MUNICIPAL BORROWING BULLETIN

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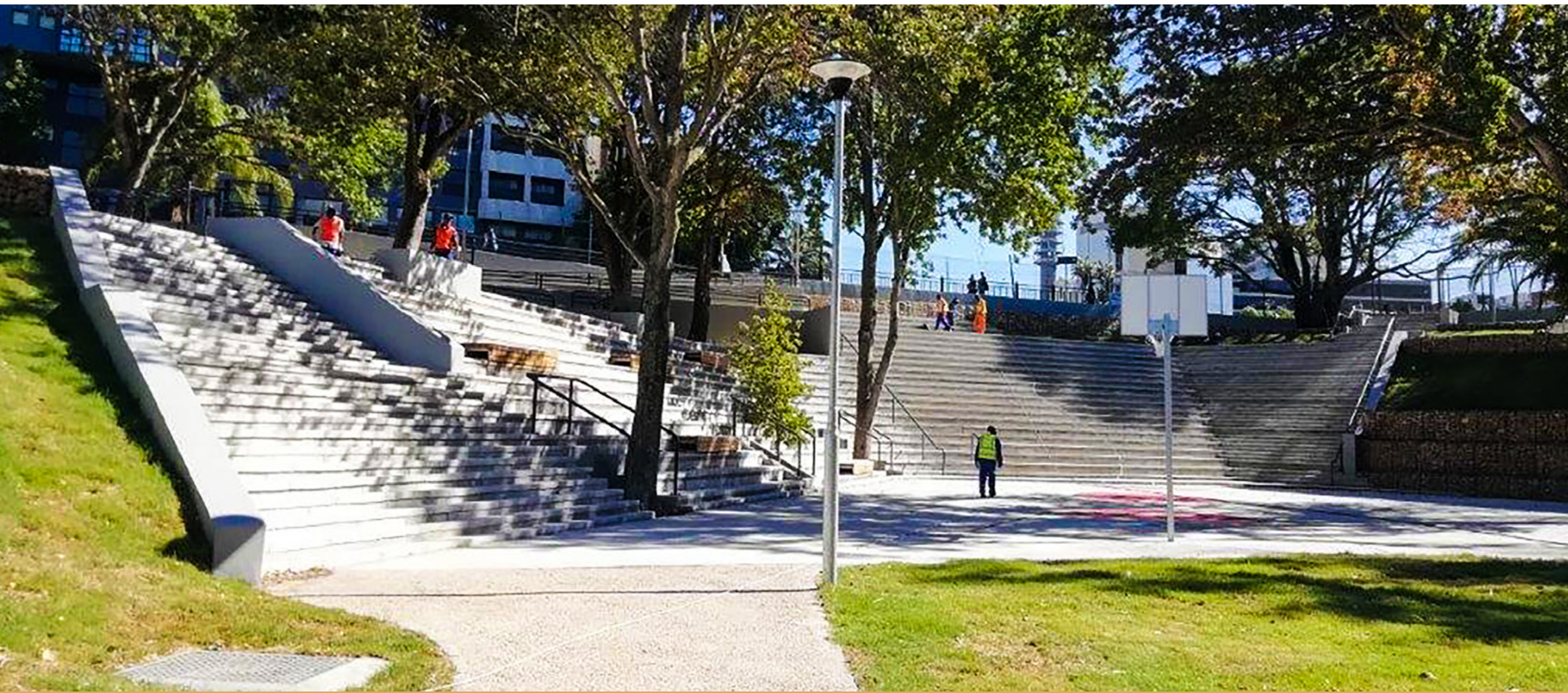
INSIDE
KEY HIGHLIGHTS
DATA ANALYSIS



CITY OF CAPE TOWN
Upgrading of Elizabeth Park

PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to advance transparency, responsibility, and the prudent and responsible utilization of municipal borrowing to finance infrastructure.

