MUNICIPAL BORROWING BULLETIN

ISSUE 15
December 2019
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PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to advance transparency, the 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 content 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 30 September 2019, corresponding to the first quarter of the 2019/20 municipal financial year.

Data used for this MBB include 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

- Lenders reported a total of R67.9 billion in outstanding long-term borrowing of municipalities, while R70.6 was reported by municipalities. The figures reported by municipalities are probably less reliable because of data issues related to the ongoing transition to mSCOA (the municipal Standard Chart of Accounts).
- New borrowing incurred so far in the current year was reported at R1.2 billion.
- The city of Ekurhuleni intends to raise about R3 billion through bond issuance.
- Capital expenditure by municipalities remains below budget projections.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

DATA AND ANALYSIS

1. Municipal borrowing budgets

The previous bulletin highlighted the importance of good financial management and the need to generate consistent operating cash surpluses before a municipality can undertake long-term borrowing. National Treasury is committed to ensuring that the spending habits of municipalities are sustainable by encouraging them to pass funded and balanced budgets. This is emphasised in the National Treasury's annual municipal budget benchmark engagements. If a municipal budget is unfunded, it is not a credible budget – either the revenue projections are unrealistic, the operating expenditures are too high, or the capital budget is too ambitious. A funded budget is foundational to good financial management. National Treasury can and does use its powers, such as withholding of funds to municipalities (MFMA section 38), to encourage them to adopt budgets that are funded and therefore sustainable.

At the start of the 2019/20 financial year, a total of 127 municipalities adopted unfunded budgets. As a result of National Treasury's withholding of funds to these municipalities, 61 of these municipalities subsequently adopted funded budgets, while the rest carried on with unfunded budgets.

Table 1: Budgeted borrowings

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Original Budget	9 631 795	9 728 855	12 038 295	12 155 568	12 015 730	13 327 264	16 195 667	17 620 931
Adjusted Budget	9 273 438	9 747 836	12 033 281	11 674 332	11 602 644	13 572 036	12 241 682	-
Actuals	6 490 000	7 583 000	9 357 000	9 222 000	8 099 900	8 749 729	8 004 007	1 264 823
	70%	78%	78%	79%	70%	64%	65%	7%

Source: National Treasury Database

Municipalities have adopted aggressive capital borrowing budgets for the 2019/20 financial year. New borrowings of R17.6 billion are planned for the current year, compared to R16.2 billion initially budgeted for the 2018/19 financial year. Actual new long-term borrowing in 2019/20 was only R1.2 billion, which equates to just 7 percent of the planned amount.

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	2018/19	2019/20
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Budget
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	54 411	58 756	55 417	70 126
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	8 099	8 750	8 004	1 265
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	17%	15%	15%	14%	2%
Outstanding debt	32 366	35 388	43 190	45 640	48 078	51 431	53 493	60 903	62 043	62 512	70 627	63 549

Source: National Treasury Database

Capital expenditure for all municipalities is budgeted at R70.1 billion for the 2019/20 financial year. This is despite the fact that actual expenditure for the previous financial year was only R55 billion, against adjusted budgets aggregating to R73.5 billion. Total capital expenditure by municipalities has been hovering around R50 billion annually for 5 years. Reliable data about actual expenditure so far in the financial year could not be obtained because of issues with the data submitted to the local government database by municipalities. New borrowing has funded only 2 percent of the capital budget so far.

Under-expenditure on the capital budget has been a common feature of most municipalities' performance over the last decade and beyond. Municipalities consistently fail to fully implement their capital programs for any given financial year. National Treasury's local government records show that aggregate municipal performance against capital budgets has averaged about 78 percent for the past ten years. The highest recorded aggregate performance on the municipal capital budget for the 10-year period has been 82.3 percent, achieved during the 2017/18 financial year. There has not been significant improvement in the implementation of capital budgets over the years. The execution rate for municipal capital programs for 2018/19 dropped to 75 percent, revealing increasing challenges with the delivery of infrastructure projects by municipalities. The last time a lower execution rate was recorded was in the 2011/12 financial year, at 72 percent.

To support effective infrastructure delivery, National Treasury issued a Standard for Infrastructure Procurement and Delivery Management (SIPDM) in 2015. This standard sought to provide a framework for the planning, design and execution of infrastructure projects and infrastructure procurement by all organs of state subject to the PFMA and the MFMA, effectively separating supply chain management requirements for general goods and services from those for infrastructure. However, this has not yielded the desired outcomes and instead, has presented implementation challenges.

