidising households with a monthly income of approximately R5000 or less (assuming they took at a bond to purchase the house).

According to the current valuation roll for Johannesburg, the R150 000 residential exclusion completely eliminates rates liabilities for 32% of residential property owners, or 24% of total rate-payers in Johannesburg. However those properties which are entirely exempt from property rates due the residential exclusion are a very small portion of the total properties on the roll and the total value of the roll. The total Rand value of residential properties under R150 000 is R11.6 billion, which is only 3% of the Rand value of all residential properties and only 2% of Rand value of the entire valuation roll.

Ultimately, the reality of lower collection rates for residents with lower-value properties means that the municipality must weigh the higher administrative costs of attempting to collect bad debts, against the actual revenue foregone if that category of property owners is instead completely exempt from rates liabilities. Lower collection rates imply higher administrative costs and smaller revenue foregone.

Rebates and exemptions for vulnerable groups

Analysis of the municipal property rates policies of the 9 SACN cities shows that some municipalities limit themselves to the minimum in rebates and exemptions, while others apply more generous and innovative rebates. Cape Town, Nelson Mandela Bay and Ekurhuleni have innovative sliding scale rebates for senior citizens, pensioners and disabled persons with varying numbers of income categories. Linking rates relief to twice the amount of the Old Age Grant is fairly typical, and is an approach adopted by four of the SACN municipalities.

In Johannesburg the key driver in setting the policy was the desire to continue the principles of the old rates policy into the new rating system. The policy intent and impact of the old rates ordinance were translated into terms and mechanisms allowable under the MPRA.

Another approach to improve targeting is to supplement the means test with a limit on the value of the property. The difficulty arises in situations where property owners may be asset-rich but cash-poor; for example, senior citizens who have fully paid off their homes but survive on an OAG as their only income. If hit with substantial property rates, such residents may be forced to sell and move from homes they have lived in for the larger part of their lives.

Many municipalities, including Tshwane and Ekhurhuleni, provide full exemptions to persons on the indigent register, although there are some exceptions. Johannesburg has developed an innovative approach for targeting rates and tariffs relief for the poor through its Social Package Policy which provides benefits based on a poverty index which takes into account other factors than income, including access to services.

Special relief for child-headed households has appeared in some municipal rates policy, such as Mangaung, Ekurhuleni and eThekwini, as a progressive mechanism to provide support to vulnerable children, many orphaned by HIV and AIDS.

The key difficulty for municipalities in applying rebates to vulnerable groups is that it is difficult to determine who is poor from the information on the valuation roll alone. The rebate process puts the onus on the rate-payer to access the benefit. Hence pro-poor rebates have sound social objectives but are very difficult to implement. Required documents to show eligibility and low levels of public awareness keep take-up rates at minimal levels. Also verification of eligibility information, in the case of rebates for farm workers, often relies solely on the applicants' self-reporting. As a result, a high number of eligible poor people are therefore not accessing available property tax rebates.

Municipalities must also consider revenue foregone when selecting and designing direct tax relief measures for the poor. In the case of the residential exclusion, the revenue foregone is a function of the value of the threshold, the number of qualifying properties on the roll and the estimated collection rate. In the Johannesburg case, one of the factors in setting the residential exclusion threshold was the collection rate for lower-value properties, specifically avoiding the administrative burden and debt write-offs associated with chasing high numbers of low-amount arrears. The examples of Johannesburg and Buffalo City suggest that the ability to calculate collection rates of different property value bands is therefore a critical part of determining the residential exclusion amount.

Given the ability to pay by these vulnerable groups and the rates base, revenue foregone due to these direct tax relief measures described above is not significant in comparison to total rates revenue. However, the total cost to the municipality of implementing any tax relief measure is the cash revenue foregone plus the administrative costs and staff time to chase arrears, verify documentation, and conduct public awareness campaigns to increase uptake. Weighing the options, the means-tested rebate instrument has higher accuracy in terms of reducing errors of inclusion. However low public awareness and difficulty verifying eligibility may reduce uptake and therefore lead to errors of exclusion.

Shaping incentives to affect market behaviour in order to increase stock of low-income housing and available land

While direct tax relief is a demand-side intervention, property rates policies can also incorporate supply-side measures to increase the stock of available land in urban areas. These instruments would work by creating incentives which favour land use decisions which promote densification and integration. The MPRA provides municipalities with the space to decide which properties to rate or exempt from rating, and whether rebates or reductions will be offered to some of the rateable property categories, based on local conditions and circumstances. The creation of particular categories of properties or property owners and the application of differential rates and rebates to those categories is a therefore a potential policy tool for pushing vacant or under-utilised land back into the market.

Rating vacant land

The practice of charging higher levies on vacant land has been adopted by the majority of the SACN municipalities. Of the nine municipalities, Tshwane applies the highest rate for vacant land R 0.0452, which is approximately 6.8 times greater than the residential rate.[1] By increasing the rates on vacant land, municipalities discourage absenteeism and speculation and create incentives for densification and improvements.

Special Ratings Areas

Given the spatial legacy of apartheid, residential areas tend to be organised by income and race; thus geographic targeting may be a less expensive and faster means of identifying and reaching low-income households than a means test. Section 22 of the MPRA allows municipalities to set up special rating areas (SRAs) whereby groups of residents in a particular geographic area voluntarily come together to increase their levies in order to have additional services or infrastructure. Neighbourhoods with an overwhelming majority of poor households could potentially be designated as an SRA and a lower rating applied to residential property in this area. The advantage of using SRAs for pro-poor purposes would be that it can provide relief to a large number of poor households quickly, without requiring an application process and means tests.

Given that most municipalities are focused on establishing the new valuation roll and implementing the new rates policy, many have pursued the idea. Of the SACN cities, Cape Town and eThekwini are the only ones who have SRA policies in place.

One potential policy problem with SRAs is that the additional levies may not be affordable for low-income households within the boundaries of the SRA. It is advisable to incorporate a clause in the SRA policy which ensures that those who are eligible for rebates under the municipality's rates policy would be exempt from any additional SRA levies. This was the approach taken in Cape Town.

Even if very poor households are exempt from additional SRA levies, households which earn too much to qualify for exemption but are still overburdened by the additional levy could potentially be outvoted in their area. Section 22(2)b of the MPRA only requires the written consent of a "majority of the members of the local community in the proposed special rating area who will be liable for paying the additional rate." This has commonly been interpreted as a simple majority (50% plus 1). An alternative would be to require a larger majority to establish an SRA (e.g. 75% as in eThekwini) and a smaller percentage of affected property owners (e.g. 26% or 33%) to disestablish an SRA.

Geographic targeting to promote densification and development

An example of geographic targeting already in practice is the inner city rebate in Johannesburg. Property owners in a demarcated area are entitled to apply for a 40% rebate if at least 80% of the property is used for residential purposes. The rebate is a

[1] Effective residential rate (net of 35% rebate).

new initiative, effective in 2009/10, which was aimed at relieving the tax burden on a number of properties in downtown Johannesburg which shared commercial and residential use but were being hit by the higher commercial rate. However, the take-up rate for the rebate has been very low; until time has passed, it will be difficult to know if the rebate is having an effect in promoting residential use in the inner city and revitalising the downtown area.

The 20% sectional title rebate in Johannesburg is part of the City's approach to encouraging higher density settlement. The automatic rebate will benefit the 22% of residential property owners in Johannesburg who are sectional title residents in properties valued over R150 000. In order to further incentivise high density settlement, the rebate is also available to any properties which are part of a development with a density of more than 70 dwelling per hectare. The impact of this rebate scheme on land use and urban planning is unknown, however take-up appears to be slow.

The effectiveness of any of these indirect instruments will depend upon how significantly property rates feature in the decision-making factors considered by developers and property owners when buying, selling or making land use decisions on property. The tax benefit may be taken up, but the incentive will not effectively change behaviour unless the cost of compliance (or revenue foregone) by the property owner is less than the tax benefits. A case study is needed which examines the impact of a rebate scheme in effect and surveys developers and property owners on how the tax benefit affected their decisions to buy, sell and develop property.

Developing pro-poor property rates policies

From the perspective of local government, the main issue appears to be the legality of giving special treatment to a particular area. Some municipalities are more aggressive in considering and experimenting with ways to provide rates relief to categories of property or property owners, in order to alleviate poverty or promote economic growth and development. The legality of such schemes will likely be questioned, if not tested in Court. Other municipalities are being more cautious in interpreting the Act regarding impermissible discrimination between property owners and property categories. As municipalities shift their energy from sorting out start-up problems with their new policy and valuation roll, we may see the addition of further rebate schemes and the wider spread of SRAs. In the meantime, research on the impact of some of these measures (such as the density bonus in Johannesburg or rebates to farmers who provide services to farm workers) would be extremely useful in understanding the potential of property rates for impacting land use and property markets in favour of the poor.

This analysis suggests that the residential exclusion is one of the most effective and least costly mechanisms (from an administration perspective) for targeting the poor for rates relief. Better information on collection rates per income band and on the secondary residential property market in township areas can improve the methodology for setting the residential exclusion threshold, thus increasing its pro-poor benefits while meeting municipal revenue needs. Income-based rebates and other specific measures to target particularly vulnerable groups can then be used to fill the gaps.

Acronyms

BCM	Buffalo City Municipality
BNG	Breaking New Ground strategy (Comprehensive plan for the creation of sustainable human settlements, approved in principle by Cabinet in 2002)
CAMA	Computer Assisted Mass Appraisal
COJ	City of Johannesburg
CGTA	Department of Cooperative Governance and Traditional Affairs (previously DPLG)
DPLG	Department of Provincial and Local Government (now CGTA)
LOS	Level of Service
MPRA	Municipal Property Rates Act
NCA	National Credit Act
NDOH	National Department of Housing
NMB	Nelson Mandela Bay
NT	National Treasury
OAG	Old Age Pension
PSI	Public Service Infrastructure
RDP	Reconstruction and Development Programme
SACN	South African Cities Network
SASSA	South Africa Social Services Agency
SRA	Special Ratings Area
TRPM study	Township Residential Property Markets study
ULM	Urban LandMark programme

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1 Introduction and background

Urban land markets are not functioning in a manner which enables or promotes access by the poor to land and low-income housing. Various external barriers and dysfunctionalities of land markets in South African cities make it difficult for the poor to enter urban areas, move out of informal settlements into formal housing, and gain secure tenure of well-located land. With the promulgation of the Municipal Property Rates Act (MPRA) in 2004, municipalities reformed their property rates systems to meet uniform standards nationwide. The MPRA was intended to enable municipalities to secure adequate revenue streams from property rates while ensuring the tax system was fair and equitable. Given the developmental role of local government in South Africa, the impact of the new municipal rates policies on the poor becomes a vital question.

The purpose of this paper is to examine how municipal property rates policies are, or could be, used as an instrument to promote access by the poor to urban land markets. This line of inquiry requires us to use a pro-poor perspective to look carefully at the dynamics and effects that occur at the intersection of two fields: urban land markets and municipal property rates. We know that zoning regulations and property rates impact on the property market by influencing land use decisions, property values and affordability—as a result, the stock of available land and low-income housing is affected and poor households may find it more difficult to move up the housing ladder to formal housing or more secure tenure. The poor are also faced with a municipal account for basic services which may place an unaffordable burden on household income. Thus the potential impact of municipal property rates on access by the poor to urban land markets must be considered alongside the role of planning and zoning regulations and the broader municipal account (including service charges).

Our analysis of municipal property tax must also take cognisance of basic tax principles. Tax theory shows us that the local government tax is an ideal tax to fund local services because the properties which benefit from those services by definition cannot relocate. However when local governments also attempt to directly achieve redistribution aims through taxation, there can be perverse effects as residents and businesses relocate to another jurisdiction with lower rates. Tax theory thus tells us that national government is best suited for redistributive aims. Given that intergovernmental transfers do not fully cover the costs of delivering infrastructure and basic services to the poor in most municipalities, cross-subsidisation from service charges and property rates must fill the gap, implying that more rateable property must come onto the roll to grow the rates base. The imperative to grow the rates base must be balanced against equity and pro-poor policy principles.

In addition to a review of relevant literature, policy documents and research nationally, interviews with national stakeholders were held to supplement written information, including municipal property rates experts (in academia and private consultancies), the National Department of Cooperative Governance and Traditional Affairs (CGTA) and National Treasury. In order to better understand the implementation of the MPRA on the ground, two municipalities were selected for more in-depth case study research. Interviews in Buffalo City Municipality and the City of Johannesburg were held with officials from the property rates, valuation and planning and development sections. The experience from these municipalities is used throughout the paper to probe implementation issues and highlight some of the key trade-offs made and approaches taken by municipalities to balance municipal revenue concerns with pro-poor policy intentions.

1.1 Significance of the Municipal Property Rates Act from a pro-poor perspective

Replacing the old system of property valuation governed by ordinances of the former Cape, Natal, Orange Free State and Transvaal provinces, the MPRA required municipalities to put in place a rates policy and establish a new valuation roll based on market value. Section 229 (1) of the Constitution assigns the power to levy property rates to municipalities, as one of the key revenue streams for this sphere of government. The MPRA, effective 1 July 2005, therefore did not ascribe a new power but essentially regulated an existing one.

The key element of the new system was the migration to a market value rating system, which set property rates as a ‘Cent amount in the Rand levied on the market value of immovable property’ (land plus buildings). The MPRA defines market value as the amount the property would have been sold at on the date of valuation in the open market between a willing buyer and willing seller. Previously provinces used one of three approaches to property rates valuation: site value rating (land values only), flat rating (land and improvements rated, with both taxed at the same rate), or composite rating (land and improvements both taxed, but at different rates). Given that there was a fairly even split between these three approaches and considerable variation amongst provinces, the migration to a single system meant considerable adjustments for some municipalities (Bell and Bowman, 2002). With the addition of newly-rateable property and the addition of improvements to the valuation roll, differential rates for particular property categories needed to be adjusted to avoid significant hikes in rates liabilities for property owners while still ensuring adequate revenue for municipalities.

Beyond essential reform and the creation of uniformity in property rating systems across the country, the MPRA introduced critical elements from a pro-poor perspective. First, the migration to a market value system meant some municipalities dropped their previous system of land value taxation (which includes site value and composite value). The idea of taxing land value only, or taxing land value at a higher rate than improvements, has been argued by some experts to be a more economically efficient, pro-poor and fair approach. By expanding the tax base to include improvements, the State creates a disincentive to improve property because by doing so the property owner increases his total rates bill. However tax simplicity was a significant argument in favour of adopting a market value approach in the MPRA, as it allows the use of available market data to establish valuation rolls. Differential rates for vacant land are a mechanism permitted within the MPRA which brings some of the same incentives and benefits as land value taxation.

Second, the MPRA contains an explicit mandate for municipalities to provide relief for the poor in their rates policies. Rates policies are foremost an instrument created through the Property Rates Act to provide a policy framework at municipal level within which a transparent and fair system of rating, exemptions, reductions and rebates can be implemented.[2] However the MPRA explicitly incorporates a pro-poor objective alongside its fiscal goals; Section 3(3)f of the Act states that municipalities must “take into account the effect of rates on the poor and include appropriate measures to

[2] Email from Veronica Mafoko, Department of Cooperative Governance and Traditional Affairs, Directorate: Municipal Finance Policy, dated 8 July 2009.

alleviate the rates burden on them." Municipalities may consider applying exemptions, rebates and reductions for vulnerable groups, including indigent property owners, social grant recipients and property owners who are unemployed or temporarily without income. The intention was for municipal rates policies to target tax relief for indigents and avoid overburdening the poor with rates liabilities.

Some specific measures were built into the MPRA for this purpose. Section 17 (1)g bars municipalities from levying rates on land reform beneficiaries or their heirs for a ten-year period from when their title was registered. Municipalities may not apply tax deferral to indigents (Section 26(3)). Where previously municipalities often provided a residential rebate set at various levels, the MPRA mandates a R15 000 exclusion for residential properties which relieved the poorest home owners of any rates burden. (The impact of this measure is discussed in greater detail in Section 2.2 below).

Third, the MPRA requires that the valuation roll in each municipality must be comprehensive, including those properties that are to be fully or partially exempted from rates (Section 30 (2)). The intention is for the valuation roll to be comprehensive and for policy to be made through rebates and not exclusions from the roll.[3] However the Act does make exceptions in the cases where municipalities do not intend to levy rates on the properties, and where the valuation of the property is too onerous for the municipality to undertake, given financial and administrative constraints. Section 7(2)iv allows a municipality not to levy rates on 'properties in respect of which it is impossible or unreasonably difficult to establish a market value because of legally insecure tenure resulting from past racially discriminatory laws or practices." In practice, this has meant that many informal settlements and old township areas are not valued.

