

MUNICIPAL BORROWING

BULLETIN

October 2022

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SESHEGO WATER TREATMENT WORKS POLOKWANE LOCAL MUNICIPALITY

PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to advance transparency, prudence, and responsible utilisation of municipal borrowing for infrastructure delivery. The MBB informs interested parties on developments in the municipal borrowing market. The MBB aims to add to a better understanding of developments and patterns in municipal borrowing through information sharing, analysis and exchange of topical content relating to municipal borrowing/ infrastructure delivery.

CONTEXT

The MBB is issued by the National Treasury on a quarterly basis. This issue covers long-term

borrowing information up to 30 June 2022, corresponding to the end of the fourth quarter of the 2021/22 municipal financial year.

This MBB includes data submitted by municipalities to National Treasury as required in terms of Sections 71 and 72 of the Municipal Finance Management Act of 2003; data acquired from lenders; information published by the South African Reserve Bank (SARB) and data from the Johannesburg Stock Exchange (JSE) sourced from STRATE.

HIGHLIGHTS

- Municipal borrowing budgets were significantly reduced halfway into the 2021/22 financial year from R11.9 billion to R7.3 billion.

- Lenders reported a total of R72.5 billion in outstanding long-term borrowing to municipalities while R72.3 billion was reported by municipalities.
- New borrowing incurred during the financial year was R5.8 billion, which is about 81 percent of the adjusted borrowing budgets for the financial year.
- Due to repayments over the past twelve months, outstanding long-term debt across all municipalities only grew by just under R1.4 billion.
- This issue highlights that long-term borrowing is not an end, but a means to ensure that well run municipalities invest sufficiently to ensure sustainable equitable service delivery and economic development.



national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA



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DATA AND ANALYSIS

1. Municipal borrowing budgets

Long-term borrowing is not a goal by itself but a means to an end. Long-term borrowing should not be undertaken simply for the sake of it but rather to invest in the infrastructure needed to fulfil the objects and mandate for local governments. The objects and mandate for local government as determined in the constitution, include ensuring the provision of services to communities in a sustainable manner as well as promoting social and economic development. To safeguard the continued fulfilment of these objectives, municipalities must, amongst other things, ensure that they are supported by the right infrastructure base. Therefore, municipalities must invest sufficiently to expand existing infrastructure so that it can support economic and population growth. Rehabilitation or replacement of aging infrastructure, eradication of backlogs as well as promoting densification and spatial transformation so that citizens have ready access to jobs, education,

services, and social amenities are among the actions municipalities must take to support social and economic development.

This much needed infrastructure investment requires funding to implement, however, both municipal own source revenues and transfers from the national fiscus fall short, coupled with the pressure that the national fiscus has been experiencing over recent years within a challenging economic environment. Consequently, municipalities must consider how to leverage their recurring revenues to fund the necessary capital investment. Long-term borrowing, if undertaken responsibly, represents an opportunity for creditworthy municipalities to address some of their capital investment needs. Well-run municipalities that invest to ensure sustainable and equitable service delivery are essential to our nation's economic development.

Table 1: Budget Borrowings

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Original Budget	9 728 855	12 038 295	12 155 568	12 015 730	13 327 264	16 195 667	17 620 931	11 395 889	11 927 324
Adjusted Budget	9 747 836	12 033 281	11 674 332	11 602 644	13 572 036	12 241 682	16 017 275	7 280 462	7 282 004
Actuals	7 583 000	9 357 000	9 222 000	8 099 900	8 749 729	8 004 007	5 897 860	5 818 870	5 905 562
	78%	78%	79%	70%	64%	65%	37%	80%	81%

Source: National Treasury Database

Municipalities implemented 81 percent of their revised borrowing plans during the 2021/22 financial year. It has been another year of below average long-term borrowing by municipalities, with only R5.9 billion borrowed, whereas R11.9 billion was originally planned and this was subsequently revised down to about R7.3 billion. Long-term borrowing continues to contribute little to municipal capital investment with only 12 percent of the R47,6 billion municipal capital expenditure for the 2021/22 financial year funded from long-term borrowing. This is a cause for concern in the context of the National Development Plan 2030 wherein the goal is for public infrastructure investment to reach 10 percent of GDP by 2030. This goal may never be realised if municipalities continue to rely mainly on national transfers and own source revenues to fund infrastructure investment on a pay-as-you go basis. National Treasury publications show that public-sector infrastructure investment has averaged only 6,7 percent of GDP during the period between 2009 and 2019, well below the National Development Plan target of 10 percent.