The MBB achieves this purpose by informing stakeholders and the public on developments in the municipal borrowing market. The MBB aims to add value to understanding developments and patterns in municipal borrowing and capital expenditure through information sharing, analysis, and exchanges relating to municipal borrowing.

CONTEXT

The MBB is issued by the National Treasury on a quarterly basis. This issue covers long term borrowing information up to 31 December 2018, corresponding to the second quarter of the 2018/19 municipal financial year.

Sources used for this MBB include data submitted by municipalities to National Treasury as required by Sections 71 and 74 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

- Municipalities have reported a balance of R62.8 billion in total outstanding long-term debt against a lender reported R61.9 billion. [1]There is a difference of R900 million between the borrowers' and the lenders' reporting.
- The actual spend on municipalities' capital budgets equals R20 billion, of which only R2.4 billion has been funded by new borrowing.
- Municipalities have invested about R454 billion on capital expenditure over the past ten years. R79.8 billion or 18 percent of this expenditure has been financed through long term debt.

[1] Note that data from 1 bank has not been updated for the past 2 quarters due to non-receipt of quarterly information. Therefore, the data has remained unchanged.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

- The total revenue of all secondary cities is slightly less than that of City of Johannesburg alone, at R52 billion and R53 billion respectively. [2] Their aggregate debt to revenue ratio is also less at 11 percent when compared to CoJ at 37 percent.
- Institutional investors hold the largest share of municipal bonds at 45 percent.

DATA AND ANALYSIS

1. Analysis of capital expenditure and long-term debt as reported by municipalities

Table 1: Capital expenditure, new borrowing and outstanding debt

R million	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2018/19
											Full year Forecast	Q2 Actual
Actual Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	54 411	58 756	73 411	19 960
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	8 099	8 750	16 196	2 405
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	17%	15%	15%	22%	12%
Outstanding debt	32 366	35 388	43 190	45 640	48 078	51 431	53 493	60 903	62 043	62 512	67 286	62 751

