MUNICIPAL BORROWING BULLETIN

September 2023

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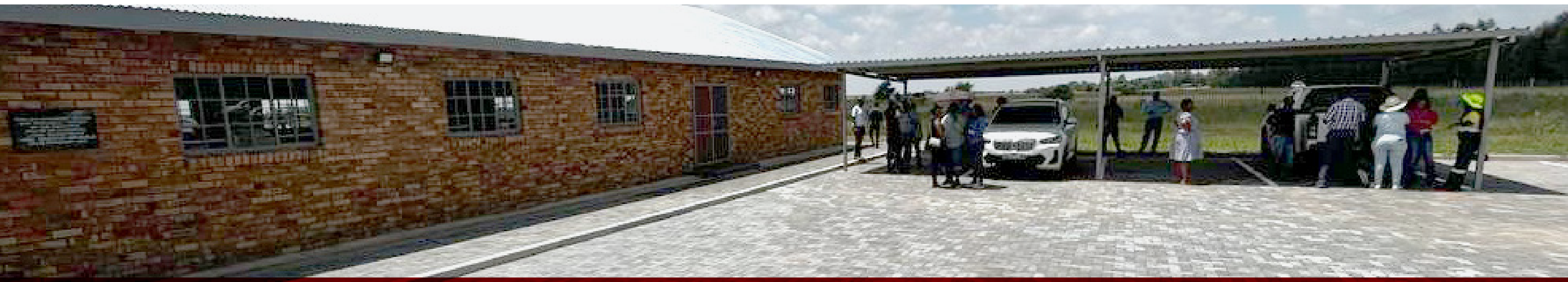
ISSUE 30



NEW MULTIPURPOSE CENTER IN GELUKSPAN
MAHIKENG 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 2023, corresponding to the end of the fourth quarter of the 2022/23 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.

COMMEMORATING THE 30TH ISSUE OF THE MUNICIPAL BORROWING BULLETIN

This marks the thirtieth issue as well as the 8th anniversary of the Municipal Borrowing Bulletin, which began publication in June 2015. The Bulletin has helped interested parties to engage with municipal borrowing topics and has improved the general understanding of municipal borrowing statistics and dynamics.

Over the last eight years, there has been an improvement in data collection, cross-checking, and analysis. Contact with potential investors has also improved, thereby broadening, and stimulating the municipal debt market. Concurrently, the Urban Finance Working Group was established as a forum where municipal borrowers, investors and other stakeholders engage with the information.

HIGHLIGHTS

- Lenders reported a total of R70.5 billion in outstanding long-term borrowing to municipalities while R70.1 billion was reported by municipalities.
- Municipal borrowing budgets were revised down by 13 percent during the third quarter of the year under review.
- Municipalities raised new borrowings of R6.4 billion, which is about 72 percent of the adjusted borrowing budgets for the 2022/23 financial year.
- The 2022/23 municipal financial year was marked by higher long-term debt repayments compared to new debt uptake.
- Lending to municipalities during the 2022/23 financial year was dominated by International DFIs.
- A significant increase in municipal long-term debt held by public sector lenders was contrasted by a sharp decline in municipal long-term debt in private sector hands.
- In this issue, we look at national government efforts to improve municipal performance through Section 139 interventions.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

DATA AND ANALYSIS

1. Municipal borrowing budgets

Revenues are the life blood of municipalities without which it will be impossible for municipalities to perform their duties. Revenue adequacy is key to the sustainable delivery of services to residents and enterprises thus, the devolution of functions to municipalities as conceptualised in the white paper was complemented by assignment of revenue authority. Municipalities must have the fiscal means to fund their legally mandated array of services such as the provision of water, sanitation, electricity, waste management, roads, etc. Municipalities mainly source their own revenues from levying property rates and service charges while they are also entitled to a portion of nationally raised revenues through the equitable share and other intergovernmental transfers. While municipalities have little control over the portion of nationally raised revenues, they bear the responsibility to manage and ensure the sustainability of own source revenues which constitute the biggest proportion of municipal revenues except for small and rural municipalities. On an annual basis a municipality must through a budget, estimate revenues reasonably expected to be raised from own sources, bill the revenue, and most importantly, take the necessary steps to collect such revenues. Revenue collection is particularly important in ensuring that municipalities have the actual cash to fund budgeted expenditures so that operating deficits are not realised where breakeven or surpluses were envisioned leading to unsustainable financial performance.

