MUNICIPAL BORROWING BULLETIN

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CITY OF CAPE TOWN
Sagaloda Smart Park Philippi

PURPOSE

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

The MBB achieves this purpose by informing 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 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 March 2019, corresponding to the third 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 reported the aggregate total outstanding long-term debt of R62.0 billion against a lender-reported R60 billion, indicating a R2 billion difference.[1]
- Municipalities' aggregated borrowing budgets were adjusted downwards from R16.1 billion to R12.3 billion.
- Municipalities have only incurred borrowing of R3.5 billion or 29 percent of their adjusted borrowing budgets of R12.3 billion as at the end of March 2019.
- Outstanding long-term borrowing by metros amounts to R53.1 billion, or 86 percent of total municipal borrowing, as of 31 March 2019.

[1] Note that verification of borrowing data is on-going and findings are being sent to the lenders for validation.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

DATA AND ANALYSIS

1. Municipal borrowing budgets

Table 1: Budgeted borrowings

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19 3rd Quarter
Original Budget	9 631 795	9 728 855	12 038 295	12 155 568	12 015 730	13 327 264	16 195 667
Adjusted Budget	9 273 438	9 747 836	12 033 281	11 674 332	11 602 644	13 572 036	12 320 906
Actuals	6 490 000	7 583 000	9 357 000	9 222 000	8 099 900	8 749 729	3 529 002
	70%	**78%**	**78%**	**79%**	**70%**	**64%**	**29%**

Source: National Treasury Database

As of 31 March 2019, municipalities' aggregated borrowing budgets amounted to R12.3 billion indicating a downward adjustment of R3.8 billion or 24 percent from the original budgeted amount of R16.1 billion. This adjusted budget for borrowing is R1.2 billion lower than the previous financial year's adjusted budget. Actual borrowing so far this fiscal year amounted to only R3.5 billion or 29 percent of the adjusted budget, which is less than R4.7 billion in the same period of the previous financial year.

Analysis of long term debt as reported by municipalities

During the quarter under review, a total of 217 municipalities out of 257 municipalities have reported their borrowings. Of these, 100 municipalities reported that they have outstanding long term debt, while 117 municipalities reported that they have no outstanding long term debt. 40 municipalities have not yet submitted borrowing reports for the third quarter of FY2018/19.

Table 2: 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	Full Year	2018/19
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Fore-cast	3rd Quarter
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	54 411	58 756	73 218	30 093
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	8 099	8 750	12 321	3 529
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	62 093

Source: National Treasury Database

Table 2 above indicates capital expenditure, actual new borrowing and the total outstanding debt for the period ended 31 March 2019. Municipalities adjusted their capital budgets downwards for the current financial year from R73.4 billion to R73.2 billion, and the portion to be financed from borrowing has also dropped to 17 percent. Spending on the capital budgets stood at R30.1 billion or 41.1 percent of the R73.2 million adjusted budgets indicating a decline when compared to 42.9 percent in the same quarter of the 2017/18 financial year. Actual new borrowing for the period amounted to R3.5 billion or 12 percent of the actual capital expenditure.

Table 3: Outstanding long term debt as at 31 March 2019

Municipal Category	Municipality	Total debt Q3 2018/19 R'000	Share of total debt	Actual Revenue 2018/19* R'000	Debt to revenue ratio
A	BUF	363 238	1%	6 550 819	6%
	NMA	1 167 934	2%	10 361 367	11%
	MAN	1 014 911	2%	6 617 549	15%
	EKU	5 594 702	9%	36 205 712	15%
	JHB	19 525 637	31%	52 214 845	37%
	TSH	10 279 973	17%	32 991 191	31%
	ETH	8 482 199	14%	35 366 557	24%
	CPT	6 705 579	11%	40 530 966	17%
	Total Metros	**53 134 173**	**86%**	**220 839 006**	**24%**
B	B1 (19)	5 457 517	9%	51 462 786	11%
	Other Municipalities	2 846 169	5%	123 342 541	2%
C	Districts	655 417	1%	21 461 171	3%
	Total all municipalities	**62 093 276**		**417 105 504**	**15%**