The Constitution provides that municipalities have the power to raise their own revenues, through property taxes and user fees. For municipalities without an adequate revenue base, the Constitution provides an equitable share of nationally raised revenues. These revenue streams must support operations and maintenance, as well as capital investment. And a reasonable portion of these revenue streams can be used to support borrowing, which is necessary to provide the local infrastructure that South Africa needs to support economic growth and job creation. Providing residents and businesses with reliable services and durable infrastructure is one of the most important functions of local government. However, sound financial management is essential. Borrowing and lending must be done responsibly, with a clear-eyed view of each municipality's ability to service its debt obligations, and to manage the operation and maintenance of its infrastructure. Therefore, municipalities must fix their ongoing financial and operational troubles and position themselves where they can access private sector capital to accelerate infrastructure investment.

2. Analysis of long-term debt as reported by municipalities

Table 2: Outstanding long term debt as at 30 June 2022

Municipal Category	Municipality	Total debt Q4 2021/22 R'000	Share of total debt	Actual Revenue 2021/22 R'000*	Debt to revenue ratio
A	BUF	187 994	0,3%	8 211 047	2%
	NMA	1 188 321	2%	9 014 227	13%
	MAN	611 843	1%	7 386 700	8%
	EKU	9 932 971	14%	44 009 248	23%
	JHB	23 779 430	33%	68 428 530	35%
	TSH	10 816 059	15%	40 928 641	26%
	ETH	9 207 993	13%	41 305 958	22%
	CPT	6 704 568	9%	49 111 841	14%
	Total Metros	62 429 179	86%	268 396 192	23%
B	B1 (19)	6 390 164	9%	60 486 937	11%
	Other Municipalities	2 993 429	4%	91 076 152	3%
C	Districts	471 417	1%	24 234 007	2%
	Total all municipalities	72 284 189		444 193 288	16%

*excluding capital transfers

Source: National Treasury Database

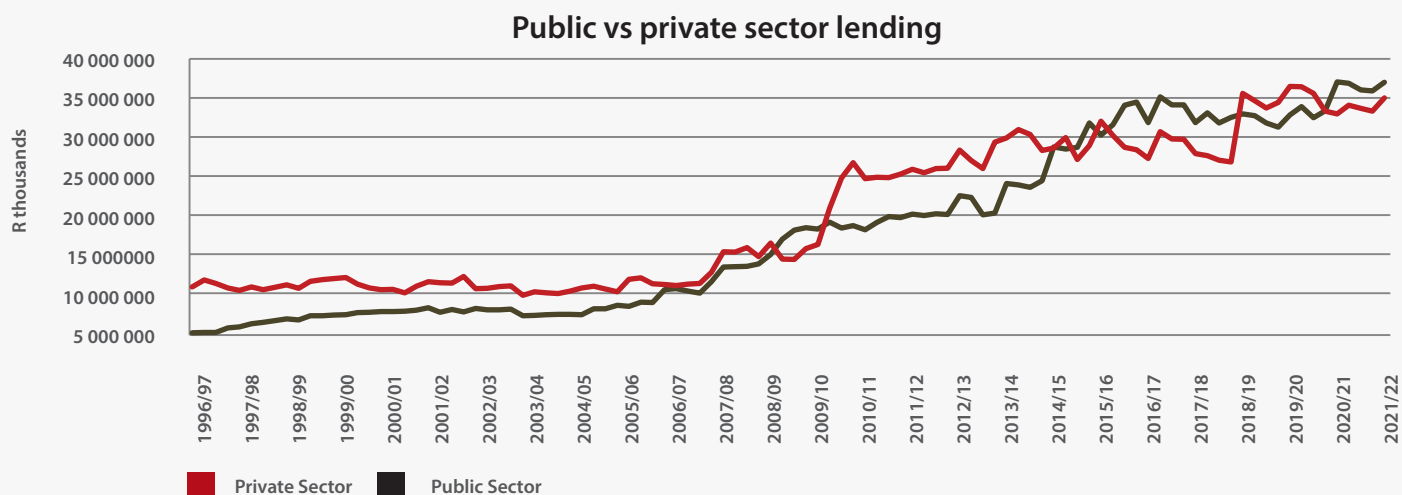
Outstanding long-term debt aggregated for all municipalities grew by just under R1.4 billion over the course of the 2021/22 financial year. Despite municipalities having taken up a total of R5.8 billion in new long-term borrowings during the financial year, outstanding long-term municipal debt has only gone up by about R1.4 billion over the same period. Municipalities owed R70.9 billion at the end of last year and as of the end of June 2022, that amount stood at R72.3 billion as reported by municipalities. Long-term debt balances fluctuate each quarter during the financial year as debt gets repaid, while municipalities habitually wait until towards the end of the financial year to undertake new borrowing. For example, long-term debt balance aggregated for all municipalities was R70.3