The issue with business forums (construction mafia) has, in recent years, been wide spreading across the country and is quickly becoming an endemic that is causing disruptions on major government projects. Government needs to take a coherent approach and swiftly deal with this decisively. Other challenges affecting the delivery of infrastructure projects include capacity problems, supply chain management issues and inadequate funding for planning and designs. To address these, government is looking at reforming the existing infrastructure grants for the metros to include dedicated funding to support proper project preparation and management practices which will be conditional on metros establishing their own project preparation capacity and their own infrastructure delivery management systems.

Table 3: Outstanding long term debt as at 30 September 2019

Municipal Category	Municipality	Total debt Q1 2019/20 R'000	Share of total debt	Budgeted Revenue 2019/20* R'000	Debt to revenue ratio
A	BUF	335 902	0,5%	7 143 008	5%
	NMA	1 116 770	2%	20 662 256	5%
	MAN	964 918	1%	6 949 638	14%
	EKU	8 424 300	12%	38 807 515	22%
	JHB	21 982 548	31%	57 485 417	38%
	TSH	11 424 047	16%	41 055 011	28%
	ETH	9 053 685	13%	39 277 508	23%
	CPT	6 611 325	9%	41 208 458	16%
	Total Metros	**59 913 495**	**85%**	**252 588 811**	**24%**
B	**B1 (19)**	6 267 498	9%	55 811 212	11%
	Other Municipalities	3 807 190	5%	78 091 912	5%
C	**Districts**	657 594	1%	23 187 721	3%
	Total all municipalities	**70 645 777**		**409 679 656**	**17%**

**excluding capital transfers*

Source: National Treasury Database

Table 3 above shows that the metros' share of outstanding long-term municipal debt has fallen by R652 million since the end of the 2018/19 financial year while the share for secondary cities has remained constant during the same period. The City of Cape Town's share of long-term municipal debt has shrunk by R129 million while that of eThekwini metro fell by R218 million. The aggregate revenue forecast for the "other municipalities" category makes up about 19 percent of total municipal revenues while they account for only 5 percent of long-term municipal debt.

The overall debt to revenue ratio for all municipalities has not changed since the fourth quarter of FY2018/19. Notably; the ratio for the City of Johannesburg has increased from 31 percent to 38 percent between the first quarter of the previous financial year and now.

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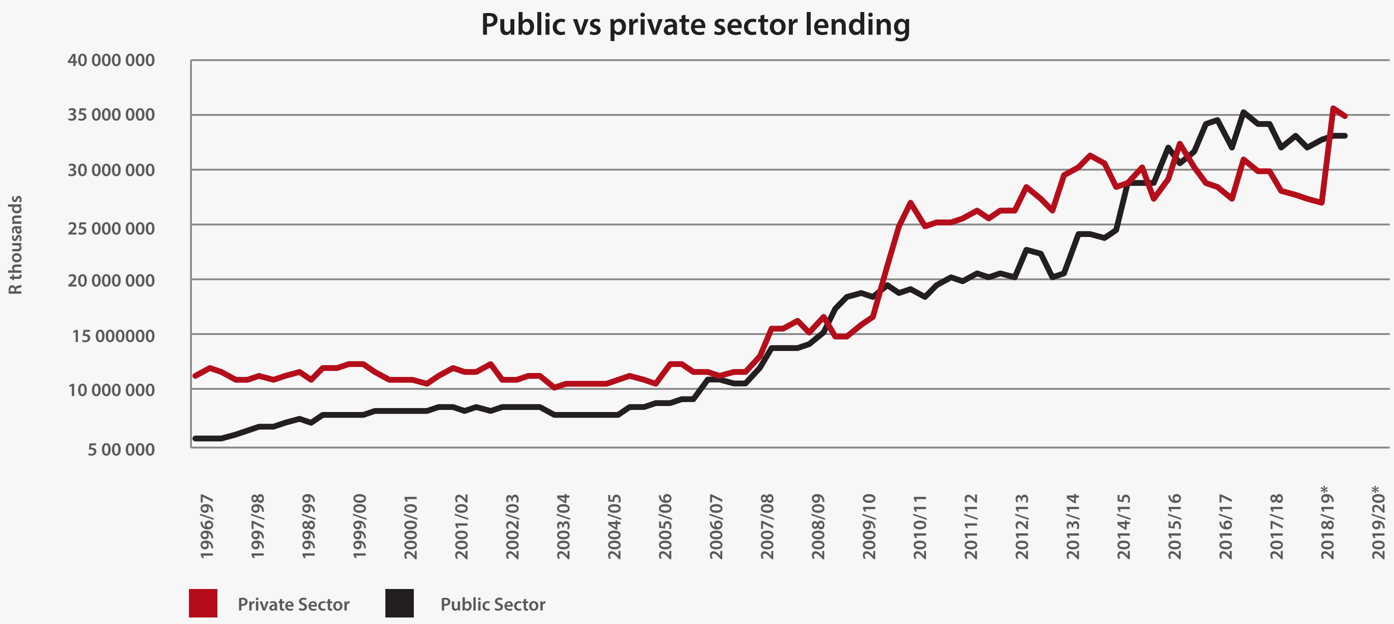
3. Analysis of long term debt as reported by municipalities

