MUNICIPAL BORROWING BULLETIN

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BACKGROUND

Investment in municipal infrastructure is an important prerequisite for creating an environment conducive to faster, more inclusive economic growth and a reduction in poverty. The need for municipal infrastructure investment in South Africa continues to increase in response to population growth and urbanisation trends, and existing asset management requirements. These include the need to provide new infrastructure in areas experiencing higher levels of population and economic growth, and to refurbish and replace ageing infrastructure. Historically, poor maintenance of infrastructure magnifies these investment requirements.

Municipalities have access to a variety of revenue sources and financing instruments to address these needs. Long term borrowing is one major instrument for financing infrastructure development. Responsible borrowing by municipalities is strongly supported in government policy and legislation as an efficient and equitable mechanism to finance municipal capital investment needs.

The Municipal Borrowing Bulletin is a quarterly publication targeted at all role players involved in the long-term municipal borrowing market. It shares data, offers analysis, highlights trends and discusses topical issues to improve the understanding of the municipal borrowing market and to promote prudent and responsible use of municipal borrowing as an effective and efficient infrastructure financing tool.

Issue 1 covers information up to 31 March 2016, which corresponds to the third quarter of 2015/16 municipal financial year. Sources of data used in this bulletin include data submitted by municipalities to National Treasury as required by Sections 71 and 74 of the Municipal Finance Management Act of 2003; data obtained from lenders; information published by the South African Reserve Bank (SARB); and data from the Johannesburg Stock Exchange (JSE) sourced from STRATE.[1]

KEY HIGHLIGHTS: THIRD QUARTER 2015/16

Total municipal debt book has crossed the R60 billion mark and stands at R61.5 billion as of 31 March 2016. In the 2015/16 financial year, municipalities budgeted to borrow approximately R11.8 billion. By the end of the third quarter, municipalities had only borrowed R4.6 billion, which is 39 percent of the total budgeted borrowing. Of the R4.6 billion, metropolitan municipalities' borrowing accounted for 85 percent (R4 billion).

[1] All figures in Rand used in this bulletin are in nominal terms

Moody's has recently introduced a new methodology for national scale ratings, which measure relative creditworthiness of sub-nationals within a single country. As a result, all South African municipalities rated by Moody's have improved their ratings. Importantly, this upward adjustment does not reflect any changes in credit quality, but is rather a result of recalibration. By contrast, the City of Johannesburg's global scale rating was upgraded even further, as a result of improved financial performance.

In the 2016/17 draft Medium Term Revenue and Expenditure Framework (MTREF) municipalities have budgeted to borrow R10.4 billion in 2016/17, R10 billion in 2017/18 and R10.6 billion in 2018/19. The forecasted new borrowing for 2016/17 would be 11 percent less than what was budgeted for 2015/16.

Overall, both the public and private sector have increased their long term lending to municipalities. The majority of the lending continues to come from private banks and the Development Bank of South Africa (DBSA). However, institutional investors and international development finance institutions (DFIs) hold a small and stable share of the debt.