National Treasury records show that municipal revenues have tripled over the 13-year period between financial year 2009/10 (when reliable reporting started) and the 2022/23 financial year. Averaging 9 percent annual growth, aggregated revenues for all municipalities reached about R470.3 billion at the end of the 2022/23 financial year from R153.3 billion in financial year 2009/10. However, where infrastructure development is concerned, municipalities have not positioned themselves to take advantage of the increasing revenues to support infrastructure development as municipal capital expenditure has stagnated over the years. Municipalities must maintain financial discipline so that they can leverage their revenues through long-term borrowing to boost local infrastructure development beyond what is affordable through capital conditional grants.

Table 1: Budget Borrowings

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
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	10 348 260
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	8 935 181
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	6 417 269
	78%	**78%**	**79%**	**70%**	**64%**	**65%**	**37%**	**80%**	**81%**	**72%**

Source: National Treasury Database

Municipalities have undertaken slightly more borrowing in rand value than last year but less than the previous financial period when comparing actual borrowings against adjustment borrowing budgets. During the previous financial year of 2021/22, municipalities undertook long-term borrowings to the tune of R5.9 billion which equates to 81 percent of the R7.3 billion adjustment borrowing budgets. In contrast, the long-term borrowings of R6.4 billion undertaken during the 2022/23 financial year amounts to only 72 percent of the R8.9 billion adjustment borrowing budgets. This also means that new borrowings uptake has broken through the R6 billion mark after having lingered just below R6 billion for three consecutive years starting with 2019/20, the COVID year.

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

Table 2: capital expenditure, new borrowing and outstanding debt

R million	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Capital budget	61 866	65 717	67 954	68 849	71 381	73 564	68 808	69 255	67 358	71 887
Capital expenditure	47 932	53 241	54 682	54 411	58 756	55 417	41 245	55 622	47 665	51 851
New Borrowing	7 583	9 357	9 222	8 099	8 750	8 004	5 898	5 819	5 906	6 417
New borrowing as a % of CAPEX	**16%**	**18%**	**17%**	**15%**	**15%**	**14%**	**14%**	**10%**	**12%**	**12%**
Outstanding debt	**51 431**	**53 493**	**60 903**	**62 043**	**62 512**	**70 627**	**69 841**	**70 908**	**72 284**	**70 533**

Source: National Treasury Database

While annual capital expenditure may seem inadequate considering overall municipal capital investment needs, these amounts can add up to a sizeable figure over a longer period. As such, sound capital investment planning becomes important in ensuring a programmatic approach towards addressing municipal capital investment needs. Municipalities must look beyond the MTREF, and plan capital investment based on potentially available fiscal resources over longer periods of time. It therefore becomes important that municipalities borrow in the context of long-term financial strategies, which reflect clear priorities and the useful life of assets. Table 2 above shows that even though capital expenditure has hovered around the R50 billion mark annually, the accumulated figure over the past 10 years is well over R500 billion. Notwithstanding that the R500 billion capital expenditure is only just 76 percent of the R686 billion that was planned for that period. Indeed, that amount could have been significantly more if municipalities had the capacity to fully implement their capital budgets.

Of this R500 billion 10-year capital expenditure, about 14 percent of it was financed through long-term borrowings to the tune of R75 billion. This means that on average, municipalities have managed to undertake long-term borrowings of only R7.5 billion annually over the 10-year period. To give context, the City of Cape town has recently indicated that it will require to borrow R12 billion annually over a 10-year period to give effect to its recently developed long-term capital investment plan. Basically, the aggregated annual borrowings of all municipalities over the past 10 years have not been enough to cover the borrowing needs of one city.