Although the MPRA emphasises that the valuation roll must be comprehensive and include all properties which the municipality intends to levy rates on, it no longer requires a physical inspection of each property to assess its value. Various methods for determining market value are permitted including computer-assisted mass appraisal techniques (CAMA) and aerial photography. The allowance for alternative valuation methods (Section 45) is critical from a pro-poor perspective since informal settlements and residential townships often do not have a functioning property market which generates sufficient market-related data.

Four years on from its enactment, not all municipalities have managed to meet the four year deadline for implementation of the MPRA. By 1 July 2009, 97% of municipalities had implemented the Act, leaving approximately 17 municipalities in the precarious position of not legally being able to levy property rates, which of course are a significant source of income for the operating budget.[4] A political decision has been taken for the national department to assist these municipalities, potentially by amending the Act to extend the implementation date.

The municipal property rates policies which have been instituted appear to be pro-poor to varying degrees, some including progressive clauses to target vulnerable groups or

[3] National Treasury officials indicated that the comprehensiveness of the valuation roll is particularly important because ultimately it will feature as a factor in the determination of the equitable share of nationally raised revenue to be transferred to each municipality. At present, the NT is conducting simulations to calculate the revenue-raising capacity component of the local government equitable share formula, which is intended to reflect the municipality's own revenue raising capacity. In the future, the intention is use the municipal valuation rolls as indicators of own revenue raising capacity.

[4] Interview with Veronica Mafuko, Municipal Finance Policy, Department of CGTA, 11 August 2009. Confirmed in interview with Jan Hattingh, National Treasury, 20 August 2009.

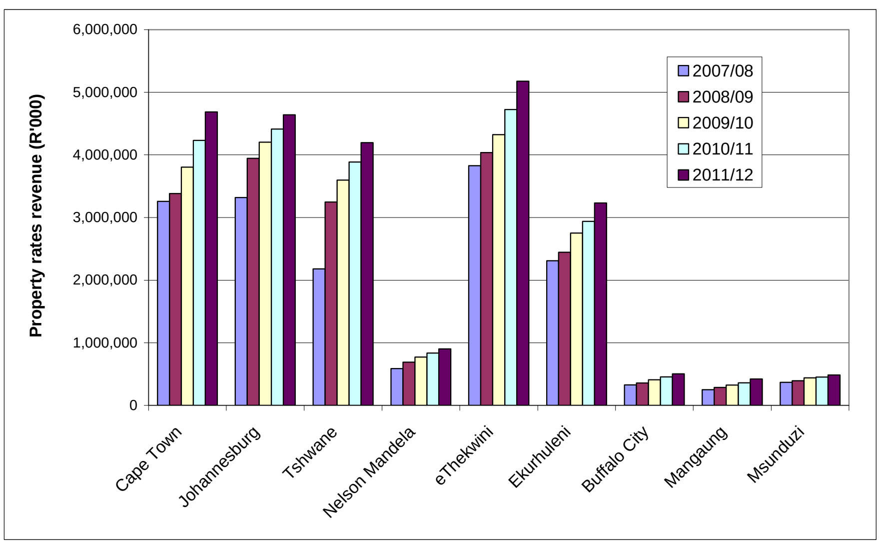
create innovative incentives for pro-poor development. However the potential link between municipal rates policies and access by the poor to urban land markets remains largely unexplored.

1.2 Significance of property rates to municipal revenue

From a fiscal perspective, property rates are a critical source of income for municipalities, constituting 18.1 per cent of total municipal revenue in 2007/08.[5] Property rates revenue grew by 4.2 per cent in real terms between 2003/04 and 2006/07 and was expected to grow slightly more slowly (3.8%) between 2007/08 and 2009/10.

Figure 1 shows revenue from property rates for the period 2007/08 to 2011/12, according to the 2009/10 municipal budgets of the nine cities of the South Africa Cities Network (SACN). Municipal property rates revenue is climbing in all nine cities. Forecasted revenue is based on the property values as contained in the current valuation roll and an assumption of 95 per cent collection in most cases. Four of the metros have valuation rolls effective 1 July 2008, while another four municipalities implemented the MPRA 1 July 2009. Cape Town is the exception with its valuation roll effective from 1 July 2007. Forecasted revenue may therefore be somewhat generous in light of the current economic downturn.

Figure 1 Total property rates revenue per municipality (2007/08-2011/12)



Source: 2009/10 municipal budgets.

Compared to other municipal revenue sources, property rates only rank third. Countrywide, service charges and intergovernmental transfers are the first and second largest contributors to municipal operating budgets, constituting 41.6 per cent and 22.4 per cent respectively in 2007/08. In the specific case of metros which are less reliant on intergovernmental transfers, service charges contributed a slightly higher share of municipal operating revenue (42.9%), while property rates accounted for 20.9 per cent of total metro operating revenue in 2007/08. [6]

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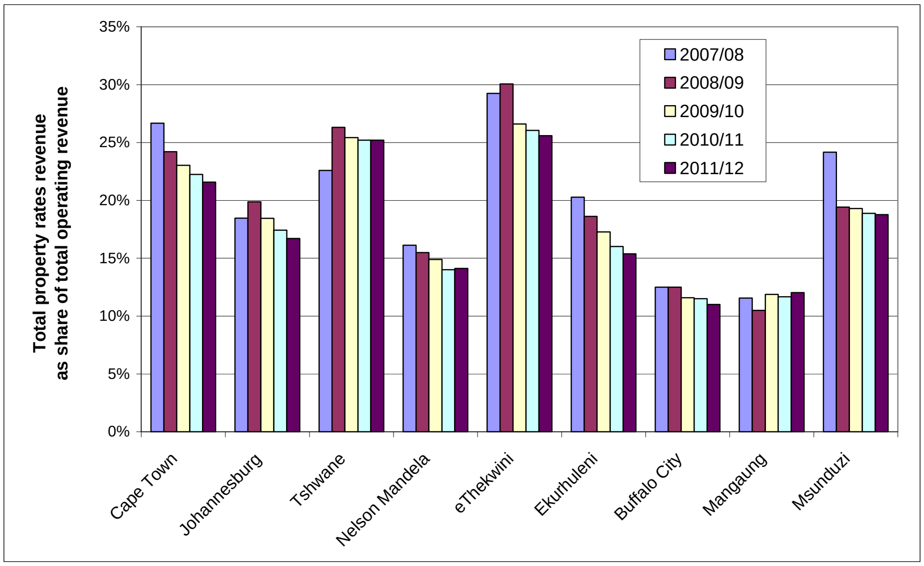
[5] National Treasury. *2008 Local Government Budgets and Expenditure Review.*

[6] National Treasury. *2008 Local Government Budgets and Expenditure Review.*

Total municipal property rates revenue is anticipated to rise in most of the 9 SACN cities over the medium term (2009/10-2011/12). However its share of total municipal revenue is declining, largely due to increased intergovernmental transfers and service charges revenue (see Figure 2).

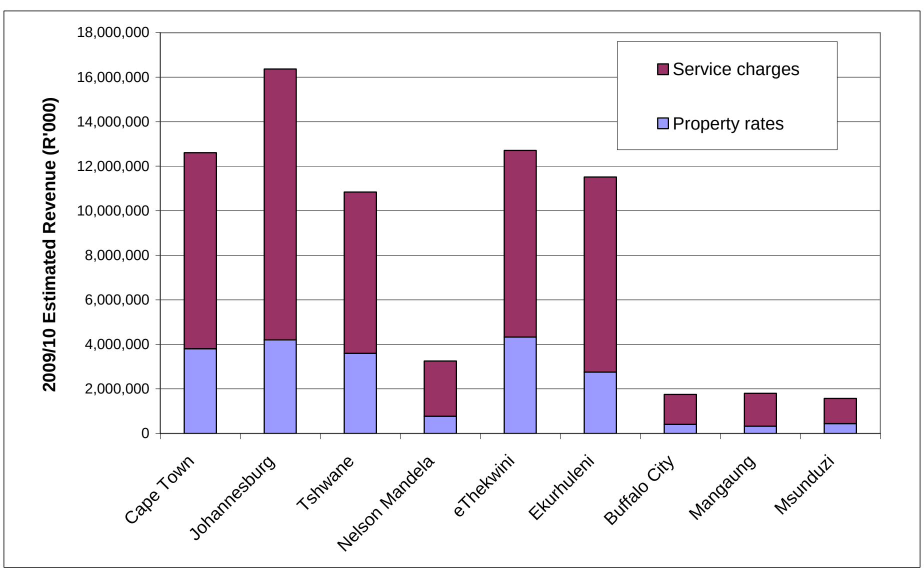
Figure 2 Property rates revenue as share of total operating revenue, per municipality (2007/08-2011/12)



Source: 2009/10 municipal budgets. Own calculations.

As shown by 2009/10 revenue figures in Figure 3, service charges overshadow property rates in their contribution to municipal revenue. Subsequently service charges also swallow a larger portion of the monthly income of poor households than property rates. Section 2.1 discusses this in more detail.

Figure 3 Property rates and service charges revenue per municipality (2009/10)



Source: 2009/10 municipal budgets.

What share of total property rates revenue comes from poor households? This will depend on the valuation roll, rates and rebates included in the rates policy, and the collection rate. In Section 2.2 we explore this question further in the case of Johannesburg.

On the flip side, what share of the poor are liable for property rates? Given different rebate schemes and residential exclusion amounts effective in various cities, the share of the total poor in the municipality which are levied property rates will vary. These questions assist us to understand the significance of property rates as an instrument to enable access by the poor to urban land markets.

1.3 Barriers to access by the poor to urban land markets

Research on the residential property markets in township areas indicates that the poor continue to struggle to access well-located land in cities—either through ownership or alternative forms of tenure (Kihato, 2007) (Marx, 2007) (Nell et al, 2004). Residential property markets require functioning primary and secondary markets, interrelated and dependant. However the Township Residential Property Markets research conducted in 2004 found that legal, institutional and procedural constraints impeded secondary property markets from functioning effectively in black townships. There is insufficient supply of available housing stock in township areas and the bulk of transactions occur informally without title deeds. In comparison with higher-income areas, the housing ladder is inactive, meaning that households, as their income increases, do not sell and move to more expensive properties but instead remain in the same house and potentially improve their property. Often improvements are made to improve the immediate quality of life of current occupants or to increase the value of the asset to be handed down to the next generation, instead of improving the property with an eye to resale.

On the whole, the secondary property market is dysfunctional in township areas due to a variety of procedural factors (Nell et al, 2004):

- delays in transferring title to beneficiaries of government subsidy houses which result in lack of legal title,
- difficulty obtaining the municipal clearance certificate required to sell to a new owner,
- prohibitions on subsidy beneficiaries from selling their RDP houses within 8 years of occupation,
- lack of conveyancers and estate agents operating in these areas, and
- expensive transaction costs which often force households to remain where they are or sell informally.

For the purposes of the research question identified here, the question is to what extent municipal rates policies impact on these factors which hinder a properly-functioning residential township property market.

1.4 Breaking down the impact of the MPRA on access by the poor to urban land markets

There are two main avenues by which municipal rates policies could be designed to positively impact on the struggle by low-income households to gain access to urban land. First, by providing direct tax relief, municipal rates policies can impact the demand-side of the equation by making it more affordable to remain in one's current property or moving up the property ladder more affordable. Second, through indirect means, municipal rates policies can create incentives for property owners to make land use decisions which increase the supply of available well-located land and the stock of low-income housing.

Section 2 begins by looking at the first of these avenues: direct tax relief. Municipal rates policies include rebates, exemptions and reductions which are targeted at vulnerable groups for the purpose of eliminating or relieving their rates liability. The impact of direct property rates tax relief on poverty alleviation is quite limited due to the simple fact that a minority of the poor—depending on the definition used—are property owners. However, with regard to the poor who *do* own property (primarily RDP housing and old government housing stock which has been transferred), we first look at overall affordability levels to better understand how significant municipal property rates are to household expenditure. Two main instruments are explored. The residential exclusion is likely the most important instrument in the municipal rates policy for providing direct relief to the poor. The second instrument is targeted rebates and exemptions. Both instruments mean revenue foregone for the municipality, while the latter instrument also incurs administration costs associated with identification and verification of eligible households. The key issue is whether measures used by municipalities to target tax relief to the poor are a) effective in reaching the right households, and b) cost-efficient in implementation.

Section 3 then explores *indirect* instruments to increase the stock of available land and affordable housing. These instruments would work by creating incentives which favour land use decisions which promote densification and integration. Through the careful design of differential rates for certain property categories and targeted rebates for particular groups of property owners, there is potential for pushing vacant or under-utilised land back into the market.

The concluding section draws out some of the main issues and suggests areas for future research so that we can better understand how to enhance the impact of municipal rates policies on urban land markets in the interest of the poor.

2 Direct tax relief to improve affordability for poor households

Municipalities are expected to target indigents in their jurisdiction and monitor the affordability of municipal rates for poor households, in order to ensure they are not overburdened with rates liabilities.[7] An unaffordable property rates account could have the following effects on property owners: cause eviction or downward movement in the housing ladder; stop households from moving up the housing ladder due to fears of being unable to pay in the future; or simply reduce disposable income available for other household necessities. To the extent that ownership by the poor of formal housing is limited by affordability, direct tax relief can assist by putting more money in the pockets of low-income property owners or prospective property owners.

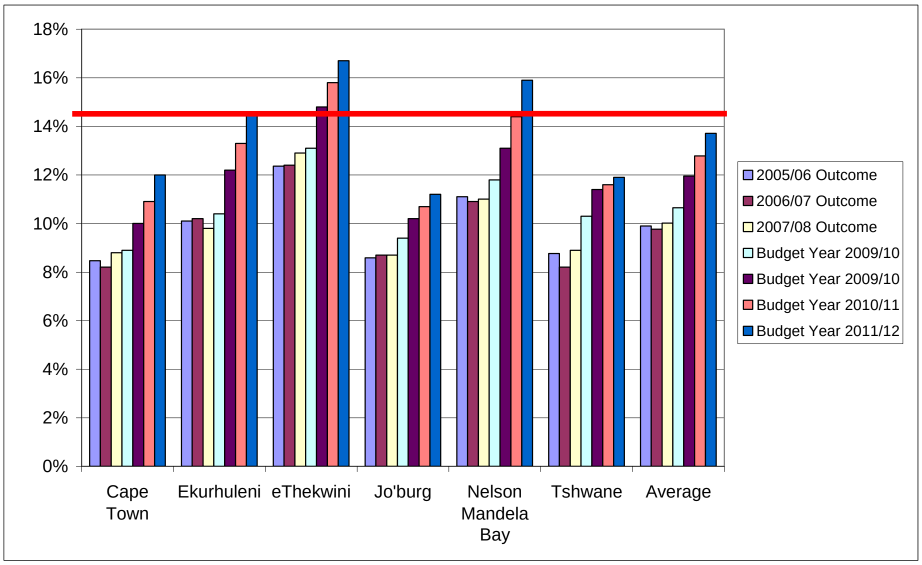
2.1 Overall affordability levels from household perspective

To better understand the impact of local government taxes at the household level, property rates and tariff bills must be considered together as a single municipal account. The level at which a municipal bill is considered affordable is taken to be 15

[7] the dplg. *Local Government: Municipal Property Rates Act No. 6 of 2004. General Guidelines.*

per cent of household income, according to the commonly-accepted benchmark.[8] Figure 4 is taken from the National Treasury's updated metro dataset and shows average rates and services revenue as a share of average household income for each of the six metros, over the 8 year period 2005/06 to 2011/12.[9] It shows that on the whole, the municipal account falls below the 15 per cent benchmark, excepting the outer years in NMB and eThekwini.[10] However it is noted that typically the tariff bills for water and electricity are a bigger burden on low-income households than property rates, and also more prone to higher annual increases; an examination of the impact of tariffs on the poor is beyond the scope of this paper.

Figure 4 Average rates and service charges as percentage of average household income



Source: National Treasury municipal database.

Although the aggregated figures indicate that municipal accounts are affordable from a household perspective, closer analysis by income band tells a more nuanced story. In 2006 pdg undertook an analysis for the City of Johannesburg of the affordability of the total municipal household account for households in 6 different income categories, based on typical service level standards for each income band.[11] The model covered 5 metros, including Johannesburg. Income categories were defined as set out in Table 1.

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[8] Literature suggests that a share of 10%-15% of household income is typical and can be considered 'reasonable'. See Foster, V in collaboration with CEER-UADE, 2004: "Toward a Social Policy for Argentina's Infrastructure Sectors: Evaluating the Past and Exploring the Future", World Bank Policy Research Working Paper 3422, October 2004. See also PDG (2004). "Final Report: Comparative Tariff Analysis." June 2006. Report prepared by pdg for City of Johannesburg: Corporate Planning Unit.