**excluding capital transfers*
Source: National Treasury Database

Table 3 above demonstrates the amount of outstanding long-term debt reported by municipalities as of end March 2019. Municipalities reported an aggregate long-term debt of R62.0 billion. Of this amount, the metropolitan municipalities accounted for a total of R53.1 billion, or 80 percent, indicating a decrease by 1 percentage point compared to the same period of FY2017/18. Secondary cities owe a combined total of R5.4 billion of outstanding long-term debt while the remaining R3.5 billion was owed by the category "other municipalities" and district municipalities. Outstanding debt for secondary cities has also decreased in comparison to the third quarter of the previous financial year and now constitutes 9 percent of total municipal long-term debt. While it has remained the same for the district municipalities, the amount owed by other municipalities has increased from 3 percent to 5 percent of aggregate long-term municipal liabilities.

As a direct consequence of overall decline in outstanding long-term debt for municipalities, the average debt to revenue ratio for all municipalities is has dropped to 15 percent from 19 percent in FY2017/18. The city of Johannesburg has consistently maintained a slightly higher gearing ratio than other metro municipalities and to date, the city's total long-term debt equates to 37 percent of its annual revenue. As a possible outcome of the city's borrowing strategy, this ratio has decreased from 45 percent noted in previous quarters. City of Cape Town, eThekwini and Tshwane; on the other hand, have always remained below 40 percent.

2. Analysis of long term debt as reported by lenders

In Figure 1 below, the outstanding long-term debt of R60 billion amounts to R17.7 billion in 1997 as depicted by the red line. Although the nominal amount has increased since 1996/7, the outstanding long-term debt after adjusting for inflation is almost the same as what it was 22 years ago.

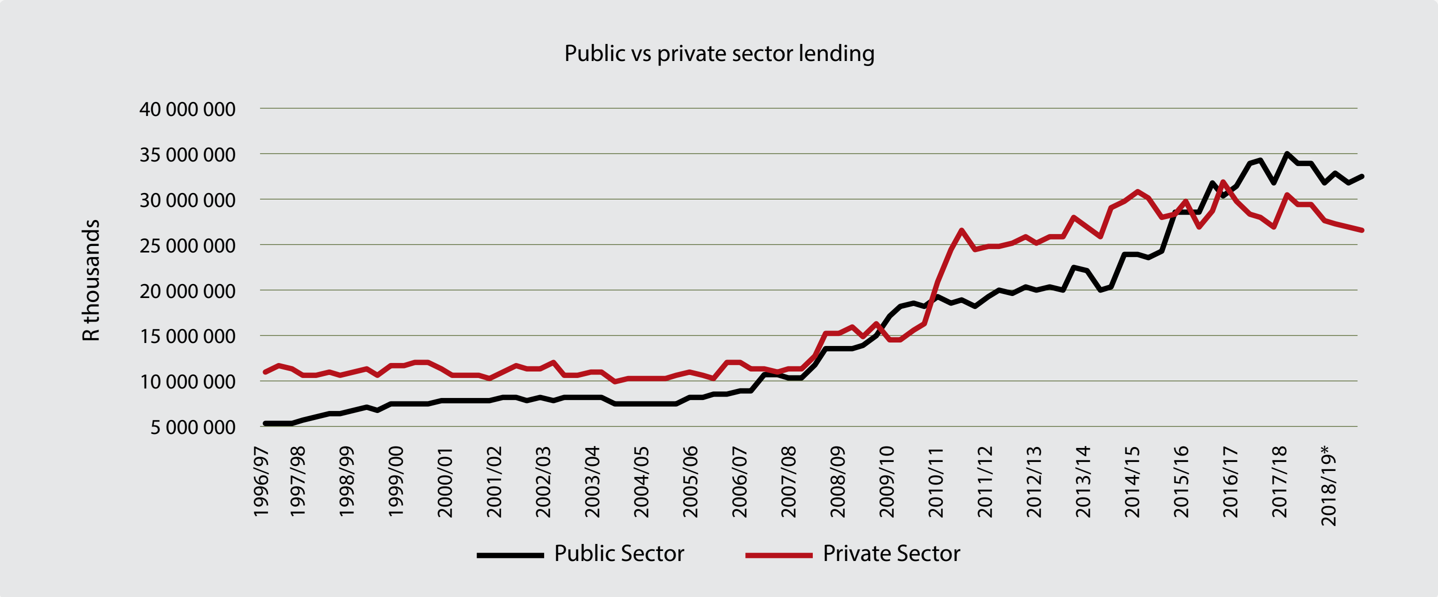
Figure 1: Growth in long term municipal borrowing

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

Appropriately structured borrowing, i.e. longer tenor (or as per the lifespan of the required asset) and fixed interest can enable reduced payments overtime and will allow the repayment of borrowing to be more manageable.