Table 3: Outstanding long-term debt as at 30 June 2023

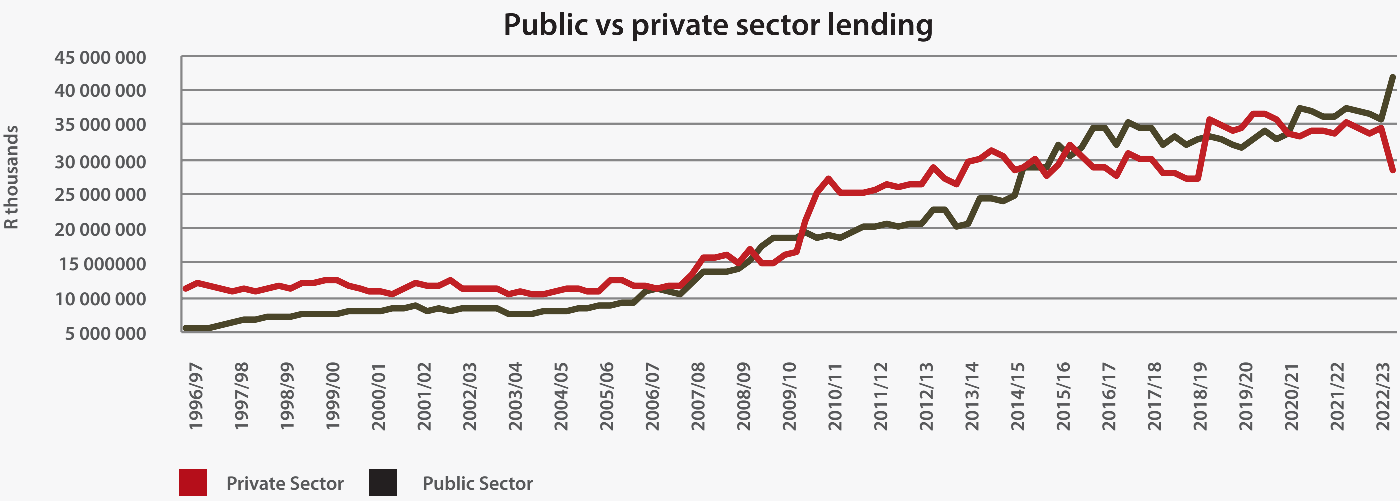
Municipal Category	Municipality	Total debt Q4 2022/23 R'000	Share of total debt	Actual Revenue 2022/23 R'000*	Debt to revenue ratio
A	BUF	138 854	0,2%	7 806 270	2%
	NMA	1 272 215	2%	16 870 262	8%
	MAN	465 855	1%	8 377 698	6%
	EKU	9 881 230	14%	47 943 208	21%
	JHB	22 054 843	31%	70 513 631	31%
	TSH	9 492 185	13%	29 560 671	32%
	ETH	9 841 193	14%	47 638 510	21%
	CPT	7 462 407	11%	53 274 755	14%
	Total Metros	**60 608 782**	**86%**	**281 985 005**	**21%**
B	**B1 (19)**	6 880 567	10%	63 190 967	11%
	Other Municipalities	2 697 961	4%	99 051 340	3%
C	**Districts**	346 187	0%	26 111 180	1%
	Total all municipalities	**70 533 497**		**470 338 492**	**15%**

**excluding capital transfers*

The 2022/23 municipal financial year was marked by higher long-term debt repayments compared to new debt uptake. In the aggregate, municipalities owed long-term debt worth R72.3 billion when the 2022/23 financial year started but at the end of the year, the total outstanding long-term debt of all municipalities was valued at R70.5 billion. Essentially, municipalities repaid outstanding long-term debt to the tune of R8.2 billion while new borrowings of only R6.4 billion was taken up during the 2022/23 financial year. The higher than usual long-term debt repayments were due to 3 metros; City of Johannesburg, City of Cape Town and City of Tshwane, having portions of their bullet bonds come up for redemption at the end of June 2023. The City of Johannesburg redeemed outstanding bonds of just under R2.3 billion, Cape town retired R1 billion of its outstanding bonds while R830 million worth of Tshwane's outstanding bonds were redeemed during the financial year. This adds up to over R4 billion worth of bond repayments alone.

While repayments were the order of the day, the metros also dominated new borrowing uptake with the City of Cape town leading the charts by raising long-term borrowing amounting to R2.2 billion. This comes 4 years after the city last engaged in long-term financing where it borrowed about R1.3 billion. The City of Johannesburg which religiously participates in long-term borrowing on an annual basis undertook new borrowings of R1.8 billion while cities of eThekwini and Ekurhuleni undertook long-term borrowings of R1.5 billion and R742 million respectively. The secondary cities were represented by uMhlathuze which raised long-term borrowings to the value of R600 million making it the highest amount ever borrowed by a secondary city in a single financial year.