[9] The dataset covers the actual results against budgets for the period 2005/06 to 2007/08 and budgeted information for 2009/10 MTREF. The data was extracted from the latest available annual financial statements (audited wherever possible) and/or budget documents). Received via email from Jan Hattingh, National Treasury, 21 August 2009.

[10] According to the *2008 Local Government Budgets and Expenditure Review, t*he weighted average was 9% of household income in 2003/04 and 2006/07, ranging from a high of 11.6% for eThekwini and a low of 7.4% in Cape Town in 2006/07.

[11] "Final Report: Comparative Tariff Analysis." June 2006. Report prepared by pdg for City of Johannesburg: Corporate Planning Unit.

Table 1 Residential income categories: 2006 pdg study

Category	*2006 income (updated from 2001 using CPI figures)*
Very poor	< R969
Poor	Between R969 and R1,938
Lower middle	Between R1,938 and R4,240
Medium	Between R4,240 and R12,113
Medium high	Between R12,113 and R24,227
High	Greater than R24,227

Source: "Final Report: Comparative Tariff Analysis." June 2006. Report prepared by pdg for City of Johannesburg: Corporate Planning Unit.

For each category, characteristics of typical household units were identified, based on analysis of Johannesburg suburbs with a median income in each category. Table 2 displays the characteristics of indicative residential consumer units which were used to run the model calculating the household tariffs and charges.[12]

Table 2 Characteristics of indicative households in each income category in Johannesburg

	Poor	*Lower middle*	*Middle*	*Medium high*	*High*
Water LOS	In-house	In-house	In-house	In-house	In-house
Water (kl/month)	15	25	26	37	58
Sanitation LOS	Waterborne	Waterborne	Waterborne	Waterborne	Waterborne
Electricity LOS	60 Amp	60 Amp	60 Amp	60 Amp	60 Amp
Electricity (kwh/month)	350	778	856	1,127	1,626
Refuse LOS	2 x 85l bin liner collected once per week	240l wheeled bins collected once per week	240l wheeled bins collected once per week	240l wheeled bins collected once per week	240l wheeled bins collected once per week
Erf Size (m2)	229	263	496	998	1,386
Land (R)	10,000	12,500	26,000	55,000	117,000
Land & property (R)	12,000	48,000	125,000	234,000	376,000
Examples of suburbs	Stretford Extension 4, Poortjie, Slovoville, Phiri	Orlando East	Malvern, Riverlea	Witpoortjie	Parkview

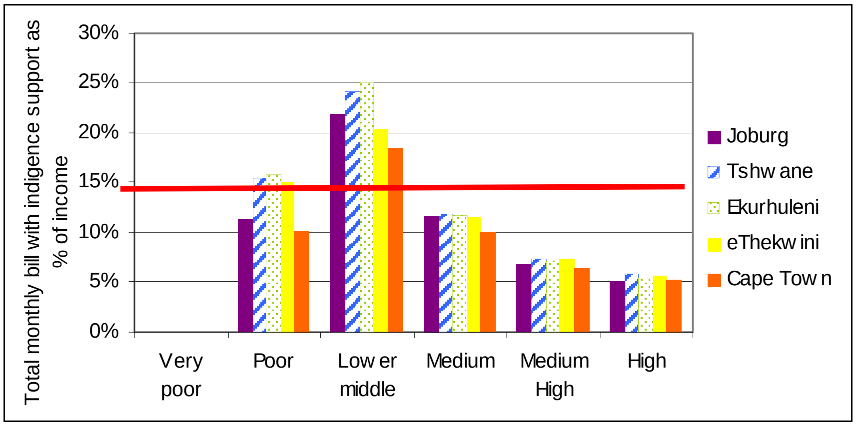
Source: "Final Report: Comparative Tariff Analysis." June 2006. Report prepared by pdg for City of Johannesburg: Corporate Planning Unit.

The model took indigent policies into account and showed that very poor households in informal settlements and backyard shacks benefit from free basic services and indigent support while poor households (R969-R1938 per month), including families residing in new RDP houses, may pay closer to 15 per cent of their household income on property rates and service charges.

[12] The study assumed very poor households lived in informal settlements, backyard shacks or inner city flats and did not have a direct relationship with the City since they are not account holders. Therefore this category was not included in the tariff model and analysis.

Many cities set the cut-off for indigent support at an income level equal to two social pensions, an amount which includes the 'poor' bracket as defined in the model. It is therefore the lower middle income bracket (R1938-R4240 per month) who were the hardest hit, as their income often exceeds the threshold eligible for indigent support. In all five metros, this income band paid 17-25 per cent of their household income on the municipal account. See Figure 5.

Figure 5 Total monthly bill with indigent support as percent of household income, by income category and municipality



Source: "Final Report: Comparative Tariff Analysis." June 2006. Report prepared by pdg for City of Johannesburg: Corporate Planning Unit.

A similar analysis for DPLG (now the Department of CGTA) done in 2007 modelled the municipal account as a share of household income for 5 different income bands, based on assumptions regarding level of service and property values for each income band, as shown in Table 3.

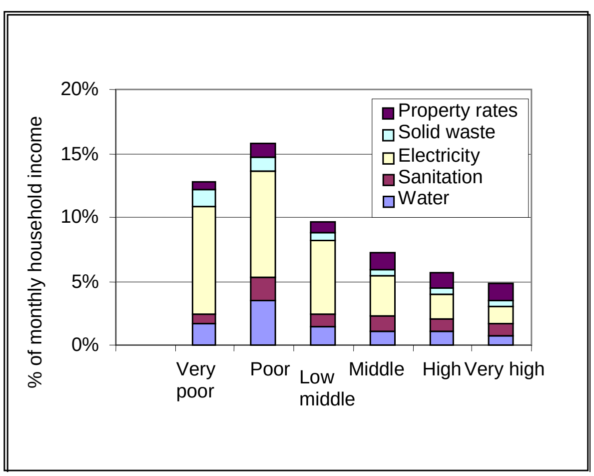
Table 3 Specification of consumer units used for modelling of household bills, per income band

	Household income per month (R)	Property value (R)	Water Level of Service (LOS)[13]	Water consumption (kl per month)	Sanitation LOS	Electricity LOS	Electricity consumption (kWh per month)	Refuse LOS
Indigent	800	16,000	On-site metered	6	Metered waterborne	60A supply	50	Kerbside
Very poor	1,650	38,000	On-site metered	15	Metered waterborne	60A supply	350	Kerbside
Poor	2,500	76,000	On-site metered	25	Metered waterborne	60A supply	500	Kerbside
Lower middle	6,500	150,000	On-site metered	26	Metered waterborne	60A supply	850	Kerbside
Middle	16,000	500,000	On-site metered	37	Metered waterborne	60A supply	1130	Kerbside
High	34,000	1,000,000	On-site metered	58	Metered waterborne	60A supply	1500	Kerbside
Very high	50,000	1,500,000	On-site metered	60	Metered waterborne	60A supply	1500	Kerbside

Source: "Analysis and policy advice related to setting of annual limits and ratios pertaining to the Municipal Property Rates Act." Final report prepared by Dataworld, Riel Franzsen and pdg for the Department of Provincial and Local Government, 11 May 2007.

When the residential property tax rate was limited to 0.5 per cent of property value (R0.005 Cents in the Rand), only municipal accounts for households in the 'poor' category (household income between R2500 to R6500 per month and property value between R76 000 and R150 000) exceeded the 15 per cent threshold (see Figure 6).

Figure 6 Household municipal bill as share of monthly income, by income category



Source: "Analysis and policy advice related to setting of annual limits and ratios pertaining to the Municipal Property Rates Act." Final report prepared by Dataworld, Riel Franzsen and pdg for DPLG, 11 May 2007.

[13] LOS stands for 'Level of service' which relates to the service experienced by the user.

Very poor households living in informal settlements and backyard shacks are not affected directly by municipal accounts due to indigent policies and the residential exclusion in most cities. 'Low middle' households with incomes over R6 500 per month received a municipal account which amounted to 5-9 per cent of their household income. Due to their higher income, wealthier households pay less than 6 or 7 per cent of their household income on the municipal account.

Both these reports support the notion that the group most adversely affected by property rates and service charges are the poor and lower-income households whose income disqualifies them from benefits provided to those on the indigent register, and whose property values may exceed the residential exclusion.

2.2 Residential rates and residential exclusion

Section 17(1)(h) of the MPRA mandates a R15 000 residential property exclusion, although a number of municipalities raise this limit to as much as R150 000.[14] Figure 7 shows the residential property rate and the exclusion amount for the nine cities of the SACN. It is important to note that this graph does not include reductions and exemptions for persons on the indigent register.[15] This is discussed in Section 2.3.2 below.

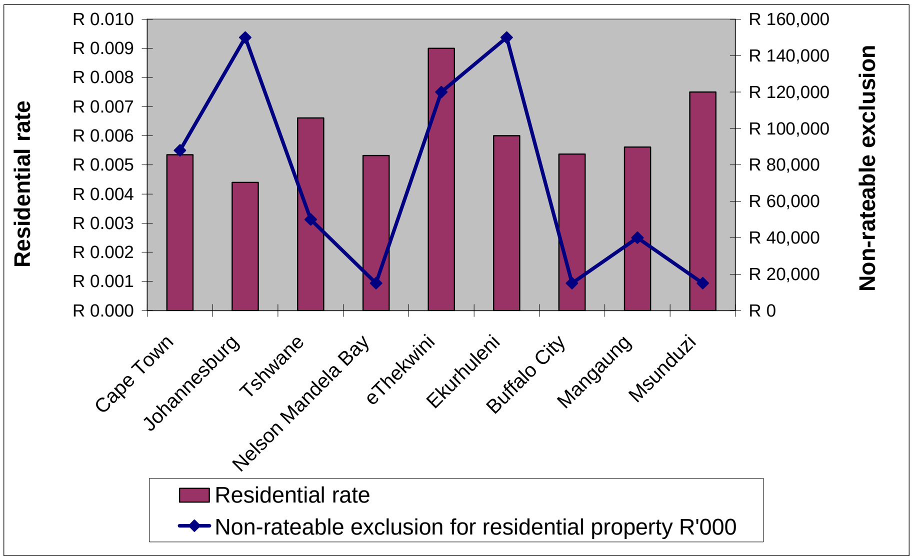
Some municipalities simply adopted the R15 000 minimum stipulated in the MPRA (e.g. Buffalo City Municipality), while other municipalities utilised more complex rationales to derive their residential exclusion threshold, as in the case of Johannesburg which is discussed below. BCM did not conduct any modelling of various thresholds or rebate amounts in order to set the residential exclusion.

At the time of the drafting of the MPRA, this R15 000 figure was chosen to reflect the perceived average market value of a government-subsidised RDP house. However since then, the amount of the subsidy has increased significantly as the specifications for the standard RDP house have improved.

[14] "A municipal council is a liberty to raise the R15 000 threshold provided that it can secure alternative rates income from other rateable properties within its area of jurisdiction. This is effectively a subsidy on the property rates." Interview with Irvine Florence, Acting Director: Rates and Taxes, City of Johannesburg. 25 August 2009.

[15] As part of its social package for indigents, BCM includes rates relief of up to R60.7, based on property value of R165 000. Similarly, Msunduzi offers a residential exemption of R130 000 for indigents.

Figure 7 Comparison of residential rates and rates exclusion levels (2009/10)[16]



Source: Municipal rates policies. Own calculations

Table 4 shows the increases to the housing subsidy quantum since its inception in 1994 at R15 000. In April 2005 the Minister of Housing "resolved that escalating land costs should not undermine the capacity of developers to build to minimum norms and standards, and therefore that land should be financed separately." In April 2007, it was decided that servicing should also be financed from separate sources than the housing subsidy, which should be used for the top structure alone.[17] The policy changes over the years have pushed the subsidy up to its current level of R55 706, as shown in Table 4.

Table 4 Evolution of housing subsidy quantum

Implementation date	***New housing subsidy***
March 1994	R15 000
April 1999	R16 000
April 2002*	R20 300
April 2003	R23 100
April 2004	R25 800
April 2005**	R31 929 + land
April 2006	R36 528 + land

[16] Notes to graph:
- Msunduzi publishes a "general rate" at R0.0165. The residential rate given here (R0.0075) is the net residential rate after the residential reduction is deducted from the general rate. Ratios given in this section are to (net) residential rate (RR0.0075), in order to compare with other cities.
- Tshwane quotes R0.01017 as the residential rate but also indicates that at 35% rebate will be granted on all residential properties. Taking the rebate into account, the net rate for residential property is therefore R0.0066105. The graphs in this section assume this residential rate.

[17] National Department of Housing (2008). "Investigation into the perceived impact of market distortions ostensibly created with the residential housing market as a result of government subsidies." 30 June 2008. Paper prepared by Kecia Rust with support from Illana Melzer and Ria Moothilal. Pg. 29

Implementation date	New housing subsidy
April 2007***	R38 984 + land + services
April 2008	R43 506 + land + services
April 2008[18]	R54 600 + land + services
April 2009	R55 706

* *Introduction of Southern Cape Coastal Condensation area to provide for higher construction costs in certain areas. R2479 contribution instituted for households with monthly income over R1500 and less than R3000.*

*** Subsidy can no longer be used for land acquisition costs.*

**** Subsidy cannot be used for municipal engineering services & land.*

Source: National Department of Housing (2008). "Investigation into the perceived impact of market distortions ostensibly created with the residential housing market as a result of government subsidies." 30 June 2008. Paper prepared by Kecia Rust with support from Illana Melzer and Ria Moothilal. Pg. 29

The link between the required residential exclusion and the value of a government subsidised house is a natural and logical one: in order for government poverty relief policies to be consistent, a housing beneficiary who is poor enough to qualify for a free house (R1500 monthly income)[19] should not subsequently be defined as *not* poor enough to qualify for rates exemption. At the time of the drafting of the MPRA, the intention was to periodically update the R15 000 amount to keep pace with the value of the RDP house; the DCGTA is currently doing a review to understand the increase in the subsidy and the value of an RDP house. However the Department does not plan to depart from the R15 000 threshold in the amendments to the Act which are currently being proposed, until adequate research has been completed on the current average value of a BNG house.[20]

Determining the market value of an RDP house is not easy. Given the 8 year restriction on sale by beneficiaries of RDP houses as well as dsyfunctionalities of the secondary property market in township areas, the formal market is very thin and there are very few recorded transactions of RDP units.[21] As a result there are highly varied estimates of the resale price of an RDP house. Research done as part of the Township Residential Property Markets (TRPM) study looked at average prices realised in formal transactions as set out in the deeds registry and found that RDP units sold at an average price of R13 200 in 2003/04 (Nell et al, 2004).

Furthermore the actual input cost of a government subsidised house appears to far exceed the formal or informal purchase prices. It is estimated that the cost of land and servicing component for a standard, government subsidised house is between R37 954 and R50 892. The top structure costs an additional R61 117 – R69 788 (including conveyancing fees). The total cost to government for producing a subsidised house is therefore estimated at between R99 000 and R143 000 (NDOH, 2008).

[18] Memo from National Department of Housing, 12 August 2009. As reported in NDOH, 2008.

[19] The current national housing subsidy programme requires households with a monthly income of R1500-R3500 to pay in a contribution of R2479 to access a BNG house. Households with an income below R1500/month are eligible for a full subsidy.

[20] Interview with Veronica Mafuko, Municipal Finance Policy, DCGTA, 11 August 2009.

[21] Only approximately 3% of properties in former black township areas have transacted since 2007, compared to 11% of properties in the R250 000 – R750 000 market segment and R13% of properties in the R750 000 – R1.5 million market segment. Rust, Kecia. "Taking Stock: South Africa's Housing Sector." Presentation at Joint Human Settlements/World Bank Spatial Outcomes Workshop, 29 September 2009, Pretoria.

In summary, two main points are critical:

- The wide variation in residential exclusion thresholds (from R15 000 to R150 000) means that RDP beneficiaries in some municipalities will be liable for rates while beneficiaries in neighboring municipalities may be exempt.
- The mandated R15 000 residential exclusion has not kept pace with the input costs of a government subsidised house nor the estimated re-sale price of a BNG house through formal or informal transactions.

The residential exclusion may not be succeeding as a tool for providing rates relief to BNG beneficiaries, but is it at least succeeding in targeting the poor (who may or may not be government housing beneficiaries)? What is the income level of the property owners who benefit from the residential exclusion?