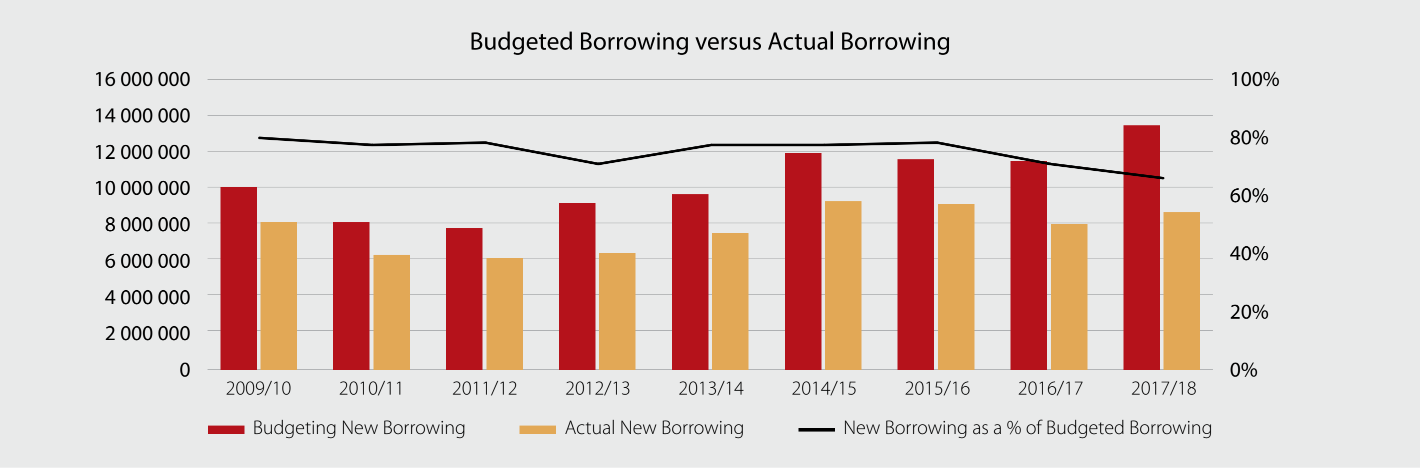
Source: National Treasury Database

Strategic infrastructure investments that follow sound investment planning are critical to sustaining economic growth and responding to service delivery requirements in the local government sphere. Municipalities are receiving a lot of support, especially the metros and secondary cities, from various capacity building programs aimed at ensuring that they can anticipate their investment needs, plan and prioritize them as well as ensuring that these are supported by sound long term financial strategies. A total of R454 billion for capital programmes has been spent by municipalities over the past 10 years, of which 18 percent was funded from borrowing; while 60 percent of the funding was from intergovernmental transfers over same the period. Internally generated funds and public contributions funded the remaining 22 percent.

For the second quarter, the actual spend on the aggregate capital budgets of municipalities stood at R20 billion or 27 percent of budgeted capital expenditure. Of this, R2.4 billion or 12 percent was funded through new borrowing.

Figure 1 below indicates the actual amounts borrowed against the budgeted borrowings in the past 9 years.

Figure 1: Budgeted Borrowing versus new Borrowing



Source: National Treasury Database

[2] CoJ was used as a benchmark as it has the largest revenue and the highest gearing ratio amongst all municipalities

As shown in the figure above, municipalities have not been able to take up borrowings as per the planned budget for the past nine years. When queried, municipalities have indicated the high cost of borrowing, change in priorities, increase in own revenue, inability to attract longer term tenors as some of the reasons for this low uptake. Overall, actual new borrowing as a percentage of budgeted borrowing has seen a decline over the past ten years from about 81 percent in 2009/10 to 64 percent in 2017/18. With an increase of 19 percent for budgeted borrowings in the current year when compared to the previous year, it remains to be seen whether municipalities will be able to improve on this trend, (note that only 15 percent has been borrowed against the current year's budget to date).

Municipalities have indicated that they are inclined to approaching the market at a time when market rates are more favourable hence they opt to using their own revenues until such time. The trends of borrowing suggest that, that time would be after the first half of the municipal financial year. However, it is difficult to infer some cyclicality in yields due to factors such as inflation, interest rate cycles, growth that affect yields, unlike for example; commodity prices. Therefore, the statement that the rates are cheaper at a particular period seems tenuous.

Table 2: Outstanding long term debt as at 31 December 2018

Municipal Category	Municipality	Total debt Q2 2018/19 R'000	Share of total debt	Forecast Revenue 2018/19* R'000	Debt to revenue ratio	Budgeted Borrowing 2018/19* R'000	Actual Borrowing Q2 2018/19* R'000	Population	Debt per Capita
A	BUF	372 569	1%	6 517 222	6%	69 000	-	781 026	498
	NMA	1 192 741	2%	10 363 386	12%	148 290	56 125	1 152 114	1048
	MAN	1 017 915	2%	6 304 424	16%	33 188	6 810	775 184	1369
	EKU	5 667 214	9%	35 317 657	16%	3 590 944	519 775	3 178 470	1839
	JHB	19 553 298	31%	53 046 409	37%	2 849 726	695 659	4 434 827	4483
	TSH	10 381 698	17%	32 530 207	32%	1 500 000	178 214	2 921 488	3638
	ETH	8 539 692	14%	35 175 463	24%	1 000 000	-	3 476 686	2552
	CPT	6 736 849	11%	39 735 877	17%	4 000 000	553 444	3 740 031	1807
	Total Metros	53 461 976	85%	218 990 645	24%	13 191 148	2 010 027	20 459 826	2671
B	B1 (19)	5 808 689	9%	52 038 248	11%	2 141 645	307 523	7 562 254	768
	Other Municipalities	2 830 546	5%	123 802 164	2%	26 977	24 596	28 499 820	106
C	Districts	649 566	1%	20 719 333	3%	835 897	62 753		
	Total all municipalities	62 750 777	100%	415 550 390	15%	16 195 667	2 404 899	56 521 900	1116

