MUNICIPAL BORROWING BULLETIN

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Msunduzi Local Municipality
NORTHDALE ELECTRICAL SUBSTATION

PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to advance transparency, prudence and responsible utilization of municipal borrowing for infrastructure delivery.

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 June 2020, corresponding to the fourth 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 R69.7 billion in outstanding long-term borrowing of municipalities, while R69.8 was reported by municipalities. The disjuncture on the reported figures is largely attributable to the ongoing transition from previous reporting systems to the current municipal Standard Chart of Accounts (mSCOA).
- New borrowing incurred for the current year was reported at R5.9 billion which is only 37 percent of the budgeted amounts.
- Approximately 60 percent of the new borrowing is attributable to the cities of Ekurhuleni and Johannesburg.
- The city of Ekurhuleni issued new bonds worth R1.650 billion during the current financial year.
- The aggregate actual revenue performance for all municipalities was recorded at 90 percent of the aggregate budgets for the 2019/20 financial year which represents a substantial shortfall from the previous financial year's revenue performance which was recorded at 98 percent.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

DATA AND ANALYSIS

1. Municipal borrowing budgets

COVID-19 has disrupted the global status quo. Since early this year, it has not been business as usual and there is not a single country that has not been affected by the pandemic. In South Africa, in particular, the pandemic came at a time when we were already dealing with a strained and declining economy.

In response to the pandemic, the government imposed a phased lockdown which meant little economic activity in the early stages. As a result, businesses could not continue to pay salaries, rent and other monthly expenses. All of these had a direct impact on municipal revenues. Restrictive working arrangements and reduced ability to pay meant that municipalities could not collect as much revenue in the fourth quarter as in the first three quarters of the 2019/20 municipal financial year. Similarly, municipal infrastructure projects which were not deemed essential were paused and consequently municipalities no longer needed to borrow for their capital programs as they planned to. This can be seen from the difference between planned borrowing and actual new borrowings taken up in table 1 below.

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	16 017 275
Actuals	6 490 000	7 583 000	9 357 000	9 222 000	8 099 900	8 749 729	8 004 007	5 897 860
	70%	78%	78%	79%	70%	64%	65%	37%

Source: National Treasury Database

Out of R16 billion in planned new borrowings (per adjusted borrowing budgets for all municipalities), only R5.9 billion was incurred during the 2019/20 financial year. This makes up only 37 percent of the adjusted borrowing budgets while the previous financial year saw municipalities take up 65 percent of their planned borrowings. This clearly highlights the impact covid-19 has had on the borrowing plans of municipalities. Approximately 60 percent of the new borrowing during FY 2019/20 is attributable to the cities of Ekurhuleni and Johannesburg which incurred new borrowing of R1.65 billion and R1.9 billion respectively.

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

Table 2: Outstanding long-term debt as at 30 June 2020

Municipal Category	Municipality	"Total debt Q4 2019/20 R'000"	Share of total debt	"Actual Revenue 2019/20* R'000"	Debt to revenue ratio
A	BUF	287 581	0,4%	6 878 947	4%
	NMA	1 062 714	2%	9 909 273	11%
	MAN	861 179	1%	6 656 362	13%
	EKU	9 774 203	14%	37 232 230	26%
	JHB	22 098 498	32%	57 385 149	39%
	TSH	12 107 557	17%	33 566 745	36%
	ETH	8 320 829	12%	37 935 445	22%
	CPT	6 288 357	9%	42 065 125	15%
	Total Metros	**60 800 918**	**87%**	**231 629 276**	**26%**
B	**B1 (19)**	5 653 130	8%	47 648 876	12%
	Other Municipalities	2 803 053	4%	71 734 037	4%
C	**Districts**	583 854	1%	20 657 623	3%
	Total all municipalities	**69 840 955**		**371 669 812**	**19%**

**excluding capital transfers*

Source: National Treasury Database

As at the end of FY 2019/20, outstanding long-term municipal debt as reported by municipalities was R69.8 billon compared to R70.6 billion at the end of last year. Overall long-term debt has slightly decreased from this time last year; however, the city of Ekurhuleni recorded an increase of about R1.2 billion while the city of Tshwane showed a climb of about half a billion Rands. eThekwini showed a decline of R950 million while no significant changes were recorded in the total amounts owed by the other 5 metros for the 2019/20 financial year. In total, the metros now owe R60.8 billion compared to R60.5 billion at the end of June 2019. The secondary cities and the rest of the local municipalities saw their debt books drop by R614 million and R433 million respectively.