billion and R69.9 billion for the second and third quarters of the 2021/22 financial year respectively. As is usually the case, the bulk of the new borrowing was incurred by the metros with the City of Johannesburg taking up new borrowing of R2.1 billion while eThekweni and Ekurhuleni incurred new borrowing of R1 billion and R841 million respectively, as per the Quarterly Borrowing Monitoring Returns for quarter 4 of FY 2021/22.

The long-term debt to revenue ratio aggregated for all municipalities, which measures total outstanding long-term debt against operating revenues, is one percentage point down to 16 percent over the past twelve months.

3. Analysis of long-term debt as reported by lenders

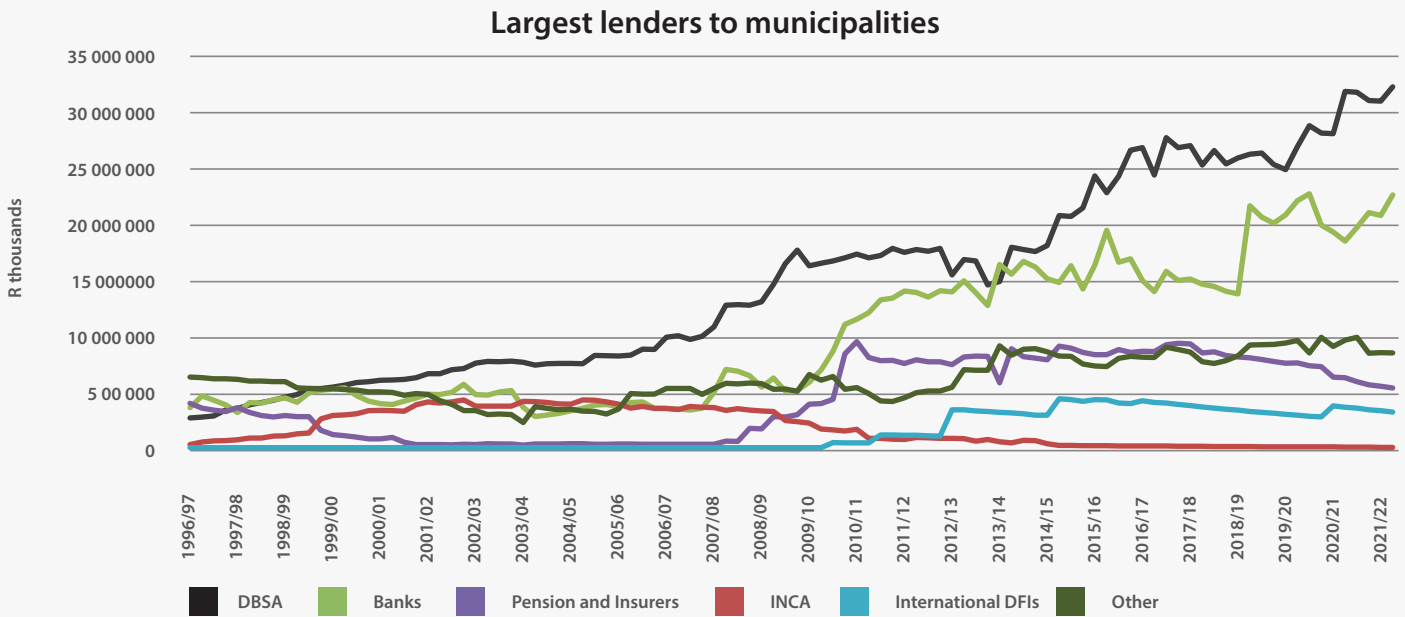
Figure 1: Public and private sector lending to municipalities



Public sector investment in municipal debt obligations is greater than private sector investment. Public sector financiers continue to dominate lending to municipalities. They are owed R37.2 billion compared to R35.2 billion owed to the private

sector. At the same time, municipal long-term debt owed to public sector lenders has remained the same while that held by private sector lenders increased by over R2 billion during the past twelve months.