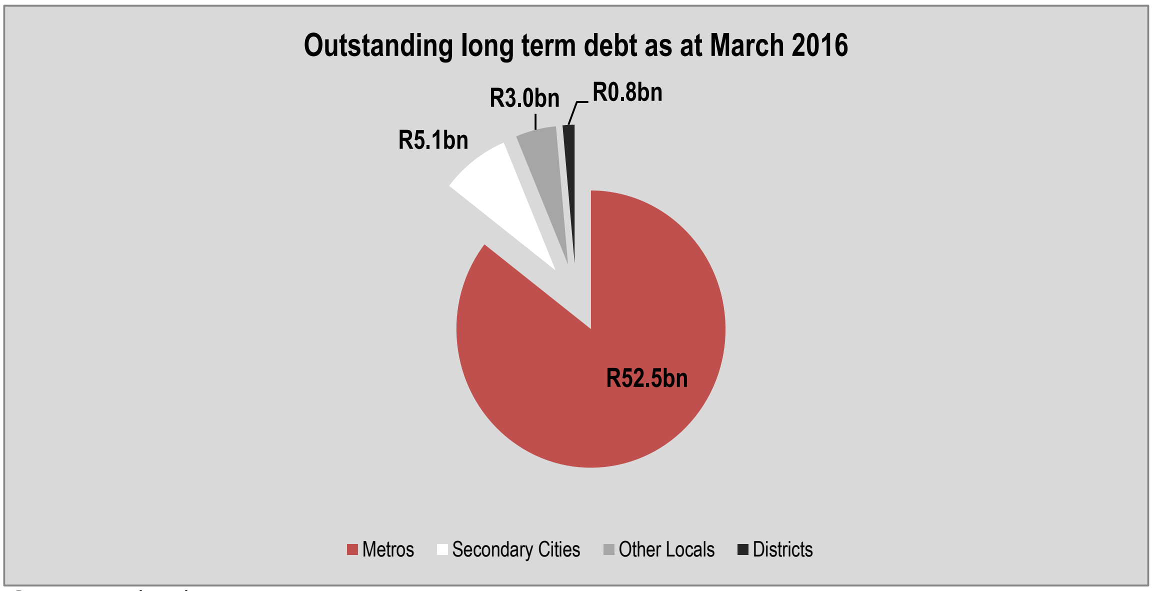
Although there has been a major improvement in data credibility, some discrepancies remains. Data received from municipalities indicate a total outstanding long term debt of R61.5 billion, whereas information supplied by lenders shows a total outstanding debt of only R61.3 billion at the end of 2015/16 third quarter (municipal financial year). National Treasury is driving a process of verifying and improving data by working closely with municipalities, SARB, STATSA and other stakeholders.

DATA ANALYSIS

Total debt outstanding: municipal data

The total outstanding long term debt for all municipalities as at the end of the third quarter of the 2015/16 municipal financial year amounted to R61.5 billion, according to quarterly data submitted to National Treasury by municipalities. Metropolitan municipalities' outstanding long term debt amounted to R52.5 billion or 85 percent of the total municipal outstanding long term debt, the 19 secondary cities' accounted for R5.1 billion or 8 percent, and the remaining 6 percent is attributable to other local and district municipalities. Most of the growth in outstanding long term debt has been in the metropolitan municipalities, which require the greatest infrastructure investment. See figure 1 below:

Figure 1: Long term municipal debt outstanding as at 31 March 2016



Source: National Treasury

In total, municipal budgets for the 2015/16 municipal financial year anticipate new long-term borrowing of R11.8 billion (against aggregate capital budgets of R67.8 billion). By the end of the third quarter of 2015/16, long-term borrowing for the year has amounted to R4.6 billion, of which metros account for R4 billion or 85 percent.

Table 1 below shows total outstanding long term debt and the funding mix for capital expenditure in municipalities over the past eight years, including the current financial year. Total capital expenditure has increased by 71 percent over the period, from R39.6 billion in 2008/09 to R67.8 billion in 2015/16. In contrast, the share of capital expenditure financed by borrowing follows a declining trend (albeit increasing in total numbers since 2011/12). This suggests a relatively greater reliance on capital grants, own revenues and developer contributions for capital expenditure. Total outstanding debt has increased by 89 percent from 2008/9 to 2015/16, from R32.3 billion to R61.3 billion.

Table 1: Capital expenditure, new borrowing and outstanding debt

R'000	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Actual	2013/14 Actual	2014/15 Actual	2015/16 Budget
Capital expenditure	39 577 441	39 624 799	30 944 941	33 238 896	41 678 912	47 931 822	53 240 759	67 776 452
New Borrowing	9 462 623	8 226 378	6 401 233	6 210 664	6 489 512	7 582 655	9 357 328	11 782 179
New borrowing as a % of CAPEX	**24%**	**21%**	**21%**	**19%**	**16%**	**16%**	**18%**	**17%**
Outstanding debt	32 365 746	35 387 552	43 190 345	45 640 353	48 077 781	51 430 509	53 493 395	61 320 165

Source: National Treasury

Table 2 below shows an overview of current debt levels in municipalities. Metropolitan municipalities (category A), as a group, are significantly more leveraged than either local municipalities (category B) or district municipalities (category C). Within the metropolitan municipalities, there is considerable variation. The City of Johannesburg is the biggest borrower both in absolute terms and in per capita. The most leveraged metropolitan municipality by a significant margin is the City of Johannesburg and the least leveraged are Buffalo City and Mangaung respectively.