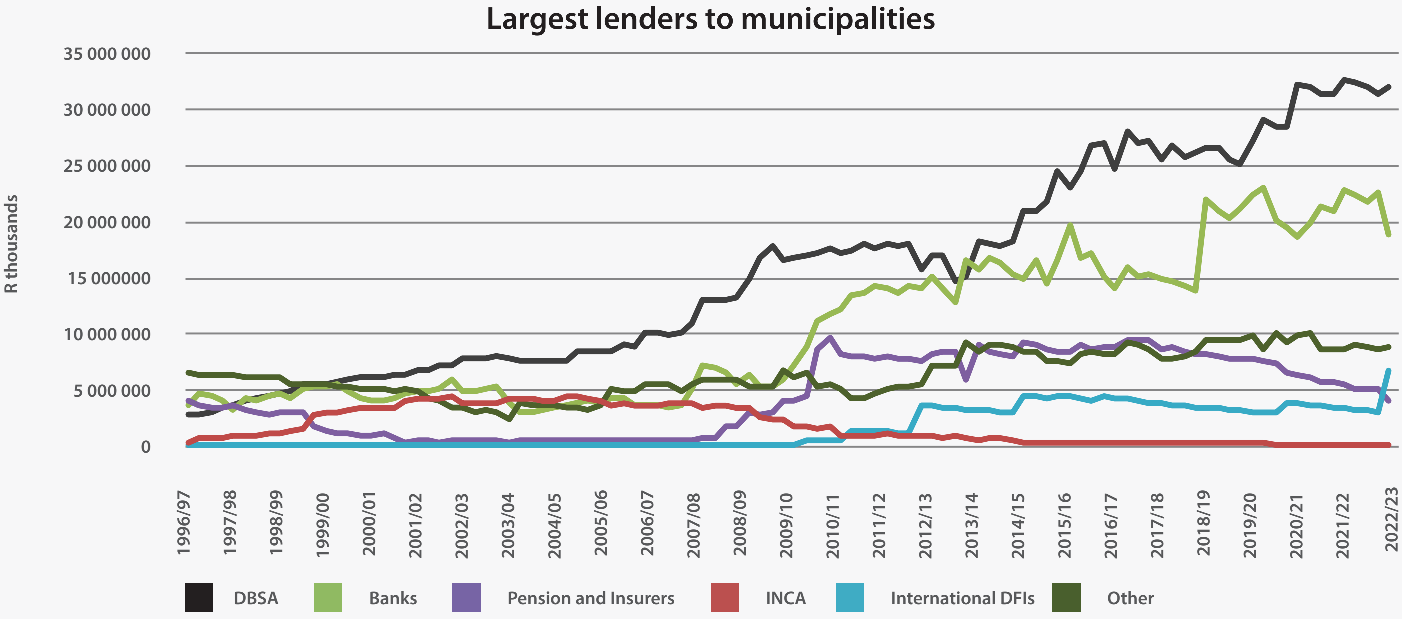
Figure 1: Public and private sector lending to municipalities



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

A significant increase in municipal long-term debt held by public sector lenders was contrasted by a sharp decline in municipal long-term debt in private sector hands. Most of the new long-term debt raised during the financial year was sourced from public sector lenders while most of the bond redemptions related to municipal bonds held by private sector lenders. Thus, public sector investment in municipal debt obligations grew by over R4.5 billion while investment by the private sector declined by R6.9 million during the 2022/23 financial year. Public sector lenders and investors were owed R37.2 billion at the end of June 2022 and are now (June 2023) owed R41.8 billion compared to private sector lenders which are now owed R28.3 billion from R35.2 billion this time last year.