Figure 2: Largest lenders to municipalities



Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

The profile of investors in municipal debt obligation has remained similar throughout recent years. Municipalities obtain most of their long-term financing from DBSA (the largest lender), commercial banks, institutional investors such as insurers and pension funds, and international DFIs, in that order. The DBSA added a net total of R400 million to its existing investment in municipal long-term debt obligations and is now owed R32.5 billion, up from

R32.1 billion this time last year. The stake of commercial banks in municipal debt obligations increased significantly by about R4.1 billion over the past twelve months. Municipal debt held by pension funds and insurers fell by R906 million since the end of June 2021 as a portion of their stock of municipal bonds was redeemed during the financial year. International DFIs are now owed R3.2 billion, down from R3.6 billion at the end of June 2021.

TOPICAL ISSUES

CABINET ADOPTION OF THE UPDATED POLICY FRAMEWORK FOR MUNICIPAL BORROWING

The completion of the review and update of the 2000 Policy Framework for Municipal Borrowing and Financial Emergencies, first introduced in Issue 1 of the Municipal Borrowing Bulletin, saw the Updated Policy Framework for Municipal Borrowing undergo an extensive formal consultation process leading to its adoption by Cabinet on 17 August 2022. The updated Policy Framework will provide certainty to all parties in the municipal debt market regarding what can be done to increase infrastructure investment within creditworthy municipalities.

It is well known that municipalities continue to be challenged by growing capital investment needs. However, the credit market has not been used to its capacity to address these needs. Together with the roles and functions of municipalities, South Africa's current diverse and sophisticated financial system can be leveraged to spur economic growth and development within municipalities, ultimately impacting the overall growth and development of the country. The updated Policy Framework provides a foundation for turning this vision into reality – it provides guiding principles on instruments and mechanisms that can be used to attract private sector financing for creditworthy municipalities.

The updated Policy Framework is evolutionary – it does not deviate from the fundamental principles of the original Policy Framework that was adopted by Cabinet in 2000. The principles outlined in the original Policy Framework remain, and these include:

- Creditworthy municipalities should borrow responsibly to finance capital investment and fulfil their constitutional responsibilities.
- Municipal access to private capital, based on investors' evaluation of municipal creditworthiness, is a key to efficient local government and fiscal discipline.
- Municipalities should borrow in the context of long-term financial strategies, which reflect clear priorities and the useful life of assets.
- A sustainable municipal credit market includes the proper pricing of risk. Government does not support "soft" or subsidized loans to municipalities.
- Investors whose funds are at risk have both the incentive and the means to limit or deny credit if there is doubt about the sustainability of proposed borrowing.
- Neither national nor provincial government will underwrite or guarantee municipal borrowing. There will be no bailouts by national or provincial government.

In a 2015 Urban Investment Partnership Conference, aimed at generating a common understanding on issues hindering the active participation of the private sector in urban investment, a commitment was made to strengthen the Policy Framework through a review and update. The update considered developments in the municipal debt market since the adoption of original Policy Framework. The key objectives of the updated Policy Framework are to:

- Introduce the necessary reforms that will expand the scope of responsible municipal borrowing and create an environment that attracts more players (e.g., insurers, pension funds, institutional investors, and fund managers, and (under specified conditions) international development finance institutions) in the municipal debt market space.
- Clarify the role of development finance institutions (DFIs) to ensure that DFI lending does not crowd out the private sector. This will require commitments to development objectives with measurable indicators to ensure that DFI lending activities are truly developmental.
- Clarify the rules for infrastructure financing mechanisms (such as pooled financing mechanisms, project finance, tax increment financing, revenue bonds, and pledging of conditional grants) that municipalities can use to support borrowing.
- Propose options that can be explored to support the development and growth of an efficient and liquid secondary market for municipal debt obligations.

The successful implementation of the Updated Policy Framework for Municipal Borrowing rests on a concomitant effort from national government, local government, investors, and financial institutions, in promoting and understanding the Policy Framework. Initiatives have already been put in place to strengthen the borrowing market. Municipalities have introduced long-term financial strategies to assess the sustainability of undertaking long-term loans. Project preparation facilities have been introduced to ensure a pipeline of bankable projects. From an investor's perspective, transparency is key – to that end National Treasury supports the Municipal Money platform, to enable all parties to assess municipalities' financial performance. National Treasury sponsors an Urban Finance Working Group which provides a forum for lenders and borrowers to engage meaningfully.

For further information relating to the Updated Policy Framework for Municipal Borrowing please contact Kolisang Molukanele at Kolisang.Molukanele@treasury.gov.za. The Updated Policy Framework for Municipal Borrowing can be accessed on the MFMA website at the following link: <http://mfma.treasury.gov.za/Guidelines/Pages/default.aspx>