In recent years property values have dropped but interest rates are only now retreating from record highs.[22] Table 5 shows the largest home loan a household can afford, depending on their monthly income. With a household income of R1500/month (the cut-off rate for a free BNG house), households can only afford a R30 000 bank-financed house. A household with a monthly income of R3500 can afford financing for a house valued at R86 000; R3500 is the upper income limit to qualify for government subsidised housing.

Table 5 Housing bond affordability[23]

Household income (R/month)	*Monthly payment as share of monthly income[24]*	*Monthly payment (R)*	*Affordable bond (R)*
1000	20%	200	19,766
1500	20%	300	29,649
2000	25%	500	49,414
2500	25%	625	61,768
3000	25%	750	74,122
3500	25%	875	86,475
4000	30%	1200	118,595
4500	30%	1350	133,419
5000	30%	1500	148,243
5500	30%	1650	163,068
6000	30%	1800	180,292
6500	30%	1950	195,316
7000	30%	2100	210,341
7500	30%	2250	225,365

Source: NDOH (2008). "Investigation into the perceived impact of market distortions ostensibly created with the residential housing market as a result of government subsidies." 30 June 2008. Prepared by Kecia Rust with support from Illana Melzer and Ria Moothilal. Own calculations.

[22] House prices have been deflating since late 2008 and are expected to decline further in nominal terms toward the end of 2009 and into 2010. Absa reports that the average price of a small house ($80m^2$-$140m^2$) was R650 900 in July 2009, which is 4.8% lower than in July 2008. (Absa Home Loans (6 August 2009). "House price deflation appears to be bottoming out." Available at http://www.absa.co.za/absacoza/content.jsp?/Home/News-&-Market-Information/Absa-Publications/Economic-Research/Property-Research)

[23] Assuming 10.7% interest rate and 20 year loan.

[24] As per National Credit Act specifications

Johannesburg and eThekwini have the highest residential exclusion rate of R150 000. A household that purchases a R150 000 house (at a 10.7 per cent interest rate, over 20 years)[25] would need to make R1 518 monthly bond payments. Assuming monthly bond payments do not exceed 30 per cent of monthly income, that household would need to have a monthly income of at least R5 059 in order to qualify for a bond of that size. This means that a municipality which has a R150 000 residential exclusion is subsidising households with a monthly income of approximately R5 000 or less (assuming they took at a bond to purchase the house, according to these parameters).

In the case of Johannesburg, the derivation of the R150 000 threshold is largely historical. Prior to the implementation of the new rates policy in Johannesburg, the city's old valuation roll had been based on site value as per the Transvaal Local Authority Rates Ordinance. Under the old system, residential properties valued under R20 000 (site value) were given a 100 per cent residential remission (effectively a 100 per cent rebate) while residential properties over this amount were provided with a 58 per cent rebate.[26] The 100 per cent residential remission for properties with a site value of R20 000 or less was decided upon after analysing payment levels in 2001. It was found that the collection rate on properties valued R20 000 or below (based on site value) was only 12.5 per cent. The low payment levels at this band of property values were creating bad debt and meant the actual rates revenue for the City was quite low. Balancing the administrative costs incurred by chasing the debt with revenue foregone, the City decided to give a 100 per cent residential remission to this category of property owners with property valued less than R20 000. This made more sense from the perspective of the municipality than levying the rates, encountering low payment levels, and being forced to write off the bad debt.

Later when the shift was made to the new market-value based system, the City then examined the new roll and noted that those residential properties which previously received the 100 per cent remission were assigned a market value of R100 000 to R150 000. R150 000 was then selected as the new threshold for residential exclusion. Essentially, the main concern of the municipality in setting the R150 000 residential exclusion was to cause as little disruption as possible compared to the old rating regime, in other words to ensure that the majority of property owners who previously benefited from the 100 per cent residential remission would now fall under the new residential exclusion.[27]

The City of Johannesburg plans to revise the R150 000 figure with the new valuation roll (1 July 2011). In revising the figure, the intention will be to retain coverage of the same category of poor households (in other words, target the households and not the properties). If the property market changes significantly by that time, it may be necessary to adjust the cap downward to ensure that the exclusion is not including

[25] The average mortgage interest rate (13 August 2009) was reportedly 10.7%, dropping from 15% since January 2009. Absa Home Loans (13 August 2009). "Interest rates cut by 50 basis points to 2006 levels." Available at http://www.absa.co.za/absacoza/content.jsp?/Home/News-&-Market-Information/Absa-Publications/Economic-Research/Property-Research

[26] One of the drawbacks of this system was that the moment a property exceeded the R20 000 threshold , the entire amount was rateable. For example, a R21 000 residential property was levied at the residential rate and then provided with a 58% rebate, while a R20 000 house was fully exempt.

[27] In a few thousand cases, properties which previously fell under R20 000 according to the site value system were valued at over R150 000 in the new market-value-based roll. These were typically houses on low-value land which had undergone significant improvements. To protect these home-owners from incurring significant hikes in their property rates bills, the municipality took a decision to treat properties in this category as 'newly rateable properties.' The MPRA requires municipalities to phase in rates liabilities for newly rateable property over a period of three years (Section 21).

higher-income property owners than intended.[28] However the R150 000 is rather 'sticky' in the sense that reducing the threshold will be quite difficult politically once the bar has been raised.

As seen in Table 6, the current valuation roll for Johannesburg contains over 794 000 properties and is valued at approximately R679 billion. Of the total roll, 76 per cent of the properties are residential (65 per cent in terms of R value).

Table 6 City of Johannesburg valuation roll

	No. properties	R value
Total properties on valuation roll	**794,099**	**678,961,891,278**
Of which:		
Freehold	606,720	
Sectional title	187,379	
Non residential	**192,573**	**237,979,293,213**
As share of total properties on valuation roll	*24%*	35%
Residential	**601,526**	**440,982,598,065**
As share of total properties on valuation roll	76%	65%
Of which:		
Freehold	441,931	322,657,249,590
Sectional title	159,595	118,325,348,475
Total residential properties valued R150 000 or less	**193,334**	**11,600,733,730**
As share of total residential properties	32%	3%
Of which:		
Freehold	168,740	11,438,695,780
Sectional title	24,594	162,037,950
Total residential properties valued over R150 000	**408,192**	**429,381,864,335**
As share of total residential properties	68%	97%
Of which:		
Freehold	273,191	311,218,553,810
Sectional title	135,001	118,163,310,525

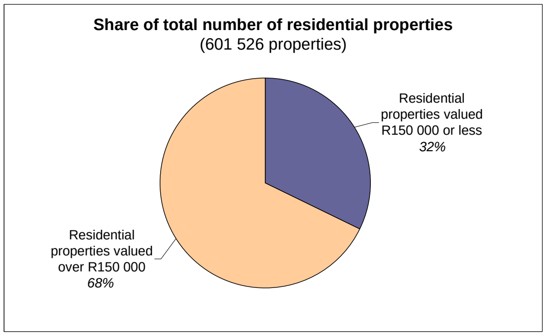
Source: Email from Piet Eloff, Director: Valuations, City of Johannesburg, 10 September 2009.

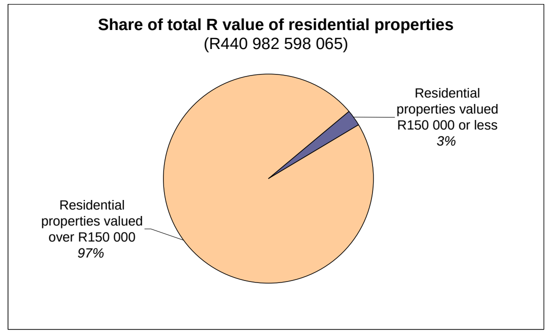
The key point is that those properties which are entirely exempt from property rates due to the R150 000 threshold are a very small portion of the total properties on the roll and the total value of the roll (Figure 8):

- Of the total residential properties, 32 per cent are valued at R150 000 or less—indicating that the R150 000 residential exclusion completely eliminates rates liabilities for 32 per cent of residential property owners, or 24 per cent of total rate-payers in Johannesburg.
- The total Rand value of residential properties under R150 000 is R11.6 billion, which is only 3 per cent of the Rand value of all residential properties and only 2 per cent of Rand value of the entire valuation roll.

[28] Interview with Piet Eloff, Director: Valuations, City of Johannesburg. 25 August 2009.

Figure 8 Johannesburg: Residential properties valued at or below R150 000 as share of total residential properties





Source: Email from Piet Eloff, Director: Valuations, City of Johannesburg, 10 Sept 2009. Own calculations.

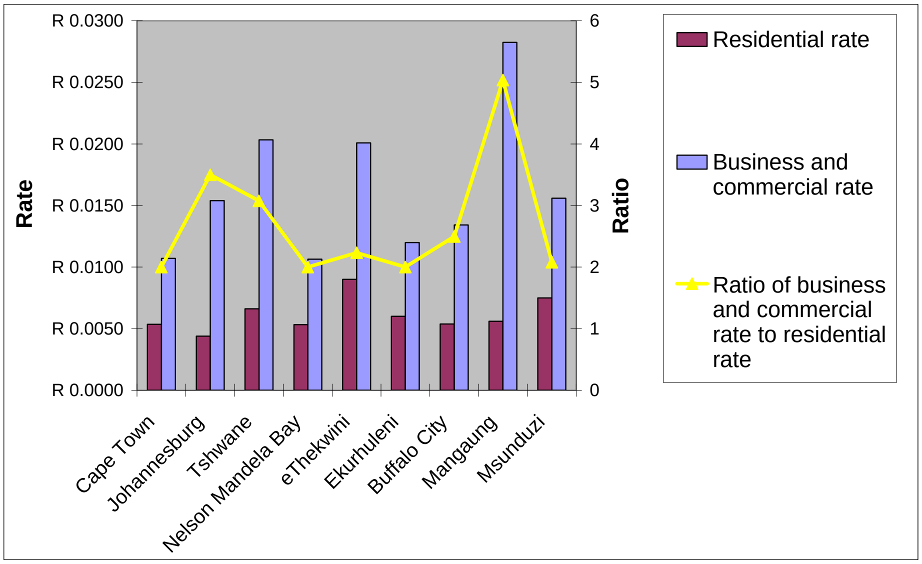
Setting the residential exclusion threshold is therefore a complex policy issue. If the threshold is set too high, then non-poor rate-payers become eligible for benefits which are intended for the poor.

If the residential exclusion is set too low, then the debtors' book grows sharply because of the poor's inability to pay. The reality of lower collection rates for residents with lower-value properties means that the municipality must weigh the higher administrative costs of attempting to collect bad debts, against the actual revenue foregone if that category of property owners is instead completely exempt from rates liabilities. Lower collection rates imply higher administrative costs and smaller revenue foregone. These trade-offs are discussed further in Section 2.4.4 below.

Apart from the residential exclusion, another mechanism for providing rates support to residential property-owners is via cross-subsidisation, achieved through differential rating for various property categories. The main form of cross subsidisation is to levy higher property rates on business and commercial property than residential property.

Figure 9 below compares the business and commercial rates to the residential rate in each of the municipalities. The ratio of residential to business and commercial serves as an indicator of the extent to which the business sector can be said to be subsidising the residential sector. Notably Johannesburg and Mangaung have the highest ratios. In the case of Johannesburg, the strength of the business sector in the metro allows cross subsidisation while in Mangaung the lower value of the residential property market probably accounts for the higher ratio.

Figure 9 Comparison and residential and business/commercial rates (2009/10)



Source: Municipal rates policies. Own calculations.

Under the old site value system in Johannesburg, business properties contributed 48 per cent of the rates revenue for the city. With the implementation of the new rates policy and valuation roll, business' share dropped to 35 per cent, indicating that more of the burden was shifted to residential property owners. In response, rates for 2009/10 were set with an intention of increasing business' share in order to return to the previous ratio. Currently, approximately 25 per cent of properties are business and 65-70 per cent residential. [29]

2.3 Rebates and exemptions for vulnerable groups

Section 15 (2) of the MPRA states that for purposes of granting exemptions, rebates, and reductions in respect of owners of categories of properties, such categories may include the following:

- indigent owners;
- owners dependent on pensions or social grants for their livelihood;
- owners temporarily without income;
- owners of property situated within an area affected by a disaster within the meaning of the Disaster Management Act (2002); or any other serious adverse social or economic conditions;
- owners of residential properties with a market value lower than an amount determined by the municipality;
- owners of agricultural properties who are bona fide farmers'

From the perspective of the Department of CGTA, the Act only permits the national department to influence the residential exclusion amount which is stipulated in the Act. Given that a living wage differs from city to city and municipalities are thus better-placed to define a 'poor' household in their jurisdiction, pro-poor rebates and exclusions are left to the municipalities to determine according to local circumstances. [30]

[29] Interview with Piet Eloff, Director: Valuations, City of Johannesburg. 25 August 2009.

[30] Interview with Veronica Mafuko, Municipal Finance Policy, Dept of CGTA, 11 August 2009.

However the MPRA guidelines do offer recommendations to municipalities that they exempt property owners who are recipients of an old age or disability grant, as well as owners who are not grant recipients but have an income equal or less than that amount.[31] Likewise, residential property owners who are unemployed (in the formal or informal economy) and without other sources of income or those temporarily without income, should be exempted from rating during the relevant municipal financial years. The burden to provide proof of circumstances rests on the property owner, but municipalities are advised to take special care in addressing the needs of those who cannot read or write.

Analysis of the municipal property rates policies of the 9 SACN cities shows that some municipalities limit themselves to the minimum in rebates and exemptions, while others apply more generous and innovative rebates. This section (2.3) provides details and examples of measures used to provide rebates to vulnerable categories of property owners: senior citizens, persons with disabilities, indigent persons and child-headed households. Section 2.4 then discusses the issues involved in considering trade-offs between the various methods presented here for providing direct property rates relief to the poor.

2.3.1 Senior citizens and property owners who are recipients of old age or disability grants

Cape Town, Nelson Mandela Bay and Ekurhuleni have innovative sliding scale rebates for senior citizens, pensioners and disabled persons. These sliding scales allow a rebate of between 10 per cent and 100 per cent, and are typically applicable to households whose income does not exceed R8000/month. Cape Town has nine levels of available rebates, while NMB has seven and Ekhuhuleni five. Johannesburg, Tshwane, Msunduzi and BCM[32] have rebate systems for pensioners and persons with disabilities, but they are single or double tier systems only. The more blocks or categories of income identified in the sliding scale, the more nuanced and sophisticated the rebate system is in targeting relief. However improved targeting comes at the expense of increased complexity in administration of multiple tiers of rebates. From a tax simplicity perspective, it is therefore better to have one or two basic levels of rebates.

Figure 10 below shows the sliding scale rebates for the seven SACN municipalities which use a sliding scale. [33]

Tshwane provides a 50 per cent rebate for pensioners and people with physical and mental disabilities who have a gross income which does not exceed twice the annual state pension; and a 40 per cent rebate for those whose income not exceed R8500.[34] Linking rates relief to twice the amount of the Old Age Grant is fairly typical, and is an approach adopted by four of the SACN municipalities.

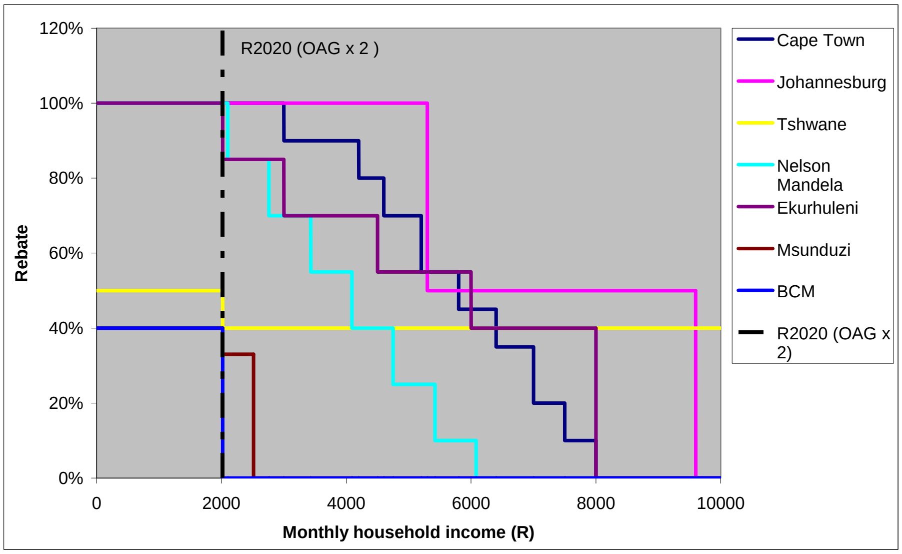
[31] DPLG. *Local Government: Municipal Property Rates Act No. 6 of 2004. General Guidelines.*

[32] Pietermaritzburg Tariffs and Charges 1 July 2009 to 30 June 2010, pg. 4. Aged persons who receive the OAG or persons receiving a disability grant are eligible for a 33.3% rebate if their household income does not exceed R2516/month and a 40% rebate if their household income does not exceed R2020.