**excluding capital transfers*
Source: National Treasury Database, Stats SA, Municipal Money

As table 2 indicates, total outstanding long-term debt for all municipalities has decreased by R799 million to R62.75 billion between 31 September 2018 and 31 December 2018. The biggest declines are from the metros, with a reduced share of outstanding long-term municipal debt from 86 percent to 85 percent, while the smaller and rural municipalities have increased their consolidated share from 4 percent in the first quarter to 5 percent in the current quarter. The aggregate debt to revenue ratio for all municipalities remains unchanged at 15 percent.

Actual new borrowing stands at R2.4 billion so far in the fiscal year. Last year at this time, actual borrowing was R2.1 billion. However, given the sharp increase in planned borrowing this year, municipal borrowing to date is only 14.8 percent of budgeted amounts, whereas last year's borrowing constituted 22.9 percent of budgeted amounts.

Table 3: Outstanding long term debt per Secondary City as at 31 December 2018

Municipal Category	Municipality	Total debt Q2 2018/19 R'000	Share of total debt	Forecast Revenue 2018/19* R'000	Debt to revenue ratio	Budgeted Borrowing 2018/19* R'000	Actual Borrowing Q2 2018/19* R'000	Population	Debt per Capita
B1	MATJHABENG	-	0%	2 490 298	0%	-	-	407 019	-
	EMFULENI	13 906	0,2%	5 492 578	0%	-	-	721 663	19
	MOGALE CITY	343 577	6%	2 798 874	12%	-	-	362 420	948
	MSUNDUZI	512 023	9%	5 032 038	10%	42 041	18 290	621 792	823
	NEWCASTLE	404 488	7%	1 768 721	23%	-	-	363 237	1114
	UMHLATHUZE	456 664	8%	3 054 874	15%	310 000	93 700	362 778	1259
	POLOKWANE	526 303	9%	3 634 554	14%	830 000	-	628 632	837
	GOVAN MBEKI	3 667	0,1%	1 758 947	0%	-	-	294 538	12
	EMALAHLENI	76 671	1%	3 064 274	3%	-	-	395 466	194
	STEVE TSHWETE	174 863	3%	1 486 348	12%	153 224	41 801	229 831	761
	CITY OF MBOMBELA	252 344	4,3%	2 800 491	9%	-	-	658 605	383
	SOL PLAATJE	219 177	4%	2 056 107	11%	-	-	248 041	884
	MADIBENG	414 000	7%	1 790 000	23%	-	-	475 796	870
	RUSTENBURG	419 487	7%	4 779 287	9%	203 000	-	549 575	763
	CITY OF MATLOSANA	45 758	1%	2 720 640	2%	30 000	-	398 674	115
	J B MARKS	-	0%	1 512 772	0%	-	-	243 527	0
	DRAKENSTEIN	1 463 156	25%	2 249 326	65%	331 835	151 770	251 262	5823
	GEORGE	316 340	5%	1 918 574	16%	160 000	-	193 671	1633
	STELLENBOSCH	166 265	3%	1 629 546	10%	81 544	1 963	155 727	1068
	Total	5 808 689	100%	52 038 248	12%	2 141 645	307 523	7 562 254	768

**excluding capital transfers*
Source: National Treasury Database, Stats SA, Municipal Money

The 19 secondary cities[3] are potential borrowers that can play a fundamental role in our efforts to developing a deep and vibrant secondary market for municipal long-term debt as envisaged by the Policy Framework for Municipal Borrowing – 2017 Update.