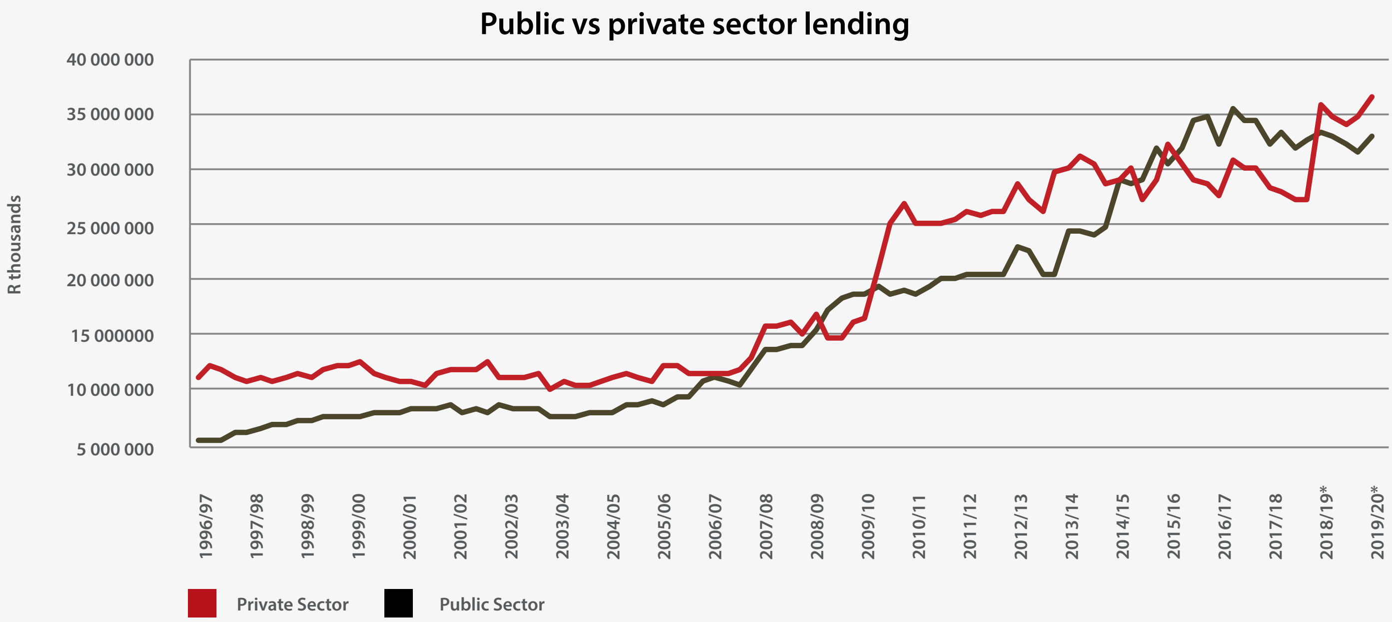
The aggregate actual revenue performance for all municipalities was recorded at R371 billion against revenue budgets aggregating to R409 billion. This is only 90 percent performance against the budget and indeed represents a substantial shortfall from the previous financial year's revenue performance which was recorded at 98 percent.

However, this is a relatively strong performance given the economic difficulty the country is facing as a result of the COVID-19 pandemic. The average debt to revenue ratio aggregated for all municipalities now stands at 19 percent compared to 17 percent last year.

Recently, National Treasury's municipal borrowing team has been in dialogue with a number of market participants. We note that while some see municipal debt obligations as most similar to sovereign government obligations, others view them as closer to corporate debt obligations. From National Treasury's perspective, the former view is more rational, since municipalities have permanent and constitutionally guaranteed revenue streams. Unlike corporations, municipalities enjoy a geographic monopoly within their boundaries, so they face no direct competition. And, unlike corporations, municipalities have perpetual existence and cannot be wound down or dissolved if they become insolvent. Instead, there are specific constitutional and legislative provisions that specify what must be done to restore financial health if a municipality finds itself in a financial crisis.