Table 2: Outstanding long term debt as at 31 March 2016

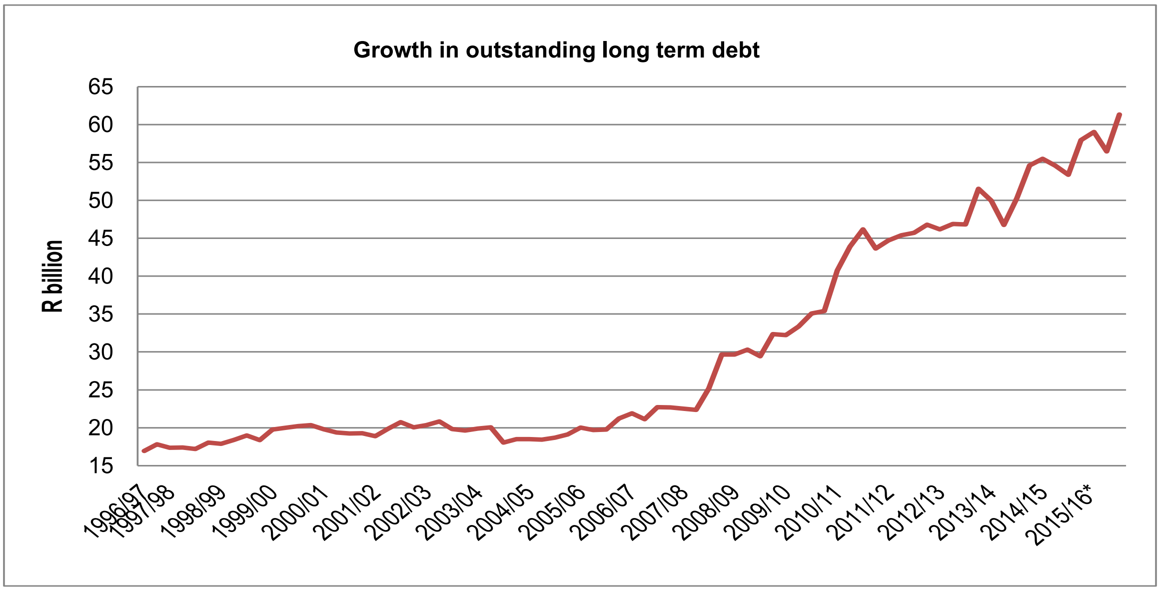
		Total debt Q3 2015/16 R'000	**Budgeted revenue 2015/16*** R'000	**Debt to revenue ratio**	**Population****	**Debt per capita** R
A	BUF	509 333	5 719 607	9%	755 200	674
	NMA	1 432 811	8 885 456	16%	1 152 115	1 244
	MAN	745 493	6 740 247	11%	747 431	997
	EKU	5 570 809	29 454 839	19%	3 178 470	1 753
	JHB	18 292 582	43 788 546	42%	4 434 827	4 125
	TSH	9 840 629	26 295 831	37%	2 921 488	3 368
	ETH	9 468 830	29 534 286	32%	3 442 361	2 751
	CPT	6 680 703	31 723 843	21%	3 740 026	1 786
	Total Metros	**52 541 190**	**182 142 655**	**29%**	**20 371 918**	**2 579**
B		8 057 843	103 673 604	8%	31 398 642	285
C		881 380	18 437 802	5%		
	Total all municipalities	**61 480 413**	**304 254 061**	**20%**	51 770 560	1188

**Excludes capital transfers*
*** 2011 Census*
Source: National Treasury and STATSSA

Growth in long term debt: lender data

Figure 2 below shows the growth in outstanding long-term debt. Municipal debt did not grow significantly between 2000/01 and 2006/07 financial years, and then increased steadily from 2007/08. Throughout 2015/16, municipal debt remained over R50bn. By end of March 2016, the total municipal long term debt was R61.3 billion, according to data received from lenders.