Table 3 includes the current borrowing levels for all secondary cities in comparison to their current revenues and gearing ratio. For this period, total outstanding long-term debt for secondary cities is at R5.8 billion and this constitutes only 12 percent of their total revenue. In relation to gearing ratio norm of 45 percent, the secondary cities have, arguably, a combined remaining borrowing capacity bordering around R17 billion, assuming sound financial management practic-es. Amongst the secondary cities, Drakenstein is the largest borrower with an outstanding long-term debt balance of R1.46 billion, and a debt to revenue ratio of 65 percent. Although the gearing ratio of the municipality is above the norm of 45 percent as recommended by the National Treas-ury, the municipality's finances appear otherwise sound, and the municipality has not defaulted on any of its payments to the lenders. Polokwane and Msunduzi follow as the second and third largest borrowers, with long term debt balances of R526 million and R512 million respectively. Matjhabeng and J B Marks are the only secondary cities with no outstanding long term debt balances.

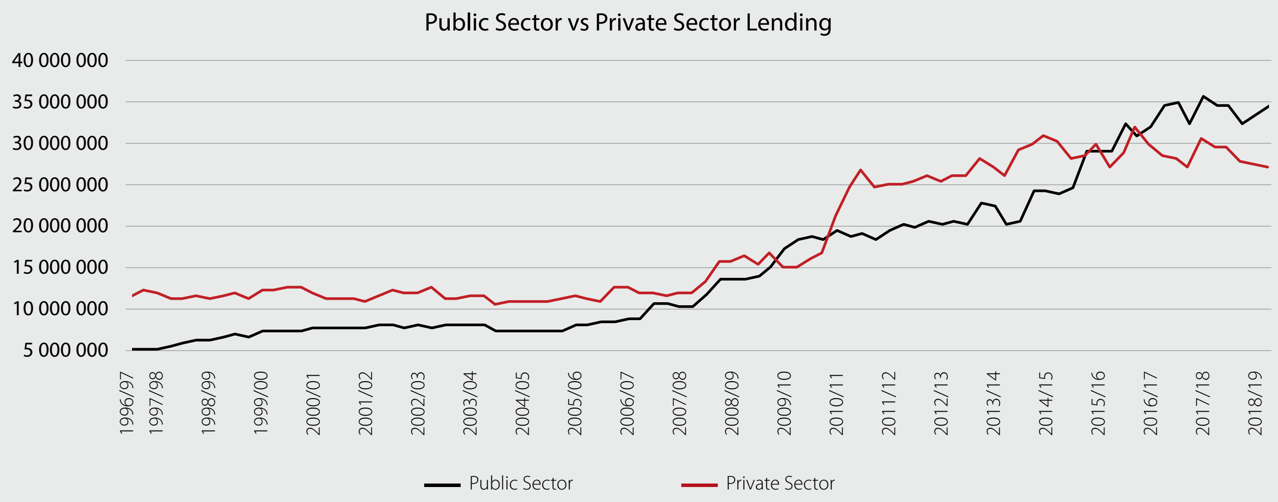
Emfuleni, although it boasts the widest revenue base amongst the secondary cities, carries the second lowest long-term debt balance. The municipality also has the biggest population to match the higher revenue but has one of the lowest debt per capita amongst the secondary cities, representing a missed opportunity by the secondary city to strategically leverage long term debt towards its infrastructure investment. However, this outcome is understandable given the operational and financial challenges the municipality is currently experiencing. Also, the municipality would possibly not be experiencing these problems had they used their borrowing capacity wisely.

The secondary cities have a combined revenue of R52 billion, which is slightly less than the revenue of the City of Johannesburg alone.[4] The revenue levels of Emfuleni and Msunduzi are almost comparable to those of Buffalo City and Mangaung metros[5]. The secondary cities have collectively budgeted for a total R2.1 billon of new borrowing for the 2018/19 financial year and have borrowed about R307 million (15 percent) of that amount so far in the 2018/19 financial year. 50 percent of this borrowing is attributable to Drakenstein municipality alone.