Figure 2: Largest lenders to municipalities



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

Lending to municipalities during the 2022/23 financial year was dominated by International DFIs. While the DBSA's stake in municipal debt obligation increased by almost R500 million, it was International DFIs that dominated lending to municipalities, effectively increasing their stake in municipal debt obligations by over R3.6 billion. In contrast, the commercial banks, which held most of the municipal bond obligations that were redeemed during the current financial year, saw their stake decline by almost R3.8 billion. Municipal debt held by pension funds and insurers also declined by over R1 billion.

TOPICAL ISSUES

LEVERAGING THE POTENTIAL OF SECTION 139 INTERVENTIONS TO IMPROVE MUNICIPAL PERFORMANCE

Local government in South Africa plays a crucial role in service delivery, community development and governance at grass roots level. However, numerous challenges impede the effective and efficient functioning of local authorities. The annual State of Local Government Finances report produced by the National Treasury shows that more than half of all municipalities in South Africa are in varying stages of financial distress. Many of the municipalities identified to be in financial distress have been in this position for some time and there are no visible signs of improvement.

Although the National Treasury has developed and institutionalised the implementation of several financial management reforms to assist municipalities to improve on financial management and reporting, the number of financially distressed municipalities continues to increase. In addition, billions of rands have been invested over the years in capacity building initiatives for local government, with little or no evidence of any return on that investment.

As the number of municipalities in financial distress and those in a full-blown financial and service delivery crisis continues to grow, more and more communities are bearing the brunt of service delivery failure. Furthermore, our prospects of creating a healthy economy and reducing unemployment and poverty are becoming slimmer by the day as a result. For this reason, more consideration must be given to the invocation of interventions in terms of Section 139 of the Constitution to correct municipal dysfunction before it becomes irreversible, particularly since support and other mechanisms have not yet demonstrated the desired improvements in performance.

In 2017/18, the National Treasury commissioned the Public Affairs Research Institute (PARI) to review the implementation of Section 139 interventions to determine the efficacy thereof. Amongst the key findings in the study were that interventions were not invoked timeously by Provinces and that most often discretionary interventions invoked in terms of S139(1) of the Constitution were preferred over any type of intervention. Since the PARI report, the National Treasury has focused much of its attention on how the implementation of Section 139 of the Constitution can be strengthened and used appropriately to reduce the number of dysfunctional municipalities. One of the key improvements in this regard has been the adoption of a phased approach to recovery to aid both the implementation and monitoring of the financial recovery plan and the recovery process.

The recovery process is based on a holistic approach and focuses on governance, institutional arrangements and service delivery in addition to financial management. The phased approach to recovery plans consists of three phases namely, a Rescue Phase, a Stabilization Phase and a Sustainability Phase. Each phase has its own objectives and timeframes and is not mutually exclusive. In each of the phases and each of the pillars, appropriate targets are selected to guide the recovery processes. These targets are identified as most appropriate given the nature of the underlying issues in a municipality which are determined upfront through a detailed status quo assessment. The targets provide an indication of high-level outcomes that must be achieved but do not specify the steps to be taken or the methods to be used to achieve those outcomes to avoid being overly prescriptive. Hence, the Financial Recovery Plan (FRP) decides what needs to be done and leaves the discretion of how to achieve those outcomes up to the municipality.

MUNICIPALITIES PREPARED IN LINE WITH THE NEW APPROACH

In accordance with the new approach, the Municipal Financial Recovery Service (MFRS) has developed and approved 15 FRPs, eleven (11) of which are new. The Municipalities are as follows; Ditsobotla LM (New), Tswaing LM (New), Madibeng LM (New), Ramotshere Moiloa LM (New), Dr Ruth SM DM (New), Kgetlengrevier LM (New), Naledi LM (New), Enoch Mgijima LM (New), Mangaung Metro (New), Mafube LM (New), Tokologo LM (New), Lekwa LM, Msunduzi LM, Beaufort West LM and Mogalakwena LM.

The new approach is starting to produce some success stories in Msunduzi and Lekwa Local Municipalities. Msunduzi Local municipality has approved a funded 2023/24 MTREF Budget and is implementing a strategy to move towards cost-reflective tariffs for all trading services. An improved cash flow and liquidity position is evident as verified against improved financial ratios. The municipality's creditors reduced significantly and all creditors older than 60 days have been cleared. Strict credit control and a metering project further contribute to the improved financial position. Filled senior management positions which are the key drivers for the successful implementation of the FRP. The Council, MM and senior management provide effective leadership and committed fully to the implementation of the FRP.