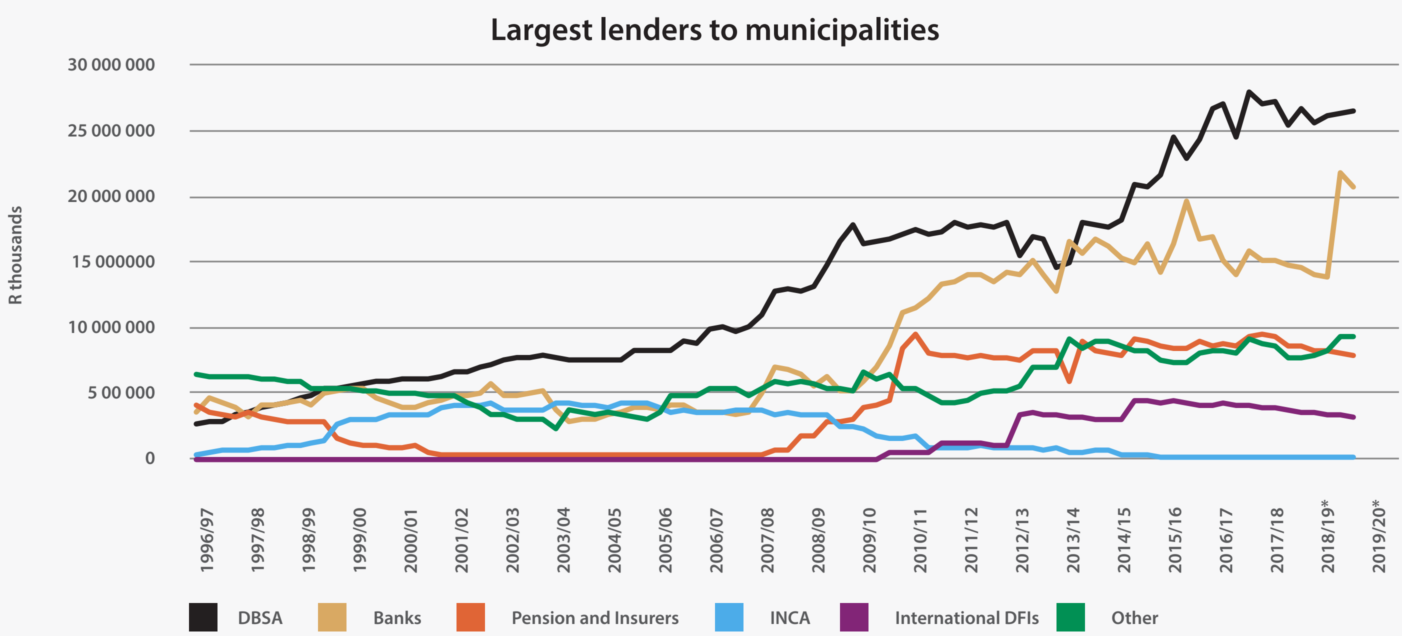
Figure 1: Public and private sector lending to municipalities



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

There has not been much change in the distribution of municipal long-term borrowing between private and public sector lenders at the time of reporting. The private sector still holds a slim lead, at R34.8 billion against R33 billion for public sector lenders. The private sector's investment is down by R916 million from the start of the current financial year while a R216 million decline was recorded for the public sector. The city of Ekurhuleni intends to issue about R3 billion in new bonds by the end of the financial year. This will help increase the volume of municipal bonds in the municipal debt market.