[33] This graph does not include exemptions for indigents, a topic which is discussed below.

[34] Tshwane 2009/10 MTREF, Annexure A. Also note that Tshwane gives 35% rebate on residential property, so pensioners can get 50% plus 35% rebate, plus first R50 000 of property value is exempt.

Figure 10 Comparison of rebates for senior citizens and disability and old age grantees



Source: Municipal rates policies. Own calculations.

Mangaung which implemented its new rates policy 1 July 2009 indicates that retired and disabled persons, not registered as indigents, qualify for a special rebate which is based on monthly household income. However the municipality currently does not have any database of possible beneficiaries and therefore 2009/10 will be spent undertaking a registration process. The rebate will therefore only be implemented 1 July 2010.[35]

The case study of Johannesburg provides greater insight into how the municipality determines the tiers and on what basis. As in the case of setting the residential exclusion, in Johannesburg the key driver in setting the policy was the desire to continue the principles of the old rates policy into the new rating system. Under the old Transvaal ordinance based on site value, pensioners with an income less than R5000/month were given a 40 per cent rebate. In 2008/09 the Johannesburg Council then decided to expand the rebate to 100% for this group and to add a 50% rebate for pensioners with a monthly income less than R9000. In 2009/10 these income thresholds were adjusted upward for inflation (to R5300/month and R9600/month respectively). The key point is that Johannesburg took the policy intent and impact of the old rates ordinance and translated this into terms and mechanisms allowable under the MPRA.

Another approach to improve targeting is to supplement the means test with a limit on the value of the property. For example, Johannesburg has an additional requirement that pensioners with property with a value exceeding R1.5 million are not eligible for the rebate. [36] Alternatively, the relief is given as a reduction in the taxable property value. In eThekwini, pensioners and disability grantees and the medically boarded are exempt from paying rates on the first R400 000 of their property; there is no limit on value of property in order to apply for this exemption.[37] This approach has the

[35] Mangaung Local Municipality Property Rates Policy-Final (18 May 2009) for implementation 1 July 2009, pg. 15. Contained in Annexure B of Mangaung Local Municipality 2009/10 Budget.

[36] 2009/10 Johannesburg Budget, Annexure 1, pg. 2

[37] eThekwini MTREF 2009/10-2011/12 pg. 83.

advantage of eliminating the need for means testing and income verification, however it is based on an assumption that property values are an accurate proxy for income.

The difficulty arises in situations where property owners may be asset-rich but cash-poor; for example, senior citizens who have fully paid off their homes but survive on an OAG as their only income. If hit with substantial property rates, such residents may be forced to sell and move from homes they have lived in for the larger part of their lives. On the other hand, the intention is not to provide rates relief to very high-value properties. This was the rationale for Johannesburg limiting the rebate to pensioners with property valued less than R1.5 million.

BCM addressed this issue differently. Under the current system in Buffalo City, theoretically a senior citizen with a monthly income of R2020 who owns a higher-value property would be eligible to receive *both* the indigent subsidy which would cover up to R60.7 of his property rates liability *and* a 40 per cent rebate on any outstanding rates levied. (R60.7 covers the rates liability on a R165 000 residential property). The intention is to ensure that senior citizens who are income-poor but asset-rich to be able to stay in their homes as far as possible.

2.3.2 Poor and indigent persons

Many municipalities, including Tshwane and Ekhurhuleni, provide full exemptions to persons on the indigent register, although there are some exceptions. For example, some municipalities (including Msunduzi[38] and Mangaung[39]) limit the full exemption to those owning property below a certain market value. Nelson Mandela Bay only provides a full exemption to indigent households with a monthly income less than R2020—twice the amount of the old age pension. [40]

Johannesburg has developed an innovative approach for targeting rates and tariffs relief for the poor through its Social Package Policy.[41] Instead of targeting subsidies to households with income below a certain threshold, individuals are given a score on a poverty index which takes into account other factors than income, including access to services. Individuals are then grouped into one of three bands, depending on their poverty score, with a differentiated comprehensive subsidy package available to each band. The subsidies are applied on an additive per-person basis, with a maximum cap per band applicable for each household. The differentiation between individuals improves the efficiency of the subsidy, allowing more relief to those who need it more. Those property owners who are not pensioners, but whose income falls below the threshold set for the Expanded Social Package, receive a rebate dependent on their points rating (maximum rebate of 75% according to the policy). [42]

[38] In Msunduzi, indigent property owners with property valued equal or less than R130 000 are exempt. Pietermaritzburg Tariffs and Charges 1 July 2009 to 30 June 2010, pg. 4.

[39] Mangaung provides an exemption for indigents with properties valued up to R100 000. Mangaung Local Municipality Property Rates Policy-Final (18 May 2009) for implementation 1 July 2009, pg. 15. Contained in Annexure B of Mangaung Local Municipality 2009/10 Budget.

[40] NMB Rates and Rebates 2009/2010.

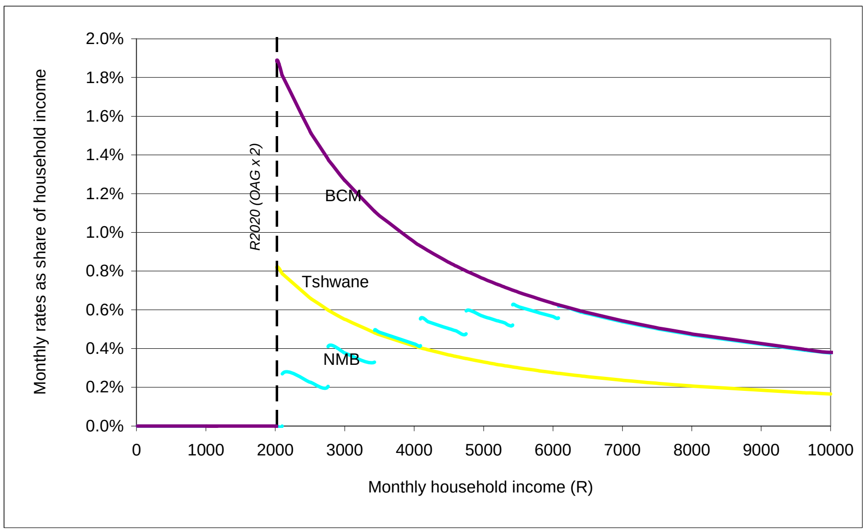
[41] Johannesburg 2009/10-11/12 MTREF Budget, pg. 62.

[42] 2009/10 Johannesburg Budget, Annexure 1, pg. 2

Box 1: Rates affordability from the perspective of poor senior citizens

How do these rebates and indigent subsidies for rates charges impact poor households in terms of affordability? Take the example of an elderly couple over 65 years of age who own a residential property valued at R100 000. Figure 11 displays the couple's monthly rates liability as a share of their household income in BCM, Tshwane and NMB. Johannesburg, eThekwini, Ekurhuleni, Mangaung, Msunduzi and Cape Town do not appear on the graph because there would be zero (or very marginal) rates liability in such a case.[43] For the purpose of this analysis, we have assumed that these senior citizens are registered as indigents if they qualify. [44]

Figure 11 Monthly rates as share of household income, after application of rebate for senior citizens and/or indigent rates subsidy (R100 000 residential property)



Source: Municipal rates policies. Own calculations.

The variability between municipalities is quite significant. If the couple is able to earn just R80/month in addition to their old age pensions, then their property rates bill could be anywhere from zero to R38/month (1.8% of their income) depending on which municipality they live in.

Despite being designed to assist the poor, some of the rebate schemes are still regressive in the sense that, above the R2020/month threshold, poorer households are spending a higher percentage of their monthly income on property rates than higher-income households.

[43] In the municipalities of Johannesburg, eThekwini and Ekurhuleni, regular residential exemptions prevent the household from incurring any rates liability at all, while in Cape Town due to the residential exemption of R88000 and generous sliding scale rebates, the rates liability never breaches 0.1% of monthly household income for senior citizens with a monthly income R10 000 or below. In Mangaung and Msunduzi there are exemptions for indigents (R100 000 and R130 000 respectively).

[44] Senior citizens in BCM with an income of R2020 or less would qualify for indigent benefits (which covers full rates liability on a R100 000 residential property).

In Msunduzi, the Indigent Policy would prevent a senior citizen with an income of R2020 or below to incur any rates liability. According to its indigent policy, Msunduzi defines an indigent as "1.) An owner of residential property where the market value of such property is equal to or less than R130 000.00. 2.) Other eligible persons who are currently indigent shall have to make application to the DMM Financial Services for indigent recognition."Msunduzi Indigent Policy, 27 May 2009. Pg. 2. Available at http://www.msunduzi.gov.za/site/user_data/files/Indigent_Policy_27_May_09_1.pdf

2.3.3 Child-headed households

Special relief for child-headed households has appeared in some municipal rates policy as a progressive mechanism to provide support to vulnerable children, many orphaned by HIV and AIDS. Mangaung provides a full exemption for child-headed households with properties valued less than R100 000. To qualify, the household must not have an income exceeding R3 000 month.[45] Ekurhuleni's policy is less stringent and applies to all child-headed households with an income less than R2 020/month.[46]

eThekwini has a particularly generous policy which lifts the residential exclusion to R400 000 for child-headed households. Furthermore, there is no limit on value of property in order to apply for this reduction/rebate.[47]

2.3.4 Other pro-poor rebates

Following on a suggestion in MPRA guidelines, Mangaung has incorporated progressive measures into their rates policies which give incentives to farmers to provide services and infrastructure to farm workers. Mangaung rates farm property at R0.00034, a ratio of 1:0.06 to the residential rate. An additional 10 per cent rebate is available as follows:[48]

- 2.5 per cent for the provision of accommodation at in a permanent structure to farm workers and their dependants
- 2.5 per cent if these residential properties are provided with potable water
- 2.5 per cent if the farmer for the farm workers electrifies these residential properties
- 2.5 per cent for the provision of land for burial to won farm workers or for educational or recreational purposes to own farm workers as well as people from surrounding farms.

Buffalo City Municipality offers a rebate which takes a somewhat similar form but has a different intent. In the case of properties "that are remotely situated and are a distance's away from council's services networks"[49], property owners are eligible for a partial rebate for each service which they do not benefit from:[50]

- 15 per cent rebate when public road not constructed on a property
- 22.5 per cent rebate when water supply is not available on a property
- 7.5 per cent rebate when refuse removal services are not provided to a property
- 15 per cent rebate when electricity supply is not available to a property
- 15 per cent rebate when sewerage services are not available to a property

Section 14.10.13 of the BCM Rates Policy requires property owners who do not receive the full range of municipal services to provide the following information in order to be eligible for the available rebate:[51]

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[45] Mangaung Local Municipality Property Rates Policy-Final (18 May 2009) for implementation 1 July 2009, pg. 14. Contained in Annexure B of Mangaung Local Municipality 2009/10 Budget.

[46] Ekurhuleni Budget Resolutions passed at 28 May 2009 meeting of Council, pg. 122.

[47] eThekwini MTREF 2009/10-2011/12 pg. 83.

[48] Mangaung Local Municipality Property Rates Policy-Final (18 May 2009) for implementation 1 July 2009, pg. 13. Contained in Annexure B of Mangaung Local Municipality 2009/10 Budget.

[49] Report to the Finance Standing Committee: 22 July 2009. Office of the CFO.

[50] In the Report to the Finance Standing Committee, it is noted that "the basis for the calculation of the various percentages of rebates is not known as the percentages have been applied for many years. It appears that more weight is put on the provision of the water service than on the other services."

[51] Buffalo City Municipality, Rates Policy, 2009/10, pg. 22.

- o The availability and condition of the municipal roads in respect of the property
- o The availability of municipal sewerage
- o The availability of municipal electricity
- o The availability of municipal supplied water
- o The availability of municipal refuse removal

In addition to the information listed in Section 14.10.13, bona fide farmers who own agricultural property must also submit the following information (Section 14.10.10), in order to be eligible for the same rebates afforded to 'regular' property owners who simply do not access municipal services:

- o Contribution to local employment and job creation (i.e. the number of permanent staff employed)
- o Extent to which permanent residential properties are provided for permanent staff
- o Extent to which such properties are provided with potable water
- o Extent to which such properties are provided with electricity
- o Extent to which land and buildings are made available to farm workers for cemeteries, education and recreational purpose

The basic operating principle in the BCM policy is that property owners should not have to pay for municipal services which are not provided on their land. These rebates support farmers and owners of rural or agricultural property and also make sense from an equity perspective, in the sense that property owners are not required to contribute towards the costs of municipal services which they do not benefit them. However the rates liability is not entirely eliminated, in acknowledgment that property rates are also intended to support public infrastructure and services which households do not directly benefit from.

The difficulty with these rebates offered for properties—often in remote areas—which are either lacking or providing certain services is the verification of eligibility. This administrative issue is discussed below in Section 2.4.2.

2.4 Discussion of direct property rates relief instruments

2.4.1 Targeting

As can be seen from the preceding description of the various rebate and exemption instruments, the key difficulty for municipalities in applying rebates to vulnerable groups is that it is difficult to determine who is poor from the information on the valuation roll alone. The assumption by the Department of CGTA is largely that municipalities must rely on their indigent register (which must be updated and comprehensive) as a source of names of property owners who would be eligible for rebates. This essentially requires some type of interface or cross-referencing between the indigent register, the valuation roll and the municipality's property rates billing system.

By another argument, additional rebates and exemptions undermine the basic principle of the rates policy, which relies fundamentally on the market value rating to serve as the instrument for achieving equity. By using market value to levy property rates, redistribution and equity are already built into the system. Some property rates experts argue the market value- based system is itself the best targeting mechanism, and that the usage of differential rates for different categories erodes this principle.[52] However all the SACN municipalities do attempt to enhance the progressiveness of their rates policies by including some form of pro-poor direct tax relief.

BCM's targeting efforts for property rates relief for the poor are limited to a means test. The underlying assumption in this policy approach is that the following vulnerable groups will be captured within the net of residents with a monthly income of R2 020 or less:

- Beneficiaries of Old Age Grants (OAG)
- Beneficiaries of disability grant
- Households on Council's Indigent Register
- Child-headed households

As noted above, senior citizens who do not receive an OAG or disability grant but can prove that their monthly income is R2 020 or less, are eligible for a 40 per cent rebate on the rates levied on their residential property (after the exemption of the first R15 000 in value).

2.4.2 Verification of eligibility

The rebate process puts the onus on the rate-payer to access the benefit. The situation in Buffalo City Municipality is an example: people must go to the nearest municipal office to apply for the rebate on an annual basis. Applicants must provide documentation of their income which can be bank statements or recent payslips. Verification of eligibility is assisted by cross-checking with the South African Social Security Agency (SASSA).[53] Applicants can provide the municipality with proof they are receiving a grant—either documentation from SASSA or recent bank statements. This system works fairly well, according to officials.

In the BCM case of the rebate offered to farmers who provide services and infrastructure to their farm workers, the main difficulty with implementation is verification. Typically municipalities require farmers to provide their SARS tax certificate confirming their status as a farmer in order to qualify for the rebate. Given the limited capacity of municipal rates departments to send inspectors to check the facilities provided on various farms, the municipalities are essentially agreeing to accept the farmer's word. Thus while the tax relief measures are admirable in their pro-poor intention, in practice the difficulties in verification have the effect of firstly making access to the rebate almost entirely dependant on the strength of the farmers as an organised group of rate-payers. Secondly, the accuracy of the instrument in targeting farms where services are legitimately provided to the farm workers is largely reliant upon the farmers' self-regulation in reporting.

2.4.3 Access and coverage

A key question is the extent to which the eligible population are accessing the available benefits. The obvious advantage of the residential exclusion as a pro-poor mechanism is that it is automatically carried out within the municipal administration between the valuation roll and the billing system. Residents need not approach the municipality to apply and no additional documentation is required to determine eligibility beyond the valuation roll itself. However there is a blanket application of the residential exclusion,

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[52] Interview with Prof RCD Franzsen, Director: African Tax Institute, Department of Economics, University of Pretoria, Pretoria. 20 August 2009.

[53] Applications for rebate for people with disabilities is also checked with SASSA to confirm that applicants are receiving a disability grant.

meaning that high income households who own low value properties will also benefit. Hence there is a trade-off between higher coverage and poorer targeting (errors of inclusion).