[3] Now sometimes referred to as **Integrated Cities Municipalities (ICMs)**: Note that all these municipalities are included in the new list of 39 ICMs.
[4] The secondary cities are compared to the City of Johannesburg because it has the highest revenue when compared to the rest of the municipalities
[5] See tables 2 and 3

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

Figure 2: Public and private sector lending to municipalities

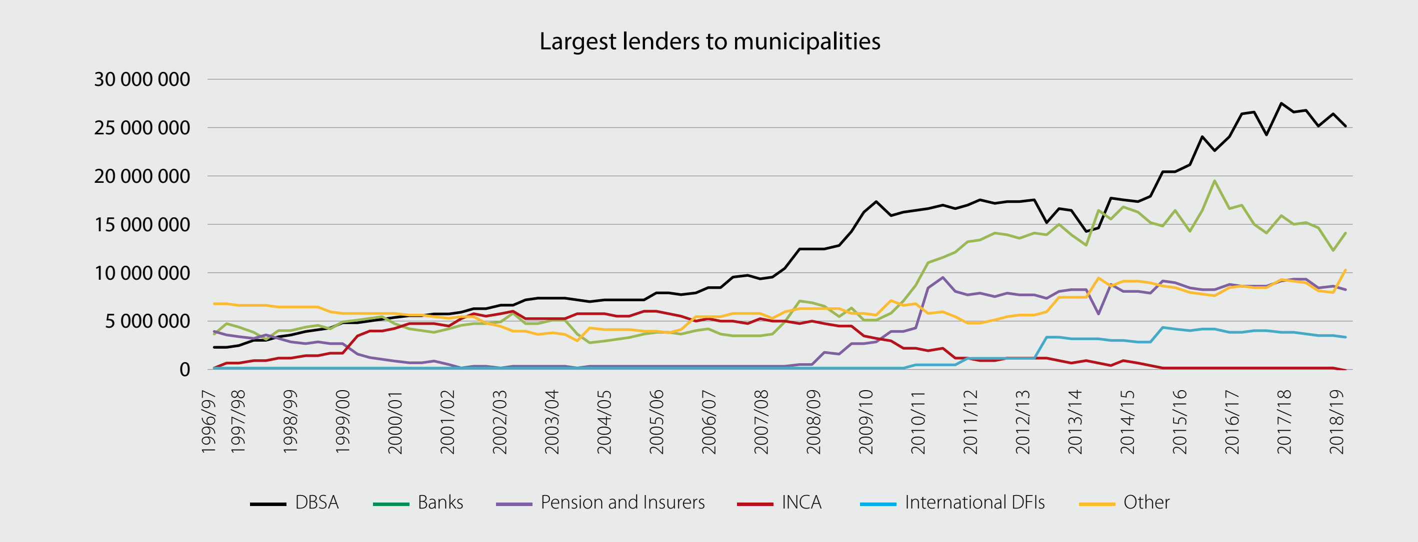


**Incl QII*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

While public sector lending to municipalities, that is lending by the DBSA and other Development Finance Institutions (DFIs), can be useful in the right circumstances, the Policy Framework for Municipal Borrowing – 2017 Update requires that DFI lending to municipalities must be guided by clearly defined developmental objectives and indicators, which have been previously agreed with National Treasury. The immediate developmental needs where public sector lending can play an important role include: financing basic infrastructure and services in rural areas; supporting the development of long term financial strategies in municipalities of any size; extending the tenor of borrowing for municipal infrastructure beyond 20 years, to better match the useful life of the assets being financed; and supporting the development of the municipal bond market.

Ideally, lending to creditworthy and well-run municipalities, especially the metros, should be left to the private sector as this will not only augment the available pool of public funds but will also support fiscal discipline. Increased private sector investment in municipal bonds is central to the development of a deep and vibrant secondary market, with appropriate risk-related pricing. However, as can be seen from figure 1 above, the situation is not evolving as envisaged by our policy framework for municipal borrowing. Instead, public sector lending continues to grow faster than the private sector, and as at mid-year 2018/19, the public sector accounts for 55 percent of total outstanding municipal long-term debt, a slight increase from 54 percent in the first quarter. There is a corresponding drop in private sector holdings of municipal debt. The National Treasury is committed to engaging with relevant stakeholders to ensure that there are deliberate and coordinated efforts towards achieving the objectives of the Policy Framework for Municipal Borrowing – 2017 Update.