3. Analysis of long term debt as reported by municipalities

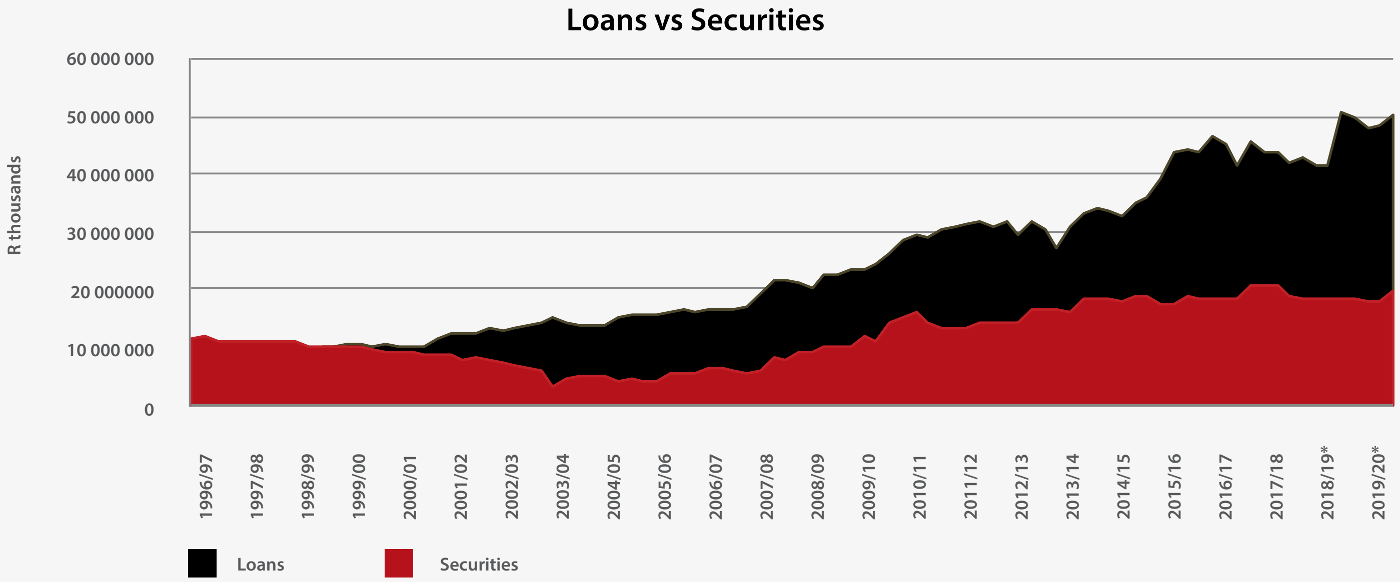
Figure 1: Public and private sector lending to municipalities



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

Private sector investment in municipal debt obligation grew by R785 million while investment by the public sector grew by only R130 during the 2019/20 financial year. Private sector lenders and investors were owed R35.8 billion at the end of June 2019 and are now (June 2020) owed R36.6 billion compared to public sector lenders which are now owed R33.2 billion from R33.1 billion this time last year. We have been seeing more private sector lending compared to public sector lending to municipalities in recent quarters.

