



## BACKGROUND

**I**nvestment 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 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

Long term borrowing is one major instrument for financing infrastructure development.

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 intends to contribute to a better understanding of the movements and trends in municipal borrowing through sharing data, offering analysis, highlighting trends and discussing topical issues. This information is shared with stakeholders to promote prudent and responsible use of municipal borrowing as an effective and efficient municipal infrastructure financing tool.

This report covers information up to 30 June 2016, which corresponds to the fourth 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.<sup>1</sup>

<sup>1</sup>All figures in Rand used in this Bulletin are in nominal terms



**national treasury**

Department:  
National Treasury  
**REPUBLIC OF SOUTH AFRICA**

## KEY HIGHLIGHTS

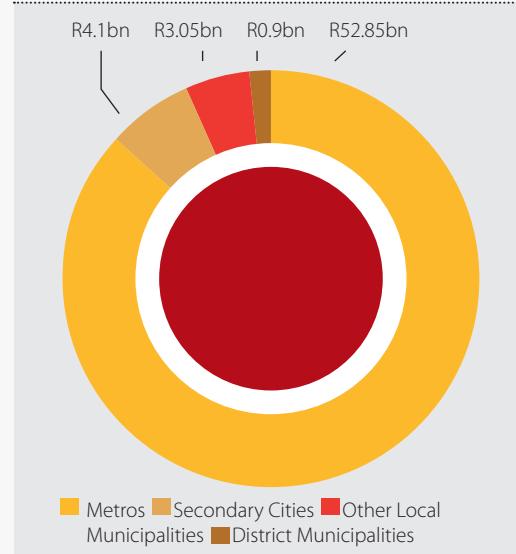
- The City of Johannesburg issued a 10 year non-marketable bond to the amount of R1.4 billion under its R30 billion Domestic Medium Term Note (DMTN) programme memorandum in June 2016. An amount of R1.7 billion was redeemed by the City during this period.
- The amount of outstanding long-term municipal debt owed to private sector lenders has increased by 23 percent over the past 5 years from R26.2 billion in 2011/12 to R32.3 billion in 2015/16 and the private sector is now the largest holder of municipal debt, surpassing public sector lending by R1.8 billion.
- Although total debt has increased from R53.5 billion in 2014/15 to R60.9 billion in 2015/16, new borrowing by municipalities as a share of total capital funding has declined to 14 percent, from 18 percent in the previous year. This is due to the large increase in municipalities' 2015/16 capital expenditure budgets as a result of a substantial increase in grants.
- A sample analysis of municipal long-term debt to municipalities indicates that the average maturity is 12 years, ranging from 2 to 25 year maturities.
- Metropolitan municipalities have increased their reserves and at the same time leveraged them through borrowing over the last 5 years; while grants also grew significantly. Secondary cities have also increased their borrowings, whereas the local and district municipalities have kept own-revenue contributions to their capital programmes relatively constant.

## DATA ANALYSIS



The total outstanding long term debt for all municipalities as at the end of the fourth quarter of the 2015/16 municipal financial year amounted to R60.9 billion, according to quarterly data submitted to National Treasury by municipalities. Metropolitan municipalities' outstanding long term debt amounted to R52.85 billion or 87 percent of total municipal long term debt, the 19 secondary cities' accounted for R4.1 billion or 7 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 due to high concentration of population in these areas. Please see figure 1:

**Figure 1: Long term municipal debt outstanding as at 30 June 2016**



In total, adjusted municipal budgets for the 2015/16 municipal financial year anticipated new long term borrowing of R11.8 billion against aggregate capital budgets of R67.8 billion, which is slightly below the previous year's aggregate borrowing budget of R12 billion. Actual new borrowing for 2015/16 is reported at R9.2 billion or 79 percent of the adjusted budget. The majority of borrowing appears to take place towards the end of the financial year.

Table 1 shows total outstanding long term debt and the funding mix for capital expenditure in municipalities over the past eight years, including the 2015/16 financial year. Total capital expenditure has increased by 71 percent over the period, from R39.6 billion in 2008/9 to R67.8 billion in 2015/16. In this context, the share of capital expenditure financed through borrowing has fallen. This indicates a relatively greater reliance on capital grants and own revenues for capital expenditure. The funding mix for capital spending is explored in detail under Topical Issues. Total outstanding debt has increased by 88 percent from 2008/9 to 2015/16, from R32.3 billion to R60.9 billion (in nominal terms).