3. Holders of municipal loans and bonds

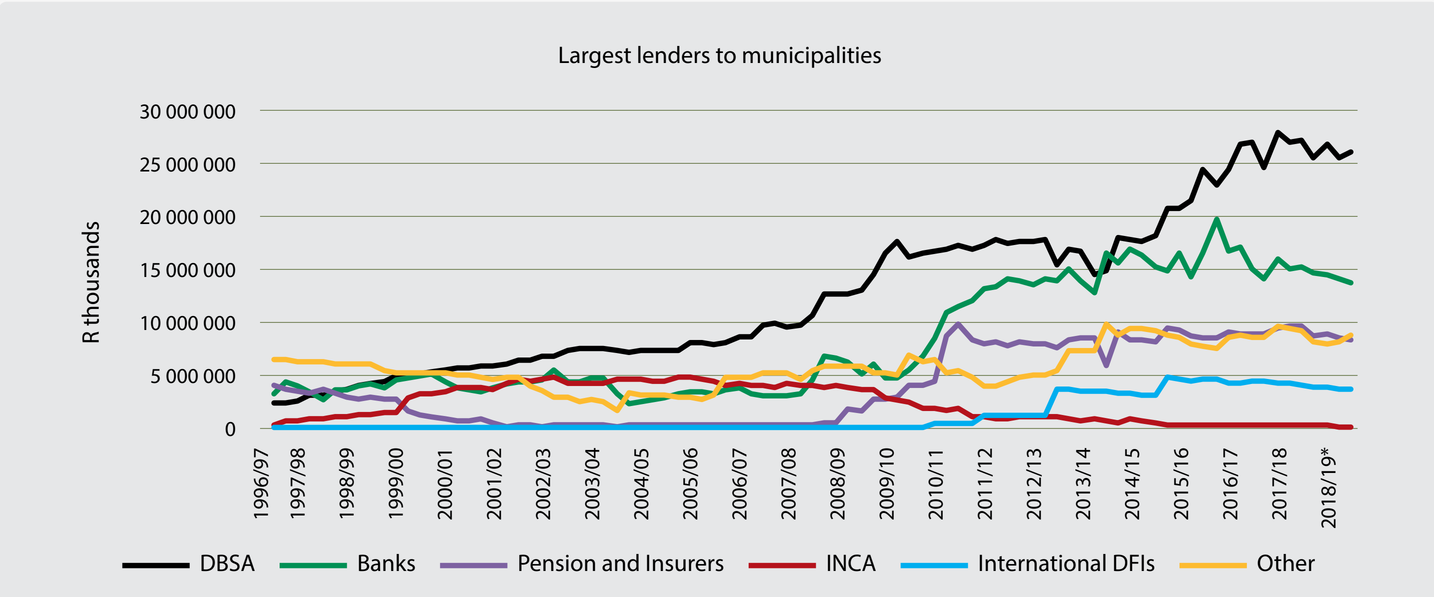
Figure 2: Public and private sector lending to municipalities



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

South Africa has a financial system that is in many ways comparable to first world countries, with a sophisticated investor base that comprises of both private sector and public sector investors. The existence of both types of investors is crucial in the country as it ensures that well run municipalities can benefit from the availability of a wider pool of private sector financing that is competitively priced, while the poor municipalities can potentially benefit from the developmental role that will ideally be played by public sector lenders in terms of financial management capacity building and availability of debt financing that will otherwise not be available from the private sector. Ideally, the actions of the public sector lenders should not hinder but accelerate progress towards more private sector based financing for municipalities. However, the trend between 31 March 2018 and 31 March 2019 shows a 2 percentage point decline in private sector lending relative to public sector lending which has risen by the same percentage points. The proportional ownership of long-term debt by the public and private sectors to date is 55 percent and 45 percent respectively.