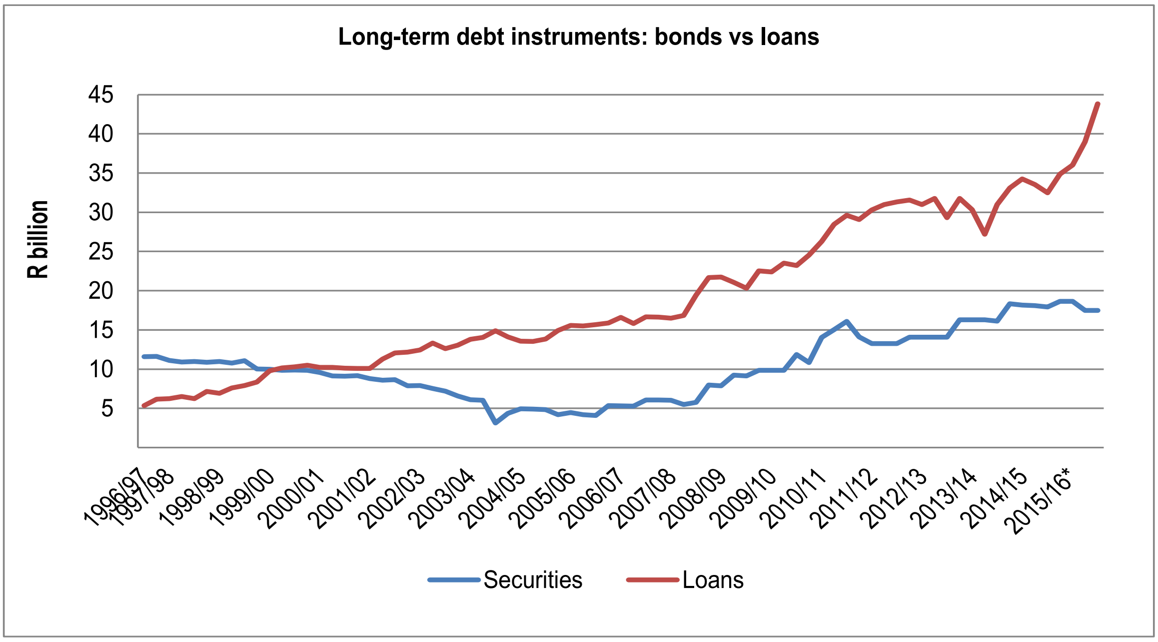
Figure 2: Growth in long term municipal borrowing



** include Q I-III*
Source: Banks, DBSA, INCA, DFI's, STRATE, SARB

Of the R61.3 billion outstanding debt reported by lenders, approximately R17.5 billion are held in municipal bonds and the remaining R43.8 billion are long term loans. Thus far, municipal bond issuers in South Africa are City of Johannesburg, City of Cape Town, City of Tshwane and Ekurhuleni.