Lenders report total long term municipal debt outstanding to be R62.8 billion, which is R1.9 billion more than what municipalities have reported to National Treasury. Efforts continue to verify these figures, including investigating any possible reporting errors. Verification requires support and timely submission of reports from all stakeholders.

Table 1: Capital expenditure, new borrowing and outstanding debt

Capital expenditure, new borrowing and outstanding debt								
R'000	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
	Actual							
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	9 222 237
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	14%
Outstanding debt	32 365 746	35 387 552	43 190 345	45 640 353	48 077 781	51 430 509	53 493 395	60 902 671

Data source: National Treasury

Table 2 shows an overview of current debt levels in municipalities. Metropolitan municipalities, as a group, are significantly more leveraged than either local municipalities or district municipalities. Within the metropolitan municipalities there is considerable variation. The City of Johannesburg and the City of Tshwane are the most leveraged with debt to revenue ratios above 40 percent, while Buffalo City has a ratio below 10 percent. The City of Johannesburg is also the biggest borrower in absolute terms and in per capita terms and City of Tshwane is the most leveraged compared to the size of its local economy<sup>2</sup>.

Table 2: Outstanding long term debt as at 30 June 2016

Long term debt outstanding (30 June 2016)									
		Total debt Q4 2015/16 R'000	Budgeted revenue 2015/16* R'000	Debt to revenue ratio	Population**	Debt per capita	GVA***	Debt as % of GVA	
Metros	BUF	496 477	5 719 607	8,7%	755 200	657	62 122 732	0,8%	
	NMA	1 411 952	8 885 456	15,9%	1 152 115	1 226	94 565 655	1,5%	
	MAN	722 063	6 740 247	10,7%	747 431	966	58 872 541	1,2%	
	EKU	5 411 930	29 454 839	18,4%	3 178 470	1 703	266 048 559	2,0%	
	JHB	18 071 380	43 788 546	41,3%	4 434 827	4 075	549 810 995	3,3%	
	TSH	10 861 687	26 295 831	41,3%	2 921 488	3 718	313 014 335	3,5%	
	ETH	9 236 444	29 534 286	31,3%	3 442 361	2 683	339 978 590	2,7%	
	CPT	6 627 090	31 723 843	20,9%	3 740 026	1 772	349 948 095	1,9%	
	Total Metros	52 839 023	182 142 655	29,0%	20 371 918	2 594	2 034 361 501	2,6%	
Local mun.		7 154 127	103 673 604	6,9%	31 398 642	257	3 110 900 920	0,3%	
District mun.		909 521	18 437 802	4,9%					
Total all municipalities		60 902 671	304 254 061	20,0%	51 770 560	1 176	5 145 262 421	1,2%	

\*Excludes capital transfers \*\* 2011 Census \*\*\* Gross value added per municipality in 2015 as reported by IHS Global Insight

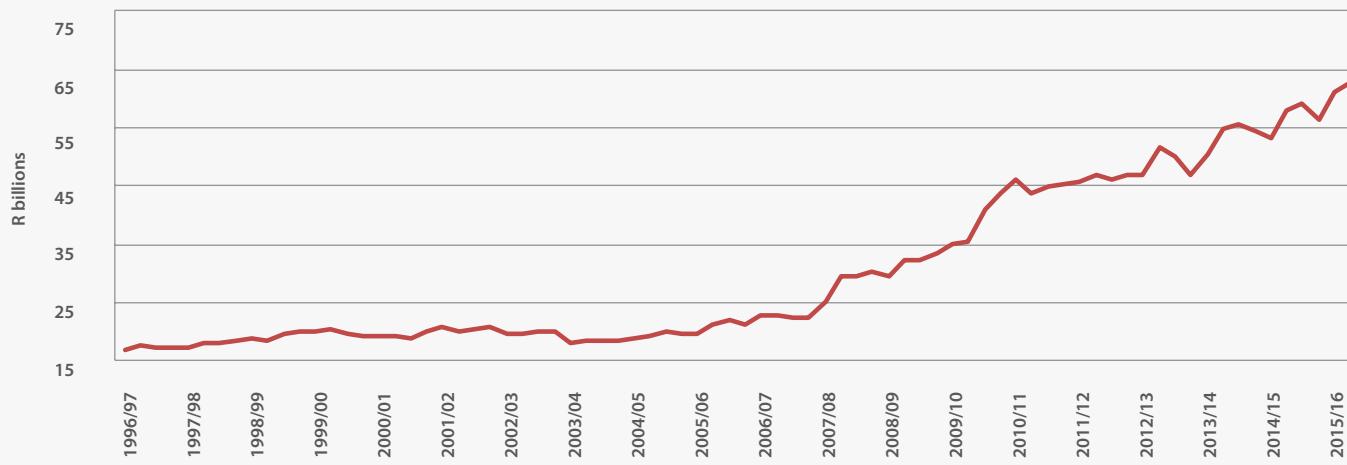
Data source: National Treasury, STATSSA, IHS Global Insight