Figure 2: Figure 2: Split between loans and securities

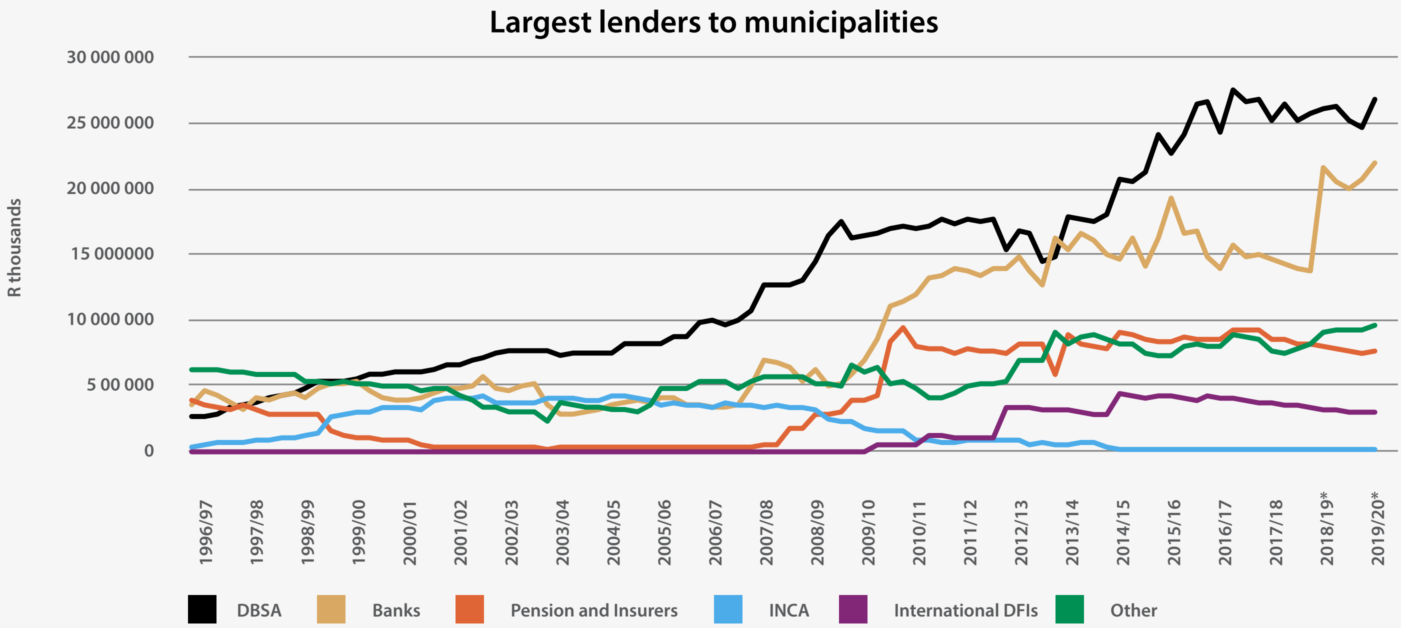


**Incl QIV*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

The city of Ekurhuleni issued new bonds worth R1.650 billion during the current financial year and as a result municipal debt in the form of bonds now stand at R19.4 billion compared to R18.2 at the end of FY 2018/19. The last time municipal bonds were issued was during the 2016/17 financial by the cities of Cape Town and Ekurhuleni. The total debt book of Ekurhuleni as at 30 June 2020 is R9.7 billion. Ekurhuleni's municipal bonds now constitute 65% (R6.3 billion) of their outstanding long-term debt, while commercial loans account for the remaining 35% (R3.4 billion). Redemption dates range from March 2021 to June 2034. For all municipalities, long-term debt is still very much skewed towards loans. As at June 2020 the split is 72:28 loans to bonds.

The profiles of the bond issuances by Ekurhuleni are level amortizing payment structure which is a more sensible repayment structure than the levelized principle structures which was seen in the 2017 issuances. The amortising bond issuance does not require the City to establish a sinking fund to cater for the redemption of the bond, as periodic payments of interest and capital will be payable semi-annually. The amortising bonds capital redemption/ payments are credited back or added on the Domestic Medium-Term Note (DMTN) Programme, thus increasing the funds available for issuance. This is similar to a revolving credit process. The remaining balance to tap/issue on the R8 billion DMTN is R1, 620 billion.

Figure 3: Largest lenders to municipalities



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

The end of the 2019/20 financial year saw the DBSA's investment in municipal debt climb up to R27.1 billion from R26 billion at the end of June 2019. Over the twelve-month period, the stake of commercial banks only rose by about R446 million. Banks are responsible for about 61 percent of private sector lending to municipalities. Municipal debt held by pension funds and insurers is down by R443 million since the end of June 2019. This group of investors account for about 21 percent of private sector lending to municipalities. International DFIs are now owed R2.9 billion, down from R3.3 billion at the beginning of the 12-month period.

TOPICAL ISSUES

2020-21 MTREF: OUTCOME OF THE BENCHMARK EXERCISE

BACKGROUND:

Twice each year, the National Treasury undertakes formal engagements with each of the 17 "non-delegated" municipalities.[1] The 2019/20 mid-year performance engagements took place in February, the "benchmark exercise engagements" took place in May and June 2020.