Figure 3: Debt instruments issued by municipalities

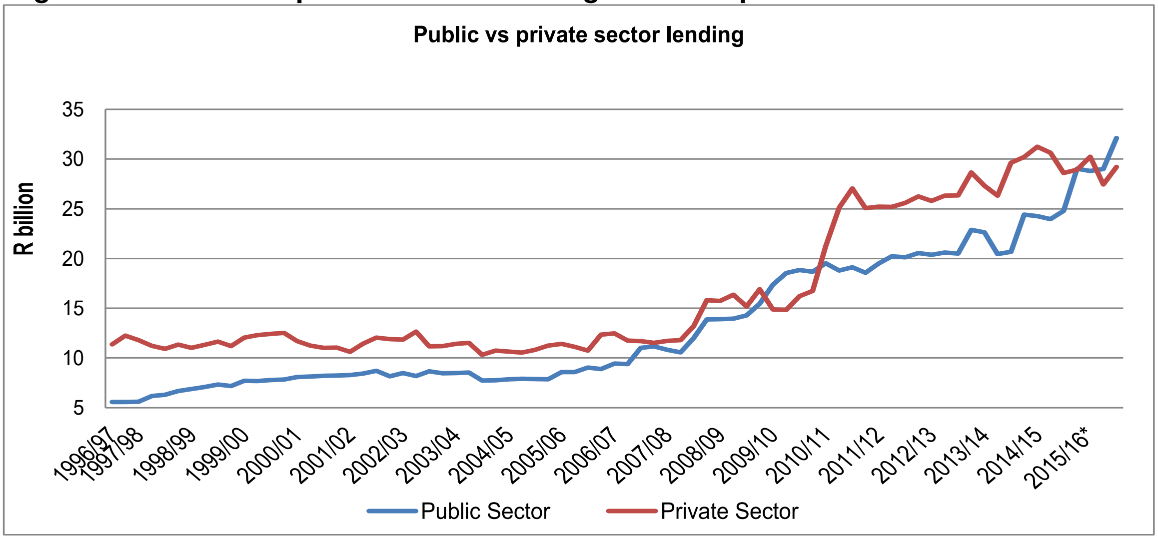


***** *include Q I-III*
Source: Banks, DBSA, INCA, DFI's, STRATE, SARB

Holders of municipal loans and bonds

Figure 4 shows the distribution of municipal debt obligations as between public and private investors. As at quarter 3 of 2015/16, the public sector held the larger share of municipal debt in an amount of R32.1 billion, with the private sector holding R29.2 billion. This reflects a steady increase over the last several quarters in net public sector lending and a slight increase in net private sector lending as compared to the first and second quarter. See the Annexure B for details.

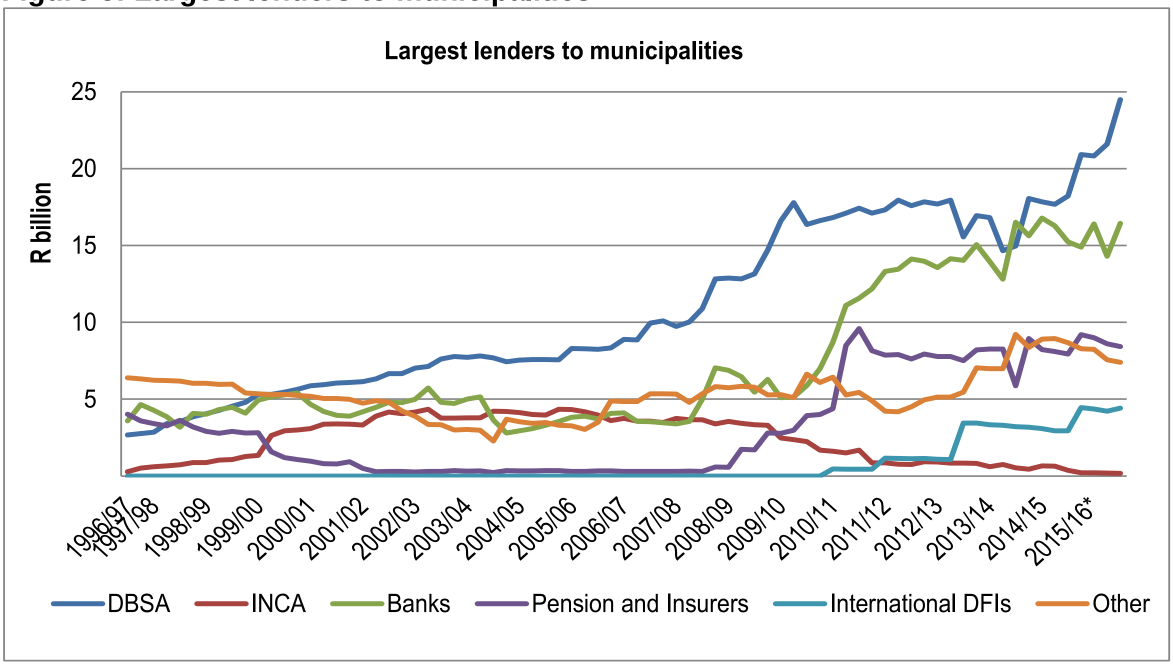
Figure 4: Public and private sector lending to municipalities