#### Growth in long term debt as reported by lenders

Figure 2 shows the growth in outstanding long-term debt as reported by lenders. Municipal debt did not grow significantly between 2000/01 and 2006/07 financial years, and then increased steadily from 2007/08. Since 2014/15, municipal debt has remained over R50 billion (note all figures are in nominal Rand). As at the end of the municipal financial year of 2015/16, the total municipal long term debt was R62.8 billion, as per the lender side data.

<sup>2</sup>Local economy, here, refers to the gross value added in each municipality as reported by IHS Global Insight, which is disaggregated from the provincial gross domestic product.

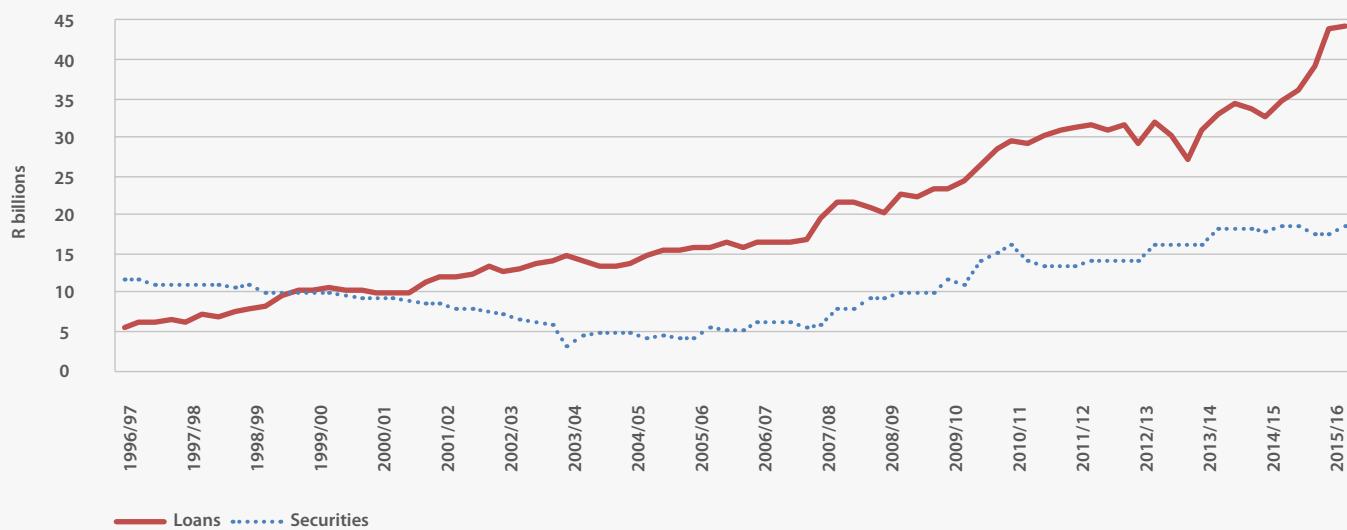
**Figure 2: Growth in long term municipal borrowing**



Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

City of Johannesburg, City of Cape Town, Tshwane and Ekurhuleni remain the only municipal bond issuers in South Africa. The City of Johannesburg has issued R1.4 billion in bonds under its DMTN programme in the fourth quarter of 2015/16; this accounts for the slight increase in long term securities as seen in figure 3. Of the R62.8 billion outstanding debt reported by lenders, 29 percent is held in municipal bonds and the remaining 71 percent in long term loans.