The national intervention in Lekwa LM is showing early signs of improvement backed by a revenue enhancement strategy. Filled senior management positions. Multiple stakeholders partnered to fund the strategy that include projects such as the installation of 8000 new smart /meters, data cleansing and cost-of-supply studies. Regarding service delivery, programmes were introduced to address persistent water leaks and network problems and there is improved reliability and capacity at the Water Treatment Plants. SANRAL is assisting the municipality with road maintenance included in the Community Development (CD) projects up to 200km.These signs of improvement underscore the importance of a well-structured financial recovery plan, strong leadership, external oversight, fiscal responsibility, and community support in overcoming fiscal challenges faced by municipalities. It serves as an important inspiration for other municipalities facing financial distress, demonstrating that with determination and effective strategies, recovery and long-term sustainability are possible.

INSTITUTIONALISATION OF FINANCIAL RECOVERY PLANS BY MUNICIPALITIES

The institutionalisation of Financial Recovery Plans by municipalities is a critical process aimed at restoring fiscal health and stability to municipalities facing financial distress. The new strategic approach to financial recovery requires the full commitment of municipal executives and the fulfilment of certain actions to ensure institutionalisation of Financial Recovery Plans. Such actions include the signing of performance scorecards that incorporate the FRP for each financial year by the Municipal Manager (MM) and heads of directorates; the revision of the Service Delivery Budget Implementation Plan (SDBIP) and Integrated Development Plan (IDP) for alignment with the FRP; the tabling and discussion of monthly FRP progress reports in top management, executive committee, and Council meetings. In addition, no decision (Executive, Legislative or Administrative) should be approved by Council, Executive Mayor and Accounting Officer that contravenes or defeats the FRP and its objectives. The MM must designate an official in his office to coordinate implementation and reporting on the FRP and must sign-off all FRP implementation progress reports before submission to NT MFRS, Provincial Treasury, Executive/ Mayoral Committee and Council.

While institutionalised financial recovery plans offer numerous benefits, their success depends on effective implementation and ongoing monitoring. Additionally, each municipality's circumstances and challenges are unique, so recovery plans are tailored to address specific local needs and priorities.

FOSTERING STAKEHOLDER RELATIONSHIP AND SUPPORT FOR SUCCESFUL SECTION 139 INTERVENTIONS.

Effective section 139 intervention relies on building strong relationships and providing comprehensive support to all stakeholders involved. By facilitating collaboration, engaging the local community, offering professional expertise, addressing concerns, and maintaining open communication, the intervention process becomes more transparent, inclusive, and effective. Ultimately, fostering a supportive environment leads to greater stakeholder buy-in, lasting positive change, and the realisation of the intervention's intended objectives.

Section 154 support packages and section 139 interventions each play a significant role in improving local government performance. By harnessing their complementary strengths and adopting a collaborative approach, municipalities can build capacity, enhance governance, and address challenges proactively. This synergy not only fosters immediate solutions but also lays the foundation for sustainable progress, empowered local communities and resilient local governance structures.

CONCLUSION

The potential contained in Section 139 of the Constitution to significantly elevate the performance of local government should not be underestimated. If appropriately applied and properly implemented, these interventions provide a structured and targeted approach to dealing with complex issues, restoring good governance, improving service delivery, and promoting equitable development. Municipalities can navigate challenges more effectively, creating a foundation for sustainable growth, improved well-being, and stronger communities.

The success of interventions ultimately depends on the collaboration between all spheres of government and engaged citizens. Effective leadership, transparent governance, collaboration among stakeholders, and a focus on addressing underlying issues can contribute to the success of the intervention. However, it's important to note that the sustainability of these improvements requires ongoing efforts, continued engagement, and vigilance in maintaining the positive outcomes achieved through the interventions. By embracing a comprehensive and forward-looking approach, municipalities can leverage section 139 to usher in a new era of governance excellence, citizen empowerment, and holistic development. This approach requires collaboration, visionary leadership, and a commitment to realising the full potential of this constitutional provision.

Topical issue provided by: *Patrick Malebye, Municipal Financial Recovery Service (MFRS) Advisor*