***** *include Q I-III*
Source: Banks, DBSA, INCA, DFI's, STRATE, SARB

Figure 5 shows the largest categories of lenders to municipalities and trends in market share over time. The Development Bank of Southern Africa remains the largest lender to municipalities since 1999/00. Institutional Investors' lending to municipalities accelerated rapidly over the 2009/10 period and has remained relatively stable since that point.

Figure 5: Largest lenders to municipalities



**include Q I-III*
Source: Banks, DBSA, INCA, DFI's, STRATE, SARB

The apparent dip in pension fund and insurers lending in the third quarter of the 2013/14 fiscal year was due to classification of lenders and it's being resolved by the SARB.

AFD and EIB started lending to municipalities in 2006 and currently have loans outstanding to City of Johannesburg, City of Cape Town and eThekwini. Data trends for these International Development Finance Institutions (IDFIs) are seen from 2010, which is the year municipalities started reporting their borrowing monthly to National Treasury. Infrastructure Finance Corporation Limited (INCA) is no longer originating new municipal loans.

DISCUSSION OF TOPICAL ISSUES

Funding for municipal capital budgets

For the 2014/15 financial year, about half of the metropolitan municipalities' capital expenditure was funded by transfers from national government, with the remainder of capital spending divided between own-source funding and borrowed funds. By contrast, the capital expenditure of local and district municipalities is funded mainly from national government transfers. The share of metropolitan municipalities' infrastructure funding financed by transfers from national government stood at 55 percent two years ago, and is expected to drop to 45 percent over the coming two years. A corresponding increase in borrowing is expected.

It should be noted that there is substantial variation within the metropolitan municipalities, some get nearly two-thirds of their capital funding from national government, raising relatively little additional capital from own sources or borrowing, while others contribute a great deal more to their own infrastructure expenditure. The City of Johannesburg is the notable standout, with the largest capital investment programme in the country, more than two thirds of which is financed from own sources and borrowing.

In some metropolitan municipalities, the level of long-term borrowing is at or near the maximum that would be reasonable and prudent in current economic circumstances. In other municipalities, there remains substantial capacity for additional borrowing.

Municipal access to capital markets

A primary goal of the national policy has been to enable municipalities to access capital markets to help meet their infrastructure investment needs. Although municipal borrowing has been below the levels anticipated when the municipal borrowing policy framework was adopted in 2000, the goal of access, at least for metropolitan municipalities, is largely met. Work is underway to better understand secondary cities' access to capital markets.

Secondary market

The secondary market for municipal debt instruments has not developed as expected. A supply-side factor in this regard is the large amount of municipal borrowing that continues to take the form of long-term loans, rather than tradable municipal bonds. Both types of debt have grown substantially. However, since 2001 long-term loans outstanding have exceeded municipal bonds. This is consistent with South Africa's experience regarding corporate bonds – most corporate debt also takes the form of loans with few corporate bonds. In South Africa, only sovereign bonds are issued and traded in sufficient amounts to speak of a secondary market.

Municipal Borrowing Policy Review

National Treasury is currently reviewing the 1998 Policy Framework for Municipal Borrowing and Financial Emergencies, in order to address new developments in the market.[2] As part of this review, a study is being undertaken to gather additional information as to how the borrowed funds have been used. Section 46(3) of the MFMA requires that the accounting officer of the municipality provide an information statement specifying "the purposes for which the debt is to be incurred," but currently most of these statements contain only a general statement of purposes, e.g. "provision of infrastructure."