**Figure 3: Debt instruments issued by municipalities**

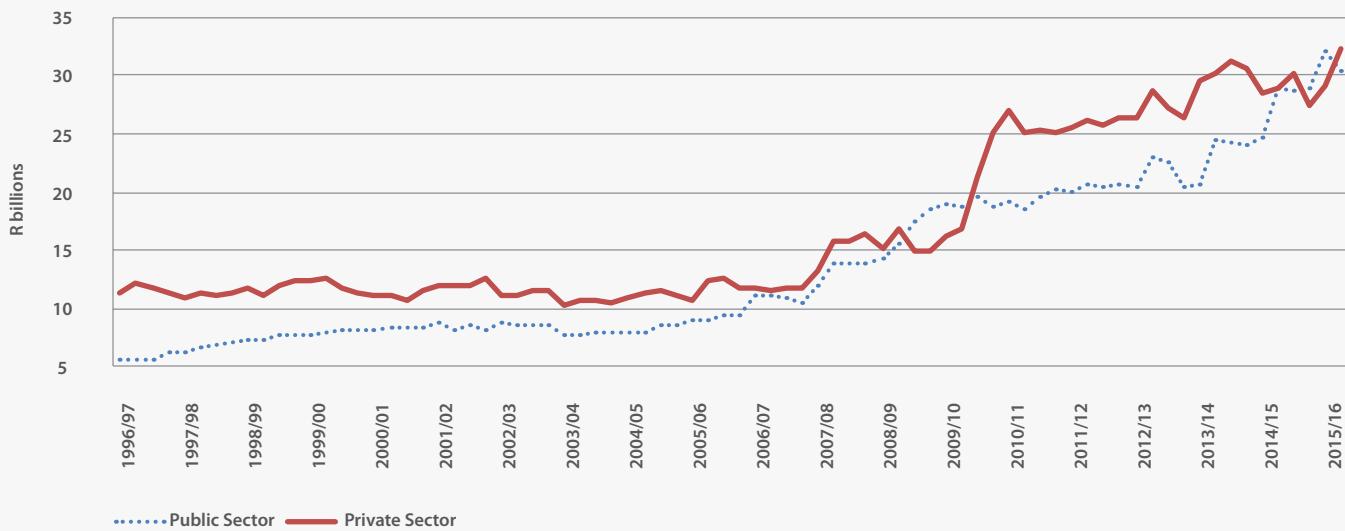


Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

## HOLDERS OF MUNICIPAL LOANS AND BONDS

Figure 4 shows the distribution of municipal debt obligations between public and private investors. During the final municipal quarter of 2015/16, the private sector again became the largest holder of municipal debt at R32.3 billion, an increase of R3.1 billion from the previous quarter. In comparison, the public sector held R30.5 billion in municipal debt, a decrease of R1.6 billion from the previous quarter. This reverses the steady increase that has been observed over the previous quarters in net public sector lending.

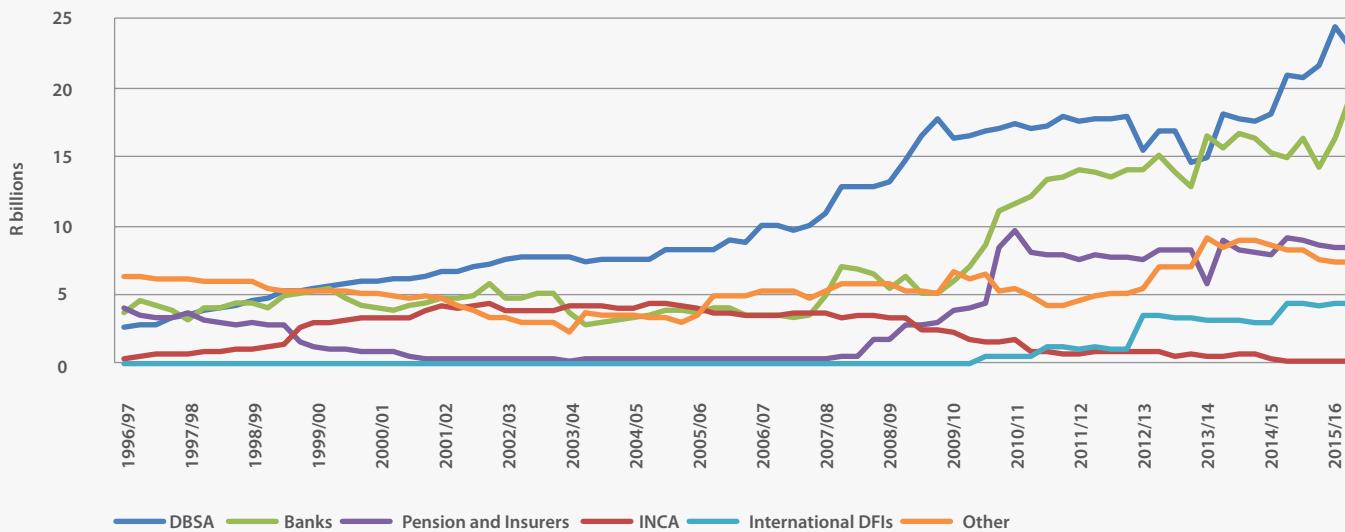
**Figure 4: Public and private sector lending to municipalities**