The ease of the application process, including the submission of various required documents, is a significant factor in the take-up rate. The second important factor is the degree of public awareness around the rebate: who is eligible and how to apply?

In 2008/09 approximately 4500 pensioners in Johannesburg received the rebate (in both income categories).[54] Johannesburg facilitates the application process by enabling residents to apply at local centres or to phone the call centre to request an application to be sent. However municipal officials admit its very difficult to compare the number of pensioners receiving rebates to the total number eligible for the rebate.

Table 7 shows the number of applications received for rebates in 2008/09 and 2009/10 in BCM. In BCM in 2008/09, a total of 130 applications for rebates were received: 126 from pensioners and 4 from persons with disabilities.[55]

Due to outreach and awareness-raising efforts, the number of applications increased in 2009/10. In 2009/10 a total of 1 479 applications were received, including 246 for pensioners, persons with disabilities, non-pensioners with income lower or equal to R2020 and child headed households. The balance of the rebates (1 479) were provided on the basis of non-availability of services — 61 per cent of which were from farms or agricultural properties. As a result of the large jump in rebates granted and the different methods of valuing and rating used, the total Rand amount of the rebates given increased enormously to R3.9 million in 2009/10.

Table 7 BCM: Rebates granted (2008/09) and rebate applications received (2009/10)

	2008/09	**2009/10**
Pensioners	126	242
Persons with disabilities	4	3
People with income equal or less than R2020 (who are not disabled or pensioners)	n/a[56]	-
Child headed households	n/a	1
Rebates due to non availability of services		1233
Total number of rebates	**130**	**1479**
Total Rand amount of rebates given	R 90 372	R3 892 093

Source: Email from Vella Maretloane, Buffalo City Municipality, 13 August and 13 September 2009.

How does the number of rebate applications compare to the estimated number of people who are eligible for property rates relief as part of indigent subsidy? According to the 2001 Census, in BCM 28 per cent reportedly had no income and another 7 per cent had an income of less than R4800/month. A survey by the Institute of Social and Economic Research (ISER) at Rhodes University also in 2001 found that almost one third of BCM's adults are unemployed and the average household income is just over R2 655.

More recently, the BCM Indigent Policy reports that: "The Growth and Development Summit (2007) Socio-Economic Profile stated that 45 per cent of the population of

[54] All these pensioners owned property valued over R150 000.

[55] Email from Vella Maretloane, Buffalo City Municipality, 13 August 2009.

[56] 2009/10 was the first year that the rebate was available to child-headed households and people who are not pensioners and not disabled, but have an income equal or less than R2020.

Buffalo City was unemployed in 2005. Another survey of the Eastern Cape in 2006 stated that around 53 per cent of households lived on an income of less than R1 500 per month."[57]

We consider first the coverage of the indigent register. Based on a mid-year population estimate for BCM of 765 343[58] and the 53 per cent figure quoted in the BCM indigent policy, over 400 000 BCM residents earn below R1 500/month today, which may suggest that the number of residents who earn less than R2 020/month (the income cut-off for the indigent register) could exceed 400 000. (Arguably, the BCM population has a higher per capita income than EC as a whole. Therefore alternatively we can estimate much more conservatively using the figure of 28 per cent of the BCM population from the 2001 Census which earned zero income. This would translate into over 200 000 people today.)

The current indigent register in BCM contains *61 913 names*, approved up to end of June 2009, or approximately 8 per cent of the current BCM population. 82 per cent of the persons on the indigent register are from urban areas.[59] Even by the most conservative estimate this represents a small portion of the BCM households with a monthly income of less than R2 020 who are eligible for the indigent register. Furthermore there are reported challenges in that on a monthly basis only very few are claiming free electricity.

With regard to the available rebate for pensioners, the take-up rate also appears to be very low. According to the 2001 Census, 8 per cent of the BCM population was aged 60 or above. The 126 rebate applications received from pensioners in 2008/09 is therefore likely to be less than one per cent of the estimated number of residents in this age group. Many of the pensioners residing in BCM will own property which falls within the R15 000 threshold or will have incomes which exceed the OAG (thereby making them ineligible for the rebate). However, given the estimated figures, its highly likely a large number of poor pensioners reside in property valued over R15 000 (e.g. a BNG house), yet are not accessing the 40 per cent rebate available to them.

Although updated 2008 survey data is not available, the scale of these gaps is large enough to conclude that a high number of eligible poor people are not accessing available property tax rebates.

BCM officials acknowledged that more public education efforts are needed to raise awareness of the rebate programme and increase take-up by eligible consumers. The municipality has relied somewhat on councillors and ward committees to be in touch with consumers in their area who are in need of a rebate but are unaware they can apply. The municipality conducted a two-month indigent registration campaign, Operation Xhamla, in early 2009. The Campaign worked to bring services and access to people in informal settlements, rural areas and areas with particularly high levels of poverty,[60] since a number of people can't afford transport costs to travel into town to register, or are unaware of the programme.[61] The aim was to facilitate access to

[57] Buffalo City Municipality Policy: Indigent Support, Second draft 21 July 2009.

[58] StatsSA mid year population estimates, July 2009.

[59] Interview with Victoria Ntsodo, Buffalo City Municipality, 13 August 2009.

[60] Free basic services include 6 kilolitres of water and 50kwh of electricity each month.

[61] The municipality also offered debtors an arrangement to people whose debt has been handed over to attorneys and debt collectors. Debtors must pay 50% of debt owed to municipality, in return for which the municipality withdraws the remaining debt owed. Window period was open until the end of

support by taking the process and forms directly to potential beneficiaries, through visits by city officials to communities, particularly in rural areas.[62]

The rebate for child-headed households in BCM is another example of an intervention which is well-intended but marred by difficulties in implementation. Child-headed households, which are treated as regular consumers with an income less than R2 020/month, must provide written documentation of their situation from a registered social worker. However there was a single application in 2009/10.

2.4.4 Revenue foregone and trade-offs in instruments

In addition to issues of targeting, verification and coverage, municipalities must also consider revenue foregone when selecting and designing direct tax relief measures for the poor. According to the MPRA, revenue foregone must be disclosed in the municipal budget and also be reported to the Council. Section 15 (4) states that the municipality's budget must reflect the Rand amount of the revenue foregone through rebates, exemptions and exclusions, both as a source of income on the revenue side and as an expenditure. However not all municipalities are complying with the requirement to report on revenue foregone and the accuracy of the methods used varies. A number of municipalities have reported difficulties in determining the amount of the revenue foregone while others are only reporting revenue foregone for exclusions, in total or part.[63]

In the case of the residential exclusion, the revenue foregone is a function of the value of the threshold, the number of qualifying properties on the roll and the estimated collection rate. The examples of Johannesburg and Buffalo City suggest that the ability to calculate collection rates of different property value bands is therefore a critical part of determining the residential exclusion amount. Data from the municipal billing sections would be a great help to officials in the rates section as they model and determine the residential exclusion rate each year.

As described above, in the Johannesburg case, one of the factors in setting the residential exclusion threshold was the collection rate for lower-value properties, specifically avoiding the administrative burden and debt write-offs associated with chasing high numbers of low-amount arrears. A report commissioned by the municipality in 2009 by Price Waterhouse Coopers calculated that revenue foregone due to the R150 000 residential exclusion was R89.1 million (in comparison to an estimated total property rates revenue of R3.95 billion in 2008/09).[64] The report estimated that raising the residential exclusion from R150 000 to R200 000 would decrease revenue by 2 per cent of cash revenue or R70 million, and take 19 000 rate-payers off the database.

The type of analysis undertaken in a high-capacity metro such as Johannesburg is contrasted with BCM which adopted the R15 000 threshold from the MPRA without apparent modelling of revenue foregone (including collection rates) for a residential exclusion threshold of R20 000, R30 000, or R50 000 for example. BCM reports that the Rand amount for the valuation reduction (both the R15 000 residential exclusion as

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February. Mntengwane, Tabisa. "Payment scheme offers debt relief." 28 January 2009. http://www.buffalocity.gov.za/news2009/jan/jan28_tabisa.stm

[62] Mntengwena, Tabisa. "Thousands sign up for indigent benefits." 30 January 2009. http://www.buffalocity.gov.za/news2009/jan/jan31_benefits.stm

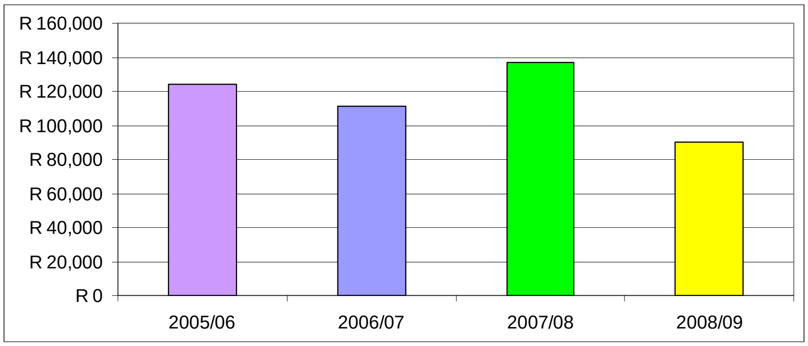
[63] Interview with Veronica Mafuko, Municipal Finance Policy, DCGTA, 11 August 2009.

[64] Interview with Irvine Florence, Acting Director: Rates and Taxes, City of Johannesburg. 25 August 2009.

well as the 30 per cent reduction for Public Service Infrastructure) was R8.56 million in 2009/10.

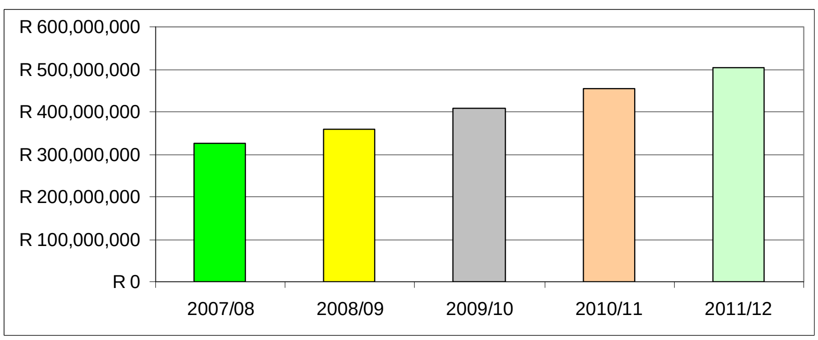
Figure 12 shows the total Rand amount of rebates granted in Buffalo City from 2005/06 to 2008/09 while Figure 13 shows the total rates revenue for the later period 2007/08 to 2011/12. In 2007/08 the total amount of rebates granted was R137 149, compared to a total of R325.7 million in rates revenue for that year. In 2008/09, the total amount of rebates granted decreased to R90 371, and then in 2009/10 the amount shot up to R3.9 million.[65]

Figure 12 BCM: Total Rand value of rebates granted, 2005/06-2008/09



Source: Email from Vella Maretloane, BCM, 13 August 2009.

Figure 13 BCM: Total property rates revenue, 2007/08 to 2011/12



Source: Buffalo City Municipality 2009/10 Budget.

In the case of BCM, changes in methods of valuing and rating used affected the figures from one financial year to the next, making comparison more difficult. Nevertheless, on the whole, the figures presented above suggest that, given the ability to pay by these vulnerable groups and the rates base, revenue foregone due to these direct tax relief measures described above is not significant in comparison to total rates revenue. However, although well-meaning and progressive, such special rebates and exemptions for certain vulnerable groups, such as child-headed households, may incur heavy costs in identification and verification if a means test is used to apply the rebate. The total cost to the municipality of implementing the tax relief measure is therefore the cash revenue foregone *plus* the administrative costs and staff time to chase arrears, verify documentation, and conduct public awareness campaigns to increase uptake.

[65] The increase in the rebate amount for 2009/10 is due to the different methods of valuing and rating used. See Section 2.4.3.

In summary, the means-tested rebate instrument has higher accuracy in terms of reducing errors of inclusion. However low public awareness and difficulty verifying eligibility may reduce uptake and therefore lead to errors of exclusion. Table 8 summarises the factors incumbent in comparing the various instruments.

Table 8 Comparison of direct property tax relief instruments

Direct property tax relief instrument	***Select municipal examples***	***Benefits***	***Costs or Downsides***
Rebate based on monthly income – single or multiple tiers/blocks[66]	Cape Town: Senior citizens and disabled persons receive 100% to 10% rebate based on monthly income (R8000 or below) – 9 tiers BCM: Senior citizen ratepayers with monthly income R2020 or less receive 40% rebate	Improved targeting of vulnerable group (reduce errors of inclusion) In case of multiple blocks, sliding scale increases accuracy of targeting	Revenue foregone Low coverage/take-up due to requirement that residents come forward to apply Financial and institutional costs related to administrative burden of: ▪ verifying documentation to test eligibility ▪ conducting public awareness campaigns to increase take-up rate ▪ providing customer service to facilitate application process for residents ▪ administering different rebates for multiple income bands
Exemption on rateable property for vulnerable groups	eThekwini: Pensioners and disabled persons exempt from paying rates on first R400 000 of residential property value Mangaung: Child-headed households exempt for properties with value up to R100 000	Means test not required Ease of administration compared to % rebate	Same as above Less accurate targeting of benefit: Provides same maximum benefit to all, regardless of income
Residential exclusion for all ratepayers	eThekwini: Rates are not levied on first R120 000 of value of residential property	Low administrative costs (automatically applied to rates accounts)	Revenue foregone (from property valued under and over the exclusion threshold) Applied to everyone: potential errors of inclusion (e.g. high-income property owners residing in low value houses) Assumes property value as proxy indicator for income (this problem is rectified if this measure is combined with means test)

Source: Municipal rates policies.

Municipalities must consider the trade-offs between instruments when developing the pro-poor aspects of their rates policy. For example, in BCM the Council recently approved a proposal to lift the income threshold for senior citizens to apply for the 40 per cent rebate from R2 020/month to R5 000/month. If poor households are defined as those with a monthly income of R5 000 or less, then the next necessary piece of information is the average property value of BCM households with an income of R5 000/less. Recent socio-economic survey data may not be available to provide this

[66] One variation of the means-tested rebate is to add a further condition tied to property value e.g. rebate not available to those with property exceeding a certain value.

information. However we learned from Table 5 above that a household earning R5 000/month can afford up to a R148 000 home loan. This tells us that raising the income threshold to R5 000/month effectively targets seniors with properties valued up to R148 000.

The BCM example relates to the 40 per cent rebate for senior citizens, but a more common issue for municipalities might be whether more poor people can be assisted by raising the residential exclusion threshold for everyone, or by raising the income threshold for the 100 per cent rebate for indigent households.

In addressing the issue, its necessary to consider the subsidy package provided to indigents (including free basic services) alongside the tax relief provided to indigents in the rates policy. To ensure consistency in municipal policy, there needs to be a link between the definition of the poor in rates policy and in the indigent or FBS policy. (See Box 2 below). The residential exclusion threshold is an effective tool to assist the poor, but it provides the same maximum benefit to all—poor and non-poor. Adjusting the income threshold to qualify as indigent will increase the number of poor who benefit, but it won't increase the benefits each poor household receives.[67] To provide further assistance to the poor, the FBS policy is the more appropriate instrument.

Box 2 Aligning Indigent and Rates Policies: BCM

Theoretically everyone with a monthly income under R2020 applies as an indigent and receives a grant for their property rates of up to R60.70/month. However, if you're earning R2 020/month, you can afford a home loan worth only R50 000 (assuming a bank would provide the finance) and your maximum property rates liability on that house would be about R16/month.

It is therefore unlikely a resident with an income which qualifies them as an indigent person would own a property over R50 000. In order to incur rates up to R60.70/month, you would need to own a home worth R165 000, in which case you would have only afforded that bond if you were earning R5 500/month, too much to be eligible for the indigent subsidy.

The maximum amount provided for property rates under the indigent policy (R60.7) equals the rates liability on a R165 000 residential property. This suggests the maximum rates grant under the welfare package may be overestimated. If the municipality chooses to define the poverty threshold at R2 020/month, then it follows that the rates grant provided as part of the social package for indigents should match the rates levied on the value of house they can afford.

2.4.5 Potential impact of residential exclusion on property markets

Finally it is worth considering the potential impact of the residential exclusion on the behaviour of property markets in township areas.[68] It is possible that property values may be perversely depressed so that they do not exceed the residential exclusion threshold and thereby incur property rates liabilities.

[67] Interview with Piet Eloff, Director: Valuations, City of Johannesburg. 25 August 2009.