[2] http://www.gov.za/sites/www.gov.za/files/mun_fin.pdf

ANNEXURE A

Source	2008/09				2009/10				2010/11				2011/12			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
PUBLIC SECTOR:																
Public Investment Corporation	705	804	804	459	487	459	1 609	1 253	1 538	214	135	135	135	135	135	135
Development Bank of Southern Africa (incl. Local Authorities Loans Fund)	12 887	12 823	13 150	14 703	16 591	17 783	16 371	16 618	16 810	17 097	17 433	17 106	17 310	17 948	17 588	17 834
Local Authorities & Public Enterprises	319	316	316	291	291	291	871	793	722	1 041	1 100	891	892	988	1 260	1 433
Sub-Total	**13 911**	**13 943**	**14 270**	**15 453**	**17 369**	**18 533**	**18 851**	**18 664**	**19 070**	**18 352**	**18 668**	**18 132**	**18 337**	**19 071**	**18 983**	**19 402**
Municipal Internal Funds	1	1	1													
Total domestic public sector	**13 912**	**13 944**	**14 271**	**15 453**	**17 369**	**18 533**	**18 851**	**18 664**	**19 070**	**18 352**	**18 668**	**18 132**	**18 337**	**19 071**	**18 983**	**19 402**
French Development Agency AFD									55	52	52	52	786	774	765	762
European Investment Bank									402	390	390	390	377	377	363	381
Other development finance institutions																
Total international development finance institutions									**458**	**442**	**442**	**442**	**1 163**	**1 151**	**1 128**	**1 142**
TOTAL PUBLIC SECTOR	**13 912**	**13 944**	**14 271**	**15 453**	**17 369**	**18 533**	**18 851**	**18 664**	**19 528**	**18 795**	**19 111**	**18 574**	**19 501**	**20 222**	**20 112**	**20 545**
PRIVATE SECTOR:																
Insurance companies	316	316	286	772	786	987	1 244	1 297	1 752	5 378	6 024	4 943	4 670	4 664	4 520	4 693
Pension Funds	261	1 425	1 425	2 035	1 999	1 993	2 693	2 700	2 624	3 109	3 571	3 214	3 189	3 235	3 100	3 251
Banks	6 883	6 471	5 461	6 283	5 090	5 137	5 890	6 989	8 696	11 103	11 577	12 170	13 315	13 461	14 112	13 975
INCA	3 547	3 423	3 343	3 302	2 477	2 368	2 245	1 693	1 615	1 509	1 682	862	853	765	759	930
Others:	4 729	4 714	4 656	4 521	4 515	4 349	4 142	4 045	4 168	4 020	4 199	3 869	3 192	3 057	3 113	3 389
Other Financial Institutions	*4 506*	*4 509*	*4 453*	*4 427*	*4 432*	*4 226*	*3 902*	*3 946*	*3 577*	*2 460*	*2 930*	*2 887*	*3 058*	*2 934*	*2 987*	*3 264*
Other and Nominees	*221*	*204*	*202*	*69*	*58*	*90*	*196*	*64*	*555*	*1 267*	*1 068*	*851*	*7*	*7*	*8*	*7*
Household Sector	*2*	*1*	*1*	*1*	*1*	*10*	*10*	*1*	*2*	*42*	*3*	*4*	*4*	*5*	*5*	*6*
Non-Residents				*24*	*24*	*23*	*34*	*34*	*34*	*251*	*198*	*127*	*123*	*111*	*113*	*112*
TOTAL PRIVATE SECTOR	**15 736**	**16 350**	**15 170**	**16 913**	**14 867**	**14 834**	**16 214**	**16 724**	**18 855**	**25 118**	**27 052**	**25 058**	**25 219**	**25 182**	**25 604**	**26 238**
TOTAL PUBLIC AND PRIVATE	**29 647**	**30 294**	**29 442**	**32 366**	**32 236**	**33 367**	**35 065**	**35 388**	**40 311**	**43 470**	**45 721**	**43 190**	**43 557**	**44 253**	**44 587**	**45 640**