Figure 2: Largest lenders to municipalities



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

The conclusion of the first quarter of the 2019/20 financial year saw the DBSA slightly increase its municipal debt book by R97.6 million to close at R26.5 billion, up from R26.4 billion at the beginning of the quarter. Over the twelve-month period from 30 September 2018 to 30 September 2019 there was an overall decline of R200 million in municipal long-term debt owed to the DBSA. Over the same period, commercial banks showed a decrease of just over R1-billion. Municipal debt held by pension funds and insurers is down by R137 million since the start of the 2019/20 fiscal year. On the other hand; international DFIs are now owed R3.2 billion, down from R3.3 billion at the beginning of the 12-month period.

TOPICAL ISSUES

Comparing municipal borrowing in India and South Africa

It is widely accepted that municipal borrowing is an important tool to help finance local infrastructure. Like South Africa, India has been making attempts to encourage municipal borrowing for capital investment. The narrative below offers few notes comparing the two countries' experiences.

India is home to over 1.3 billion people, more than 20 times the population of South Africa. India has a much lower per capita GDP than South Africa, with only US $2,016 per capita, compared to South Africa's per capita GDP of US $6,374. India is a federal country in which the powers of local government depend entirely on state laws. By contrast, although South Africa is decentralized in many ways, it is considered a unitary country and the powers and functions of municipalities depend on the Constitution and national legislation. India has over 4,000 "urban local bodies" (ULBs) that might theoretically issue bonds as well as a large number of state-created development authorities, water and sewerage boards and other entities responsible for investment in urban infrastructure. By contrast, South Africa has only 257 municipalities.

In general, Indian municipalities have fewer responsibilities and fewer revenue sources, compared to South African municipalities. This affects both their need for investment capital and their ability to service debt. In 1993, the 74th Amendment to the Indian Constitution recognized ULBs as a third tier of government and provided that a state legislature may devolve to ULBs the responsibility for specified matters but it left actual devolution to the states, and few states have devolved significant financial powers to ULBs.

Property taxes: In India, as in South Africa and many other countries, property taxes are the backbone of local government financial sustainability because they are an unconditional revenue source which can be used for any legitimate local government purpose. They are therefore especially important in considering a municipality's ability to sustain itself financially and successfully issue long term municipal debt. Property taxes account for 60 percent of local government taxes in India and virtually 100% of local taxes in South Africa.

User charges can also support municipal borrowing to finance infrastructure, provided that they generate an operating surplus, i.e. more than enough revenue to cover the annual expenditures associated with services such as water and electricity. In South Africa, some municipalities are able to generate an operating surplus, while essentially none are able to do so in India.

Intergovernmental transfers: India's intergovernmental fiscal architecture relies on Finance Commissions to make recommendations, every five years, for transfers to municipalities. The amount provided for municipalities has been rising steadily for decades, from a low base. By contrast, South Africa has more substantial and predictable transfers to local government, with a constitutionally mandated "equitable share" of national revenues that is transferred to local government. Smaller and rural municipalities, who have less own-source revenue potential, receive more equitable share funding per capita than large urban municipalities.

Amount of long term borrowing for infrastructure: Municipal borrowing takes place in the context of larger financial markets. Let's consider some benchmarks:

- In India, the total of outstanding municipal bonds is only about US $200 million out of an estimated $1.7 trillion overall bond market. Indian municipal bond debt comes to only about US $0.15 per capita. We don't have a good handle on direct loans to Indian municipalities.
- In South Africa, outstanding municipal bonds are at US $1.3 billion out of an overall bond market of approximately US $234 billion. Borrowing in the form of bonds has been losing ground to direct lending and long-term loans to municipalities are now at around US $3.62 billion. Municipal bond debt stands at about US $22 per capita while municipal loans are at about $62 per capita.
- For comparison, in the US, the total debt market is now around $75 trillion. State and local government bonds account for just over $3 trillion or 4% of this amount. This comes to some $9,000 dollars of municipal debt per capita.

The US level of municipal debt per capita is about 14.65% of US GDP per capita. By contrast, if we take the total level of municipal debt for South Africa, it comes to only about 1.3% of GDP per capita, and for Indian municipalities probably less than 0.5% of GDP per capita.

Does this indicate that South African and Indian cities should borrow more? That depends. The responsible use of borrowing can help a well-managed municipality to more quickly invest in infrastructure to improve living conditions and support a growing economy and population. Conversely, ill-advised borrowing can lead a poorly managed municipality into serious financial crisis. Municipal borrowing should never be an end in itself but it can be a powerful tool for well-managed municipalities.