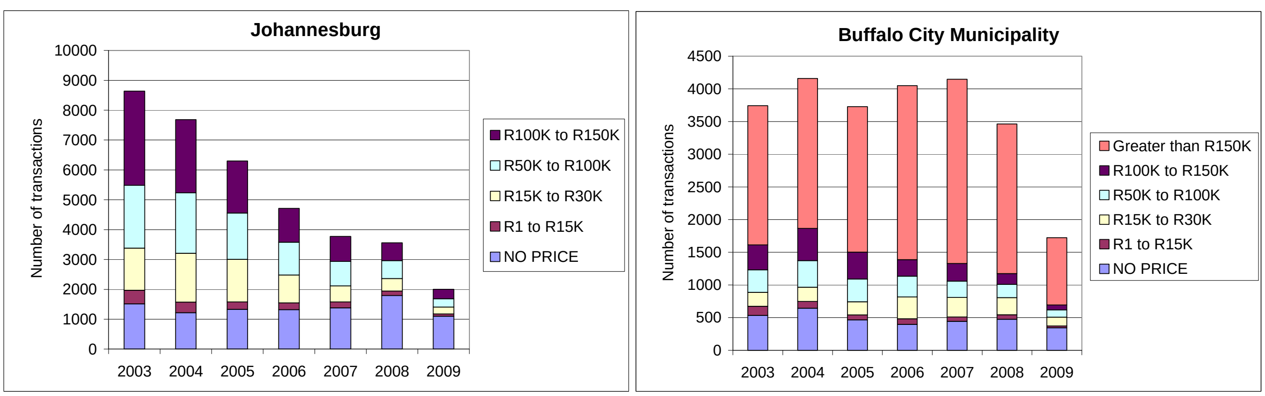
[68] This issue was discussed in particular at the SACN Roundtable on Property Rates and the Poor, 9 July 2009 in Johannesburg.

However the rates burden of a property which exceeds the residential exclusion threshold would not be significant, given that rates will only be levied on the market value above the threshold. For example, a R160 000 property would be levied rates on R10 000, not the full R160 000. If it was discovered that the residential exclusion was having this negative effect on the secondary property market, one option would be to institute a sliding scale rebate.

In order to better understand the residential exclusion threshold in the context of the property market in Johannesburg and Buffalo City, we accessed data from the Centre for Affordable Housing Finance on the number of formal re-sale transactions between individuals which were recorded at the Title Deeds Office for the period 2003-2009.[69] How does the residential exclusion compare to the average transaction price of houses sold in the secondary market in both cities?

Figure 14 show the number of properties sold at each price band, over the period from 2003 to 2009. The data shows a steady, significant decline in the number of properties sold in Johannesburg in recent years. This trend is particularly stark in terms of high-value properties in Johannesburg: although the number of properties priced over R150 000 has remained fairly steady in BCM, in Johannesburg the number of properties over R150 000 plummeted in 2008 and 2009, as can be seen from Figure 15.

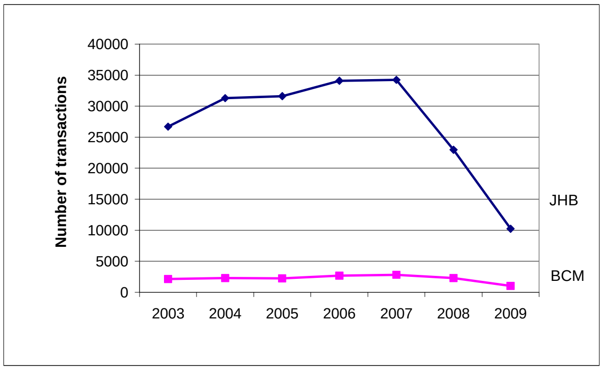
Figure 14 Number of transactions by price band (2003-2009)



Source: Centre for Affordable Housing Finance in Africa.

[69] There are some problems with the reliability of the data on low-value properties which are recorded as 'No price' at the deeds office. Transactions in the lower income bands are often erratic with houses in close proximity being sold for very different prices. These may be transfers between family members although it is unclear or errors in reporting.

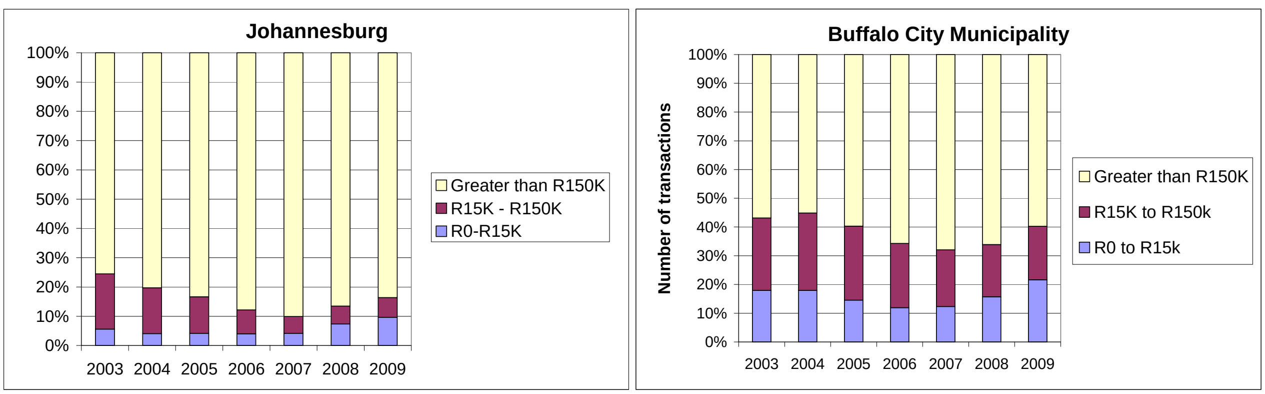
Figure 15 Number of transactions of properties priced over R150 000: Johannesburg and BCM



Source: Centre for Affordable Housing Finance in Africa.

How has the share of properties which fall within the residential exclusion varied over the last six years?[70] In Johannesburg, the percent share of re-sale transactions at prices equal or less than R150 000 declined to a low of 10 per cent in 2007, and has since climbed to 16 per cent in 2009. In Buffalo City, where the residential exclusion sits at R15 000, the percent share of re-sale transactions at a price equal or less than R15 000 also dipped to a low of 12 per cent in 2006-2007 and then climbed to 22 per cent in 2009.

Figure 16 Percent share of properties sold per transaction price band (2003-2009)



Source: Centre for Affordable Housing Finance in Africa.

This data from the Centre for Affordable Housing Finance in Africa sheds some light on the trends in the prices at which houses are sold in these two municipalities, but does not give us a spatial perspective on what is happening in particular neighbourhoods. One of the noticeable trends in recent years has been the quick rise in property values in some former township areas. Because the restrictions of the Group Areas Act artificially limited the property market in particular areas, neighbourhoods which were formerly restricted to black and coloured residents have seen steep escalations in property values as the property market opens up. In many cases this may create greater property tax burdens on low-income families who see their property values climb sharply from one valuation roll to the next. One option for protecting these households would be to introduce initiatives which enable property owners in former township areas whose properties have escalated in value by 200 per cent or more to

[70] This analysis shows the percent share of properties sold each year at prices within a particular value band. It does not actually show the share of total properties on the valuation roll which have values within that range.

be allowed to defer payment until their property is sold. More research is required on where this is occurring and what impact it has on the resident households.

An innovative valuation approach, called banding, may offer relevant advantages which could provide incentives for improvements and reduce the shock of significant jumps in rates liabilities.[71] Used in the United Kingdom and India, banding is a valuation method whereby rateable properties are not valued individually but instead are put in one of a number of value bands. The value bands are constructed around the average property values for the area, based on an informed opinion as opposed to a precise individual valuation. With the adoption of a 'banded' property tax in the UK in 1993, it was found that banding was a faster and less expensive process than standard valuation and prompted fewer appeals from property owners (Plimmer et al, 2002). Another key advantage is that properties can increase or decrease in value within the band without it affecting the amount of rates levied. An analysis and evaluation of valuation methods is beyond the scope of this paper, but the topic is raised for its possible pro-poor impacts on land use and property markets.

3 Shaping incentives to affect market behaviour in order to increase stock of low-income housing and available land

The preceding section has considered how direct tax relief can aid poor households by increasing their ability to pay for land and/or housing. While direct tax relief is a demand-side intervention, property rates policies can also incorporate supply-side measures to increase the stock of available land and low-income housing. Such supply-side measures would use indirect approaches intended to impact market behaviour in ways which might create opportunities for poor households in urban areas.

Approached creatively, property tax policies can be designed to create incentives to property owners for particular types of land use, including affordable housing. The MPRA provides municipalities with the space to decide which properties to rate or exempt from rating, and whether rebates or reductions will be offered to some of the rateable property categories, based on local conditions and circumstances. The creation of particular categories of properties or property owners and the application of differential rates and rebates to those categories is a critical policy tool available to municipalities. For example, by increasing the rates on vacant land, the municipality can discourage absenteeism and speculation and create incentives for densification and improvements. Such measures are considered in this section.

3.1 Vacant land

The literature in favour of land value taxation argues that site-value taxation (or composite rating systems which have a higher rate for land than for improvements) have multiple benefits in terms of urban development. By taxing land the same or more than developments, property owners are incentivised to improve or release the land. According to Dunkley, a land value tax pushes vacant land back into the market because the speculative value of vacant, underused but centrally-located land drops (Wenzer, 2002). Gihring argues that property tax reform which includes land value taxation can serve as a tool for managing urban development. The land value tax

[71] Interview with Prof RCD Franzsen, Director: African Tax Institute, Department of Economics, University of Pretoria, Pretoria. 20 August 2009.

reduces the tax burden on improvements and thus facilitates revitalization and infill development, bringing idle land into production (Gihring, 1999). Brown-Luthango makes a case that land value taxation reduces urban sprawl by increasing the land use efficiency closer to the city center (Brown-Luthango, 2006).

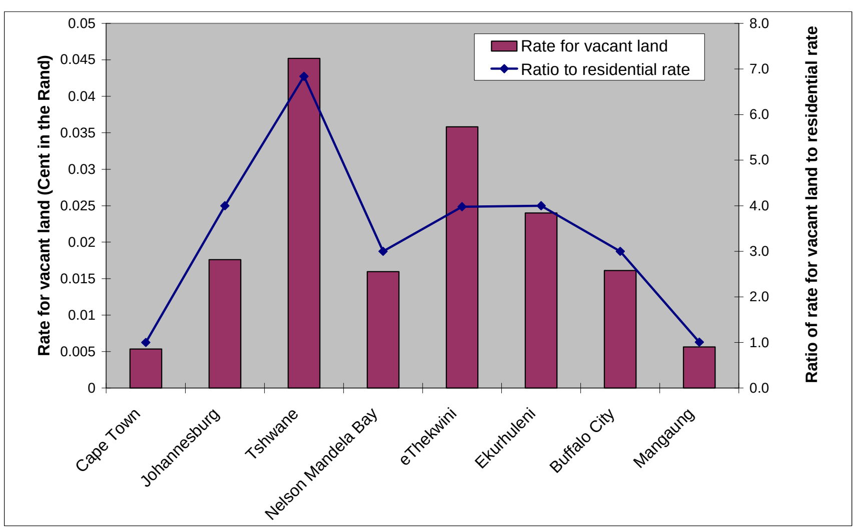
The MPRA has ended the debate around land value taxation in South Africa, for the time being, by instead legislating a market value system. However, by designating vacant land as a property category and then assigning a higher differential rate to this category, some of the same social benefits of land value taxation can be achieved.

Higher differential rates for vacant land are common internationally, and in Africa specifically (Namibia, Botswana). [72] The 2007 analysis by PDG for DPLG recommended a significantly higher rate for vacant land, in order to incentivise development, increase efficiency of land use, and facilitate densification. In contrast municipalities which tax developed vacant land at the same rates as commercial or residential property or grant exemptions or exclusions for vacant land are essentially rewarding speculation.

A ratio to residential land of 1:4 has been proposed for vacant urban land. Under this policy, a land owner can make improvements equal to 3 times the land value before he will begin paying more tax as a result of the improvements. In order to prevent land owners from making minimal improvements which are only intended to avoid escaping the vacant land rating, the municipality can require that improvements must exceed a certain percentage of land value in order for the property to no longer be categorized as vacant.[73]

The practice of charging higher levies on vacant land has been adopted by the majority of the SACN municipalities, as shown in Figure 17.

Figure 17 Comparison of rates for vacant land (2009/10)[74]



Source: Municipal rates policies. Own calculations.

[72] Interview with Prof RCD Franzsen, Director: African Tax Institute, Department of Economics, University of Pretoria, Pretoria. 20 August 2009.

[73] *Analysis and policy advice related to setting of annual limits and ratios pertaining to the Municipal Property Rates Act.* Final report prepared by Dataworld, Riel Franzsen and pdg for the Department of Provincial and Local Government, 11 May 2007.

[74] Msunduzi publishes a "general rate" at R0.0165. The residential rate used herer (R0.0075) is the net residential rate after the residential reduction is deducted from the general rate.

Of the nine municipalities, Tshwane applies the highest rate for vacant land R 0.0452, which is approximately 6.8 times greater than the residential rate.[75] Johannesburg, eThekwini[76] and Ekurhuleni tax vacant land at four times the residential rate, while Nelson Mandela Bay and Buffalo City[77] use a 1:3 ratio for vacant land in order to encourage development.

Particularly in the case where services have been installed on vacant property, the municipality will want to promote the development of the land. However in those cases where services have *not* been installed, a significantly higher rate for vacant land can penalise property owners for circumstances beyond their control. In Johannesburg, properties with old mine dumps were examples of vacant land without services. In order to avoid penalising these land owners, the Johannesburg property rates policy includes a clause which provides a 50 per cent rebate on the vacant land rating if the land cannot be developed because the Council has not provided services.[78]

Msunduzi is unusual in that they use reductions or exclusions which reward property owners with vacant land. A 100 per cent rebate is given on vacant land valued below R60 000. This may be a measure to try to provide assistance to small business owners in township areas.

Both Cape Town and Mangaung have no special rate for vacant land, instead taxing undeveloped property at the regular business or residential rate. This has the effect of providing a comfort zone for property owners to hold well-located land in the City without further investing in developments or releasing the land back into the market for investment by the next owner.

3.2 Special rating areas

Section 2.3 addressed mechanisms for supporting poor property owners by identifying them according to household income or market value of the property. An alternative targeting mechanism used in social policy programmes is geographic targeting. Given the spatial legacy of apartheid, residential areas tend to be organised by income and race, thus suggesting that geographic targeting may be a less expensive and faster means of identifying and reaching low-income households than a means test. Although BCM has not used geographic targeting in property rates relief, the municipality does undertake spatial analysis to understand the take-up patterns of rates rebate programmes. BCM plans to conduct a mapping exercise by the end of September 2009 to identify the geographic areas where most of the rebate applications are received from, in order to understand if there are gaps where large groups of eligible households did not apply, or likely areas where persons who applied do not actually

[75] Tshwane quotes R0.01017 as the residential rate but also indicates that at 35% rebate will be granted on all residential properties. Taking the rebate into account, the net rate for residential property is therefore R0.0066105.

[76] eThekwini levies vacant land at a rate 4 times the residential rate, but exempts the first R30 000 of property value.

[77] Notably BCM also levied vacant land at a higher rate under the previous rates policy pre-2009/10. The approach then was to charge vacant commercial properties at three time the commercial rate and vacant residential properties at three times the residential rate. Now, regardless of zoning and use, vacant property is charged at three times the residential rate.

[78] Prior to 2008, these properties were charged at the higher business rate. In order to qualify for the lower residential rate, property owners had to submit an occupation certificate to show the property was being used for residential purposes.

qualify.[79] Such analysis is critical for understanding whether the chosen direct tax relief instruments are effectively targeting the poor.

Section 22 of the MPRA allows municipalities to set up special rating areas (SRAs) whereby groups of residents in a particular geographic area voluntarily come together to increase their levies in order to have additional services or infrastructure. Although none of the SACN municipalities in this study have yet considered using the SRA mechanism in the MPRA to extend discounted rates to poor areas, the idea was raised at the 9 July Roundtable hosted by SACN as a means of geographic targeting. DCGTA confirms that SRAs were not originally intended as a mechanism for applying a lower residential rate to a particular designated area, in order to provide property rates relief to poor households. It is also unclear if the MPRA would allow this use of the instrument. Section 19(1) stops municipalities from levying different rates on residential properties, except in cases of phasing-in newly rateable property (Section 21), transitioning from the old to the new valuation roll (Section 89), and public service infrastructure (Section 11(1)b). However Section 8(1)c permits municipalities to levy different rates for different categories of rateable property, according to the geographical area in which the property is situated, "subject to Section 19". Furthermore Section 8(2)k) identifies 'formal and informal settlements' as one of the permissible categories of rateable property.