Source	2012/13				2013/14				2014/15				2015/16			
	I	II	III	IV	I	II	III	IV	I	II	III	IV	I	II	III	IV
PUBLIC SECTOR:																
Public Investment Corporation	135	135	975	1 725	1 725	2 437	10	135	134	134	134	125	125	125	125	
Development Bank of Southern Africa (incl. Local Authorities Loans Fund)	17 698	17 948	15 558	16 948	16 813	14 664	14 964	18 057	17 843	17 675	18 212	20 914	20 817	21 594	24 483	
Local Authorities & Public Enterprises	1 440	1 440	522	763	771	55	2 482	3 041	3 200	3 201	3 492	3 533	3 488	3 071	3 091	
Sub-Total	**19 273**	**19 523**	**17 055**	**19 436**	**19 309**	**17 156**	**17 456**	**21 233**	**21 177**	**21 010**	**21 838**	**24 572**	**24 430**	**24 790**	**27 699**	
Municipal Internal Funds																
Total domestic public sector	**19 273**	**19 523**	**17 055**	**19 436**	**19 309**	**17 156**	**17 456**	**21 233**	**21 177**	**21 010**	**21 838**	**24 572**	**24 430**	**24 790**	**27 699**	
French Development Agency AFD	744	731	3 116	3 103	3 015	2 993	2 905	2 893	2 804	2 683	2 683	4 205	4 117	3 993	4 180	
European Investment Bank	349	334	334	350	318	302	302	284	284	266	266	247	247	227	227	
Other development finance institutions																
Total international development finance institutions	**1 093**	**1 065**	**3 450**	**3 453**	**3 333**	**3 295**	**3 207**	**3 177**	**3 088**	**2 949**	**2 949**	**4 452**	**4 364**	**4 220**	**4 407**	
TOTAL PUBLIC SECTOR	**20 365**	**20 589**	**20 505**	**22 890**	**22 642**	**20 451**	**20 663**	**24 410**	**24 265**	**23 959**	**24 787**	**29 024**	**28 794**	**29 011**	**32 107**	
PRIVATE SECTOR:																
Insurance companies	4 524	4 524	4 148	5 016	5 012	5 002	4 909	5 531	4 885	4 760	4 624	5 816	5 641	5 530	5 399	
Pension Funds	3 248	3 248	3 365	3 192	3 258	3 260	960	3 412	3 339	3 344	3 320	3 371	3 352	3 073	3 022	
Banks	13 570	14 139	14 027	15 053	13 966	12 807	16 512	15 621	16 778	16 276	15 228	14 890	16 410	14 296	16 443	
INCA	903	848	841	825	600	750	536	445	661	646	370	217	205	192	175	
Others:	3 555	3 555	3 957	4 555	4 489	4 496	6 726	5 189	5 568	5 604	5 049	4 627	4 631	4 366	4 175	
Other Financial Institutions	*3 430*	*3 430*	*3 825*	*4 423*	*4 347*	*4 355*	*6 584*	*5 034*	*5 414*	*5 440*	*4 800*	*4 396*	*4 398*	*4 143*	*3 969*	
Other and Nominees	*7*	*7*	*11*									*2*	*2*	*2*	*2*	
Household Sector	*6*	*6*	*3*	*4*	*4*	*4*	*4*	*4*	*3*	*3*	*24*	*2*	*2*	*5*	*5*	
Non-Residents	*112*	*112*	*118*	*128*	*138*	*137*	*138*	*151*	*151*	*161*	*225*	*227*	*229*	*216*	*199*	
TOTAL PRIVATE SECTOR	**25 800**	**26 314**	**26 338**	**28 641**	**27 325**	**26 315**	**29 643**	**30 198**	**31 231**	**30 630**	**28 591**	**28 921**	**30 239**	**27 457**	**29 213**	
TOTAL PUBLIC AND PRIVATE	**45 072**	**45 837**	**43 394**	**48 078**	**46 634**	**43 470**	**47 100**	**51 431**	**52 407**	**51 640**	**50 429**	**53 493**	**54 668**	**56 467**	**61 320**	