A key objective of both the budget performance and benchmark engagements is to support these municipalities in achieving better alignment between municipal planning, budgeting and reporting. Another objective for the benchmark engagement was to understand how COVID-19 has impacted FY 2019/20 outcomes and the preparation of 2020/21 MTREF budgets. During these engagements, National Treasury also reinforced priorities outlined in the President's State of the Nation address and key messages from the Minister of Finance's Budget Speech. At the heart of these engagements is the importance of the long-term financial sustainability in local government.

Also, during these engagements, municipalities are asked to share their vision, strategy, plans and their budgets.

For each of the 17 non-delegated municipalities, National Treasury compiles a comprehensive report, including recommendations, and distributes it to the municipalities. These reports are meant to be tabled in the municipal council and, where appropriate, influence the final budget prior to adoption. This year, there were delays in the benchmark meetings as a result of COVID-19. As a result, some cities may not have had enough time to take these reports on board before adopting their budgets.

HIGH LEVEL OUTCOMES:

During these engagements, most municipalities were able to demonstrate strategic alignment between key policy instruments, including the Medium-Term Strategic Framework (MTSF), the Integrated Urban Development Framework (IUDF), growth and development strategies (GDS), the Integrated Development Plan (IDP), mayoral priorities and catalytic programmes. It was clear that municipalities are planning to improve service delivery through visible and impactful programmes supported by capital spending. Municipalities continue to improve their township economies through incubation programmes and Expanded Public Works Programmes (EPWP).

At the same time, it is obvious that cities are experiencing challenges increasing capital expenditure, especially with the impacts of COVID-19. A chronic implementation challenge results from delays due to losing bidders' challenges to procurement processes, especially where a winning bidder is from outside the municipality.

Some municipalities have cut their 2020/21 MTREF budgets in anticipation that conditional grants and the macro-economy would shrink, while others said their budgets would remain as they are until the impact of COVID-19 can be better quantified. If need be, this latter group would adjust their budgets in February 2021, once the impact of COVID-19 is better understood. Most municipalities have cut funding of their capital budgets from internally generated funds as a measure to cushion the negative impact of declining revenues on operating budgets.

Underfunded mandates remain a centre of debate, especially in relation to libraries (a provincial competence) and health (a concurrent provincial and national competence) on municipalities' budgets. Funds provided by provincial and national governments do not cover municipalities' costs incurred in providing these services.

An inverse relationship is expected on employee related cost and contracted services in an effort to curb employee related costs and contracted services under 45 per cent of the operational expenditure.

REPRIORITISATION DUE TO COVID-19

The COVID-19 pandemic has affected implementation of municipalities' 2019/20 budgets. Impacts range from underspending on conditional grants and capital budgets to an increase in COVID-19 related expenditure. Metros have had to reprioritise their 2020/21 MTREF budgets as a result of this pandemic. Going forward, further adjustments seem likely, as the full impact of the pandemic is still unfolding.

Revenue collections are also being impacted, in the case of both residential and commercial customers. Electricity sales are expected to drop as some firms close, and others implement energy saving measures. Most municipalities have made provision for an expected increase in bad debt due to lower collection rates. Indigent registers are expected to increase as the economy contracts and employees are retrenched. The demand for social assistance will increase.

Even as revenues are falling, some expenditure items are increasing. For example, salary increases continue to be above inflation.

1 *Such engagements with the remaining 240 municipalities are the responsibility of provincial treasuries.*

NATIONAL TREASURY ADVICE

National Treasury does an independent assessment of each municipality's budget plans to determine the extent to which the planned budgets are credible, sustainable, funded and relevant to the municipalities' strategic priorities over the medium term. The National Treasury team stressed to municipalities that where budgets are not fully funded, problems in implementation are inevitable.[2]

As a general proposition, National Treasury advised municipalities to continue investment in initiatives that conserve water and ensure the security of supply.

Municipalities were also advised to focus on collecting revenues owed, on eliminating wasteful and non-core spending, and on adequately provisions to service their debt obligations.

A full report on the outcome of the benchmark exercise is available from National Treasury. Please contact Sandra Sekgetle at Sandra.sekgetle@treasury.gov.za

2 *National Treasury found that 13 of the 17 non-delegated municipalities' budgets were funded for 2020/21. The four municipalities that did not have a funded budget were: Msunduzi LM, City of Mbombela, Rustenburg LM and Mahikeng LM.*