It is thus somewhat unclear whether neighbourhoods with an overwhelming majority of poor households could potentially be designated as an SRA and a *lower* rating applied to residential property in this area. If the social policy objective is to provide relief to low-income neighbourhoods, arguably it would be better to use the rates revenue to provide additional services in those areas, as opposed to reducing the rates liability for this group.

However the advantage of using SRAs for pro-poor purposes would be that it can provide relief to a large number of poor households quickly, without requiring an application process and means tests. Areas with a very high percentage (e.g. over 90%) of low-value homes *and* low-income households could be identified through a socio-economic survey.

The drawbacks include errors of inclusion; there is a danger an incentive will be created for people to move into the area who are not part of the target low-income group.[80] Furthermore the 'stickiness' of the program could be a major drawback; if property rates rise significantly in the area, it would be necessary to remove the SRA designation and return the rating to regular levels. However once a discount is introduced, it will be politically difficult to remove.

Box 3 Addressing the issue of geographic targeting at public hearings in BCM[81]

Public hearings on property rates were held in November 2007 in Buffalo City Municipality to listen to input from residents' associations, businesses and other interested organisations on the draft rates policy.

The Sunset Bay Residence Committee came before the panel to speak on behalf of residents of their area, a newly developed middle class neighbourhood which originated in 1998. Their complaints included a variety of infrastructure service delivery

[79] Interview with Vella Maretloane, Buffalo City Municipality, 31 August 2009.

[80] Interview with Prof RCD Franzsen, Director: African Tax Institute, Department of Economics, University of Pretoria, Pretoria. 20 August 2009.

[81] Transcripts of public hearings, provided via email by Sikhander Coopoo, 20 August 2009.

issues, especially roads; also, safety issues due to vegetation on vacant lots not being cleared away, illegal dumping, noise from the nearby racetrack and poor street lighting. The area may be called middle class, as the average value of the homes was described as R500 000 to R1m, thus exceeding the R15 000 residential exclusion effective in BCM. On the basis of the poor infrastructure, the Committee requested that the municipality provide some property rates relief. In response, the panel explained that the municipality cannot treat residential property in Sunset Bay differently than in other areas of the municipality, in terms of equity. Emphasising that special dispensation cannot be given to particular residential areas, the panel separated the service delivery issues—which ought to be addressed via the ward councillor with the respective municipal department—from the rates obligations.

Later in the hearings the Eastern Cape Development Corporation (ECDC) made a submission requesting consideration for special rates in Dimbaza and Fort Jackson as a separate development area. They explained that they are unable to attract rentals to properties in the area because in order to attract a tenant in these depressed areas, the rent would need to be so low that it will not even cover the rates liabilities. “But as ECD we then get left with a hard choice to make. Do we chase the tenant away who is offering to pay us R2 per square metre and depress the area of Dimbaza further or do we choose to say, look lets give you the R2 per sq metre and you then create the 50 or 100 jobs in the area.”

The panel struggled in response, saying that they are unable to distinguish within a category of properties by providing special treatment. The only option would be to create a separate property category—a special development area—in order to be able to provide a rebate or reduction which could promote the revitalisation of these industrial areas. ECDC emphasized that even temporary relief—until these areas became more financially viable—would be welcomed. The establishment of an SRA in this case may be a means for creating a ‘win-win’ situation which balances rates obligations with the need to promote economic growth and alleviate poverty in depressed areas.

Given that most municipalities are focused on establishing the new valuation roll and implementing the new rates policy, many have not included SRAs in their policies or have considered the idea but not yet developed specific SRA policies and by-laws. Of the SACN cities, Cape Town and eThekwini are the only ones who have SRA policies in place.

There are a number of potential problems related to the impact of SRA’s on poor households. First, the additional levies may not be affordable for low-income households within the boundaries of the SRA. The City of Cape Town approved a Special Ratings Area By-Law and Policy, effective 1 July 2009. One of the changes made to the draft policy, as a result of the public consultation process, was the insertion of a clause stating that all property owners who qualify for relief under the City’s Rates Policy will be 100 per cent exempt from any SRA levies (Section 12(2)). This stipulation is a minimum requirement in the City’s By-Law; SRA’s are encouraged to further alleviate poverty by adding further exemptions for other property owners.[82]

Even if very poor households are exempt from additional SRA levies, households which earn too much to qualify for exemption but are still overburdened by the additional levy could potentially be outvoted in their area. Section 22(2)b of the MPRA only

[82] City of Cape Town Special Ratings Area Policy, Section 6.1.

requires the written consent of a "majority of the members of the local community in the proposed special rating area who will be liable for paying the additional rate."

During the public consultation process preceding the approval of the Cape Town SRA By-Law, written submissions from ratepayers' and residents' associations from Barbarossa, Camps Bay, Rondebosch, Rosebank, and the City Bowl argued that a 75 per cent majority should be required to establish an SRA. However the Cape Town Council interpreted 'majority' in Section 22(2)b of the MPRA to refer to a simple majority of 50 per cent plus 1. The Council also required that the same majority must be present to dissolve an SRA, despite some suggestions from residents' associations that a smaller percentage of affected property owners (e.g. 26% or 33%) should be required to get an SRA disestablished.

Section 9 of the Cape Town By-Law allows for 'limited SRAs' if there is not majority support in the originally designated area, but the applicant can show that a sub-set of that geographical area does offer majority support. SRAs may also impose differential additional rates on different categories of property within the SRA. Its not clear from the By-Law whether the majority of members of each property category must approve the differential levy for their category. The Cape Town policy specifically states that the SRAs "will not be used to reinforce existing inequities in the development of the City's area of jurisdiction" as per Section 22(4) of the MPRA. However the potential for SRAs to contribute to segregation in urban areas, by enhancing gaps in service delivery between poor and wealthy areas, remains.

Taking a different approach to SRA's than Cape Town, eThekwini provides further restrictions and conditions on their establishment. An SRA in eThekwini must contain not less than 200 properties or the total value of the properties must exceed a value as determined by Council from time to time. This clause permits the municipality to prohibit very small SRAs which might contribute to divisions within the City. Furthermore, eThekwini raises the bar in terms of the majority requirement for establishment: 66 per cent of owners (in numbers) and 51 per cent of the property value in the designated area must have voted in favour of the SRA in order for it to be established.[83] Although the MPRA does not contain any requirements around transparency and publication of SRA information, eThekwini has elected to list the additional rates levied in each of its 9 SRAs in Annexure A of its 2009/10 budget. The SRAs charge differential rates for residential, business and commercial, industrial and vacant land categories, although not all SRAs include all four property categories. Both eThekwini's increase of the majority requirement and its publication of SRA information are positive improvements on SRA policy and practice.

3.3 Targeting of inner city properties

One example of geographic targeting in practice is the inner city rebate in Johannesburg. Property owners in a demarcated area of the inner city are entitled to apply for a 40 per cent rebate on their rates if the property is used for the purpose of accommodating three or more dwelling units and if no less than 80 per cent of the floor space on the property is being used for residential accommodation (Section 10(4)g).[84]

[83] eThekwini Rates Policy, Section 8.3.

[84] City of Johannesburg Property Rates Policy, 24 February 2009. Available at http://www.joburg-archive.co.za/2009/pdfs/draft_property_rates_policy09.pdf

The rebate is a new initiative, effective in 2009/10, which was aimed at relieving the tax burden on a number of properties in downtown Johannesburg which shared commercial and residential use but were being hit by the higher commercial rate. However, despite advertising in the local newspaper and online as well as meetings with social partners, the take-up rate for the rebate has been very low thus far, with just one application received as at 25 August.[85] Until time has passed, it is difficult to know if this rebate will have any effect in promoting residential use in the inner city and revitalising the downtown area.

3.4 Sectional title and high density properties

Another significant change introduced with the MPRA was the stipulation that all sectional title properties would be separately levied rates. For the City of Johannesburg, this meant over 180 000 new properties were added to the roll for sectional titles. In 2009/10 26 per cent of the residential properties were sectional title (see Table 6 above).

An automatic 20 per cent rebate was introduced to all residential sectional-title property owners (Section 10(4)j). The sectional title rebate in Johannesburg is part of the municipality's approach to encouraging higher density settlement. The rebate was also intended to reduce the rates shock to this category of property owners: under the site value system, rates liabilities were quite low for sectional title owners and climbed sometimes by 300% with the shift to the market value system.

Returning to the data in Table 6 also allows us to better understand the population of property owners who benefit from the sectional title rebate. The majority (87%) of the residential properties valued under R150 000 are *free-standing houses* and nearly all (99%) of the Rand value of residential properties under R150 000 are freehold. This contrasts with the more expensive residential properties valued over R150 000, one third of which are sectional title, making up 28% of the Rand value of residential properties valued over R150 000. 85 per cent of residential sectional title properties exceed R150 000 in value, compared to only 62 per cent of freehold properties.

Thus 22 per cent of residential property owners are sectional title residents in properties valued over R150 000 who will benefit from the sectional title rebate. In this category individuals who benefit are primarily higher-value property owners.

An unusual aspect of Johannesburg's approach is that this rebate is extended to other properties as part of the aim to incentivise high density development. According to Section 9(n) of the policy, properties (including sectional title units) which are part of a development with a density of more than 70 dwelling per hectare can also apply for the 20 per cent rebate. These applications would be submitted to the Rates and Taxes unit, and then forwarded to the Town Planning section of the municipal administration who would be responsible for confirming that the property fell in an area which met the density requirements. The impact of this rebate scheme on land use and urban planning is not known, however take-up appears to be slow. As of 25 August, no applications had been received.[86]

It may be argued that such initiatives do not comply with the MPRA as they rate different types of residential property at different rates. As noted above, Section 19 of the MPRA forbids municipalities from levying different rates on residential properties (except in cases of phasing-in newly rateable property, transitioning from the old to

[85] Interview with Phumza Jack, City of Johannesburg, 25 August 2009.

[86] Interview wit Irvine Florence, City of Johannesburg, 25 August 2009.

the new valuation roll, and public service infrastructure). However Section 8(1)c permits municipalities to levy different rates for different categories of rateable property, according to the geographical area in which the property is situated, “subject to Section 19”. The City of Johannesburg defines their inner-city and section-title schemes as *rebates* for a category of ownership, which is permissible under Section 15 of the MPRA.

3.5 Discussion

The effectiveness of any of these indirect instruments will depend upon how significantly property rates feature in the decision-making factors considered by developers and property owners when buying, selling or making land use decisions on property. The tax benefit may be taken up, but the incentive will not effectively change behaviour unless the cost of compliance (or revenue foregone) by the property owner is less than the tax benefits. A case study is needed which examines the impact of a rebate scheme and surveys developers and property owners on how the tax benefit affected their decisions to buy, sell and develop property.

Additional instruments may be feasible; for example, rebates or exemptions for landlords who provide affordable rental, or rebates for property owners who include a certain percentage of low-income units in their developments. Tax relief could be offered to employers who provide housing for workers and/or landlords of low-income rental units. Monitoring would be required to ensure the tax benefits are passed on to the poor.

From the perspective of local government, the main issue appears to be the legality of giving special treatment to a particular area. Some municipalities are more aggressive in considering and experimenting with ways to provide rates relief to categories of property or property owners, in order to promote economic growth and development or alleviate poverty. The legality of such schemes will likely be questioned, if not tested in Court. Other municipalities are being more cautious in interpreting the Act regarding impermissible discrimination between property owners and property categories. As municipalities shift their energy from sorting out start-up problems with their new policy and valuation roll, we may see the addition of further rebate schemes and the wider spread of SRAs. In the meantime, research on the impact of some of these measures (such as the density bonus in Johannesburg or rebates to farmers who provide services to farm workers) would be extremely useful in understanding the potential value of property rates policies for impacting land use and property markets in favour of the poor.

4 Conclusion

Going forward, the monitoring framework for the Act will likely become a larger issue. Although the Act requires the MEC for local government in a province to monitor municipal compliance, the legislation only states that the national Minister ‘may monitor, and from time to time investigate and issue a public report on the effectiveness, consistency, uniformity and application of municipal valuations for rates purposes” (Section 82). Arguably the mandate for monitoring is therefore less strong for DCGTA than for provincial departments of local government. For example there is currently no institutionalised means for national to check that municipalities are complying with ratings ratios and equitably applying legal and pro-poor rebates and exclusions, or to monitor municipal budgets to ensure figures on revenue foregone are included. [87]

Up to now, National Treasury and the Department of CGTA have been focused on enabling and monitoring compliance to the MPRA by the deadline; Ensuring that municipalities get new valuation rolls and rates policies in place has been the top priority. However in subsequent phases of implementation of the Act, it will be possible to shift attention to examining the content of those policies, their quality and impact on the poor especially. The choices municipalities have made and the trade-offs taken in interpreting and implementing the requirements of the MPRA will hopefully come under closer scrutiny.

National Treasury is currently directing a process of municipal budget format reform, as per Circular 28, which includes a set of prescribed budget tables and recommended supporting tables. In the first phase, 27 municipalities (6 metros and 21 secondary cities) are required to conform by 1 July 2009, while the remaining municipalities must comply by the following year. The formatting regulations support the implementation of the Act by including the following three tables in the supporting tables: [88]

- SA11 Property rates summary
  - Transparent reflection of tax increases, their impact on revenue, valuation trends and the treatment of 'reductions', rebates and exemptions
- SA12-A13 Property rates by category
  - Both the current year and the budget year data is required to ensure that the budget clearly illustrates trends and changes.
- SA14 Household bills
  - a comparison of various municipal bills, indicating the cost implication on households of proposed rates and tariff changes

When completed with accurate and comprehensive data, such tables can assist monitoring by national and provincial government and provide data for better policy design by municipalities.

Another factor which has not yet been considered in this paper is the impact of transfer duties on poor households who wish to sell and/or acquire a house. Transfer duties are levied according to the following schedule:

- 5 per cent for properties valued R500 000 to R1 million
- 8 per cent for properties valued over R1 million

Properties below R500 000 are zero-rated for transfers involving a natural person (i.e. not company or organisation). However VAT is applied to newly-built houses which are sold by developers: "This means that the subsidy has already 15 per cent more value than if that same amount were applied to a non-subsidised unit." (NDOH, 2008).

[87] Interview with Veronica Mafuko, Municipal Finance Policy, DCGTA, 11 August 2009.

[88] National Treasury (January 2009). "Municipal Budget and Reporting Regulations: Rollout Presentation." Chief Directorate: Local Government Budget Analysis, Intergovernmental Relations. Available at http://www.treasury.gov.za/legislation/mfma/reg_gaz/Gazette%20No%2031804.aspx

Recommendations have therefore been made that government waive VAT on newly built houses in the affordable housing market.[89]

The VAT example highlights a theme running throughout this paper, which is the need for alignment between different government initiatives to support the poor. At a minimum, tax measures and social programmes should not run at counter-measures. The definition of a poor household as per the indigent policy should be a guide in the determination of the residential exclusion amount in municipal rates policy. The residential exclusion amount mandated in national legislation should be calibrated to keep pace with a government-subsidised house, in order not to unfairly and unevenly burden beneficiaries from one municipality to another.

This analysis has provided evidence that the lower-middle income band is the hardest hit by property rates: specifically those who earn too much to qualify as indigent but whose property value may exceed the residential exclusion. However the current research is insufficient in providing evidence of *how* the poor are affected by property rates liabilities: Rates rebates can leave more money in the pocket of poor households, but can they save a family from needing to relocate, or assist a household to move up the property ladder? The general opinion from interviews of municipal officials was that the residential exclusion did not likely affect the property market but further research is needed to test the relationship between the residential exclusion and resale prices in the residential property market.

Effective direct property tax relief measures must a) be narrowly targeted to the poor, b) reach a majority of the eligible population, and c) be cost-effective from the perspective of the municipality which must weigh revenue foregone and administration costs. This analysis has suggested that the residential exclusion is one of the most effective and least costly mechanisms (from an administration perspective) for targeting the poor for rates relief. Better information on collection rates at different income bands and the secondary residential property market in township areas can assist to improve the methodology for setting the residential exclusion threshold, thus improving its pro-poor benefits while respecting municipal revenue needs. Income-based rebates and other specific measures to address particular vulnerable groups can then be used to enhance the rates safety net for the poor.

[89] This idea was also raised by Prof RCD Franzsen, Director: African Tax Institute, Department of Economics, University of Pretoria, Pretoria. 20 August 2009.

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