Figure 3: Largest lenders lending to municipalities



**Incl. QII of 2018/19*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Institutional investors such as pension funds and insurers generally have longer term mandates which make them ideal investors for municipal securities with longer tenors. Although these institutions' investment in municipal debt rose sharply between the years 2008/09 and 2011/12, it has since levelled off, understandably owing to the limited number of municipal bonds in the market. Their investment in municipal debt has solely been in municipal bonds and as at the end of the second quarter of FY2018/19, their share of municipal bonds stands at R8.3 billion, which makes them the holders of the majority of municipal debt securities totalling R18.4 billion. From this and the engagements that the National Treasury continues to hold with similar investors, it is understood that there is appetite in the market for high quality municipal bonds. However, the reluctance of municipalities to issue municipal bonds continues to limit the participation of these investors.

Commercial banks tend to prefer municipal loans to municipal bonds, and collectively hold municipal debt securities of only R2.2 billion. Their overall share of total municipal long-term debt is down by 4 percent to R8.3 billion between the first and second quarter. The remaining 42 percent of municipal bonds is held by investors such as households, the DBSA, non-residents and other financial institutions.

DISCUSSION

MUNICIPAL LONG TERM FINANCING PLANS (LTFPs)

1. Municipal infrastructure is key to service delivery by municipalities. However, the physical construction of infrastructure has been hindered by various challenges, including lack of proper investment planning and appropriate funding mechanisms. In most instances, funding has not been secured for the full implementation of infrastructure projects which are often multiyear in nature. In some instances, projects have been found to be packaged in a manner that is not appealing to leverage private sector investment.

2. In 2016 National Treasury partnered with the Infrastructure Investment Programme for South Africa (IIPSA) and the World Bank to support several municipalities to develop and fast-track long-term infrastructure planning. This support helps the municipalities develop a Long Term Financial Plan (LTFP). The work includes identifying bankable projects for preparation and implementation. The idea is to assist municipalities in identifying sources of investment capital that the municipality can mobilise, to achieve its infrastructure goals without negatively impacting the municipality's long term financial sustainability. Long term financial planning entails considering various financing strategies, policies and levels of investments that will maximise the probability of the municipality's financial sustainability into the future and help it to respond to the demands of its integrated development plan and remain resilient in a changing environment. This is achieved by forecasting future revenues, affordable expenditure levels and cash flows based on the municipality's historic performance and an assessment of the expected future environment.

3. The outcome of this planning is packaged into an LTFP that provides guidance and recommendations on: policy and strategy interventions to be considered by the Council; capital investment affordability and implementing capacity; guidance on funding sources to be accessed; and assistance in creating a cash backed asset management reserve. As part of the LTFP, focus is placed on ensuring that the municipality achieves short-term turn-around (if needed); and medium-term and long-term financial viability.

4. Some municipalities, particularly metros, have developed long term financial policies and models, but these may not be well

integrated with their development strategies and plans, may not be based on cash flow analysis and expenditure plans, and may not have considered alternative financial scenarios and outcomes in relation to the ability to borrow and the structuring of transactions. Also, these strategies are often not aligned with other strategic documents like the Spatial Development Framework (SDF) or Built Environment Performance Plans (BEPP). The targeted outcome of this new generation of long term plans is to create a more sustainable and integrated infrastructure development program that is informed by the spatial framework and financed in the most effective and efficient manner over the longer term.

5. The pilot metros for LTFP support were Nelson Mandela Bay, City of Tshwane and eThekwini; and pilot secondary cities municipalities Midvaal, Steve Tshwete, Sol Plaatje, KwaDukuza, uMhlathuze and Polokwane. The work in these cities has since been completed and the second phase of the programmes is currently being implemented in another ten cities.