Figure 3: Largest lenders to municipalities



The amount owed by municipalities to the DBSA has declined by R1.1 billion over the period between March 2018 and March 2019. Currently, the DBSA is owed R26 billion by these municipalities which translates to 43 percent of total municipal debt. Conversely, commercial banks are owed R13.8 billion by the municipalities. This indicates a decrease of R1.3 billion when benchmarked against the same period of FY2017/18. An amount of R104 million is still outstanding for INCA which no longer lends to municipalities.

DISCUSSION

4. Municipal Own Revenue – Municipal Surcharges

Municipalities have significant own revenue sources at their disposal which they leverage through borrowing. However, there are some revenue sources that have not traditionally been leveraged due to challenges arising from legislation and implementation. One such revenue source is municipal surcharges on fees for services provided by or on behalf of a municipality. Historically, many municipalities have generated a surplus from trading services (especially electricity). Anecdotal evidence indicates that surcharges significantly contributed to these surpluses. The rapid increases in bulk tariffs have, however, squeezed these surpluses.

Given their fiscal constraints, there have been indications that some municipalities are considering surcharges on customers that are directly supplied by Eskom. This possibility has received significant resistance from concerned customers. Various stakeholders contend that the process that has be followed by municipalities to impose municipal surcharges is not clear.

Municipalities derive their power to levy surcharges from Section 229 of the Constitution, which provides that municipalities may impose a property tax and surcharges on fees for municipal services, subject to national regulation. The Municipal Fiscal Powers and Functions Act (MFPFA) and Local Government: Municipal Systems Act (MSA) give effect to section 229 of the Constitution. Section 8 of the MFPFA gives power to the Minister of Finance to prescribe compulsory national norms and standards for imposing "municipal surcharges". Municipal surcharges are defined as: "a charge in excess of the municipal base tariff that a municipality may impose on fees for a municipal service provided by or on behalf of a municipality, in terms of section 229(1)(a) of the Constitution;".

Section 75A of the MSA empowers municipalities to "levy and recover fees, charges or tariffs in respect of any function or service of the municipality". Municipalities must also adopt and implement a tariff policy on the levying of fees for municipal services in terms of section 74 of the MSA. The tariff policy should then guide the how the power given under section 75A should be applied. In subsection 74(2), the

MSA provides that the tariff policy must reflect certain principles, and expressly provides that provision may be made in appropriate circumstances for a surcharge on the tariff for a service." Section 9 of the MFPFA requires a municipality to comply with processes in section 75A (2), (3) and (4) of the Systems Act in levying a surcharge.

To summarise, the Minister of Finance may determine the norms and standards that municipalities must comply with when applying their powers in terms of section 75A of the Systems Act. Approval for surcharges is done by the municipality in terms of section 75A of the Systems Act but subject to the norms and standards prescribed by the Minister of Finance in terms of the MFPFA.

To date the Minister of Finance has not prescribed such norms and standards (The power to prescribe is discretionary). The absence of norms and standards does not prevent municipalities from including surcharges in their tariffs as the power to impose a surcharge is given in the Municipal Systems Act. And, if a municipality decide to levy a surcharge, an approval is done by the municipal council in terms of a tariff policy, pursuant to section 75A of the MSA.

When a municipality determines a tariff, it can include a surcharge. A municipality can determine the municipal base tariff and a surcharge and collectively the sum of the two becomes the tariff for that service. It must be subjected to the prescribed budget processes (as it is part of the tariff which must form part of the municipal budget) in terms of the MFMA. In the case of electricity, the tariff (which includes base tariff and a surcharge) as determined by a municipality will be submitted to NERSA for approval in terms of the Electricity Regulation Act, 2006 which provides that the National Electricity Regulator of South Africa (NERSA) must regulate prices and tariffs (i.e. NERSA approves the upper limits by which electricity may be increased).

Municipalities are prohibited from increasing electricity tariffs by a percentage which is higher than the upper limit determined or approved by the Regulator (NERSA). However, NERSA may approve a deviation in prescribed circumstances.

Update on Development Charges

The seventh Municipal Borrowing Bulletin, dated December 2017, indicated that the Municipal Fiscal Powers and Functions Act is being amended to regulate the levying of development charges. The proposed Amendment Bill will be published for public comments between October and December 2019.