Data sources: Banks, DBSA, INCA, DFI's, STRATE, SARB

Figure 5 shows the largest categories of lenders to municipalities and the trends in market share over time. The Development Bank of Southern Africa (DBSA) has remained the largest lender to municipalities since 1999/00. This is closely followed by commercial banks, which have substantially increased their investment to municipalities by 445 percent between 1996/97 and 2015/16. Institutional Investors' investment in municipalities accelerated rapidly over the 2009/10 period and has remained relatively stable since that point.

**Figure 5: Largest lenders to municipalities**



Data sources: Banks, DBSA, INCA, DFI's, STRATE, SARB

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

## COST OF BORROWING FOR MUNICIPALITIES

Table 3 shows maturities and interest rate spreads for a small sample of municipal debt instruments. The sample consists of 75 fixed interest rate debt obligations issued by municipalities from 2004 to be repaid from 2014 and beyond, and to be repaid as bullet or straight line amortisation. Each municipal debt instrument is first matched with a government bond in terms of maturity. Then, the yield-to-maturity (YTM) for each sovereign is calculated at the date of issue of the corresponding municipal debt instrument.

Summary descriptive statistics for all 75 debt instruments are reported in the second column of the table. As seen on the table below, the weighted average maturity on debt of all 75 municipal debt instruments is 12 years, the shortest maturity being 2 years and the longest 25 years. Some small municipalities use the provision of Clause 8 (4) (a) of the Division of Revenue Act and the Municipal Budget Circular 51 to pledge conditional infrastructure grants over 2 years.<sup>3</sup>

The maximum interest rate spread for all categories in the sample is 600 basis points, the minimum, is -230 basis points. The weighted average of the interest that municipalities pay is 170 basis points above the yield to maturity (YTM) of a government bond of similar term at the date of issue, as depicted in column two in the lower block of the table below. Sixty-eight of the sampled 75 municipal debt instruments were issued above YTM of corresponding government debt. This implies that municipalities were able to issue seven debt obligations at the cheaper cost than the sovereign where DBSA is the main lender.

**Table 3: Maturities and interest spreads of municipal debt instruments**

Maturity	Full sample	Metros	Districts	Locals
Maximum	25	20	15	25
	2	7	2	5
	12	14	9	12
Interest rate spread				
Maximum	6,005	2,838	2,797	6,005
	-2,300	-1,586	0,732	-2,300
	1,700	1,984	1,695	1,596
	68	17	8	43
	7	1	0	6
	75	18	8	49

*Data sources: National Treasury and Bloomberg*

Metropolitan municipalities have issued debt instruments with a weighted average maturity of 14 years. This is the longest average maturity compared across groups of municipalities. (columns three, four and five). Similarly, the minimum maturity for debt instruments issued by metropolitan municipalities is 7 years, whereas for district and local municipalities the minimum maturity corresponds to 2 and 5 years respectively. The average interest rate spread for metropolitan municipalities is 198 basis points, which is higher than the averages for the shorter term district and local municipalities' borrowing.

<sup>3</sup> <http://mfma.treasury.gov.za/MFMA/Circulars/Circular%2051/MFMA%20Circular%20No%2051%20-%20Municipal%20Budget%20Circular%20for%20the%20201011%20MTREF.pdf>

## DISCUSSION OF TOPICAL ISSUES

### FUNDING FOR MUNICIPAL CAPITAL BUDGETS



Figure 6 below shows the funding mix for capital expenditure per group of municipalities for the 2014/15 fiscal year (as 2015/16 data is not yet available). For all groups of municipalities, transfers from provincial and national governments make up the largest share in the capital funding mix. As a group, metropolitan municipalities on average fund around half of the capital budget from transfers and make up the rest from own revenues (internally generated funds and borrowing). There is considerable variation across metros, as shown in figure 9. Secondary cities, as a group, on average rely on grants for roughly two-thirds of their capital expenditure and for one third on own revenues. Local and district municipalities use mainly transfers, supplemented by own revenues and public contributions.

**Figure 6: Sources of capital expenditure funding per group of municipalities**

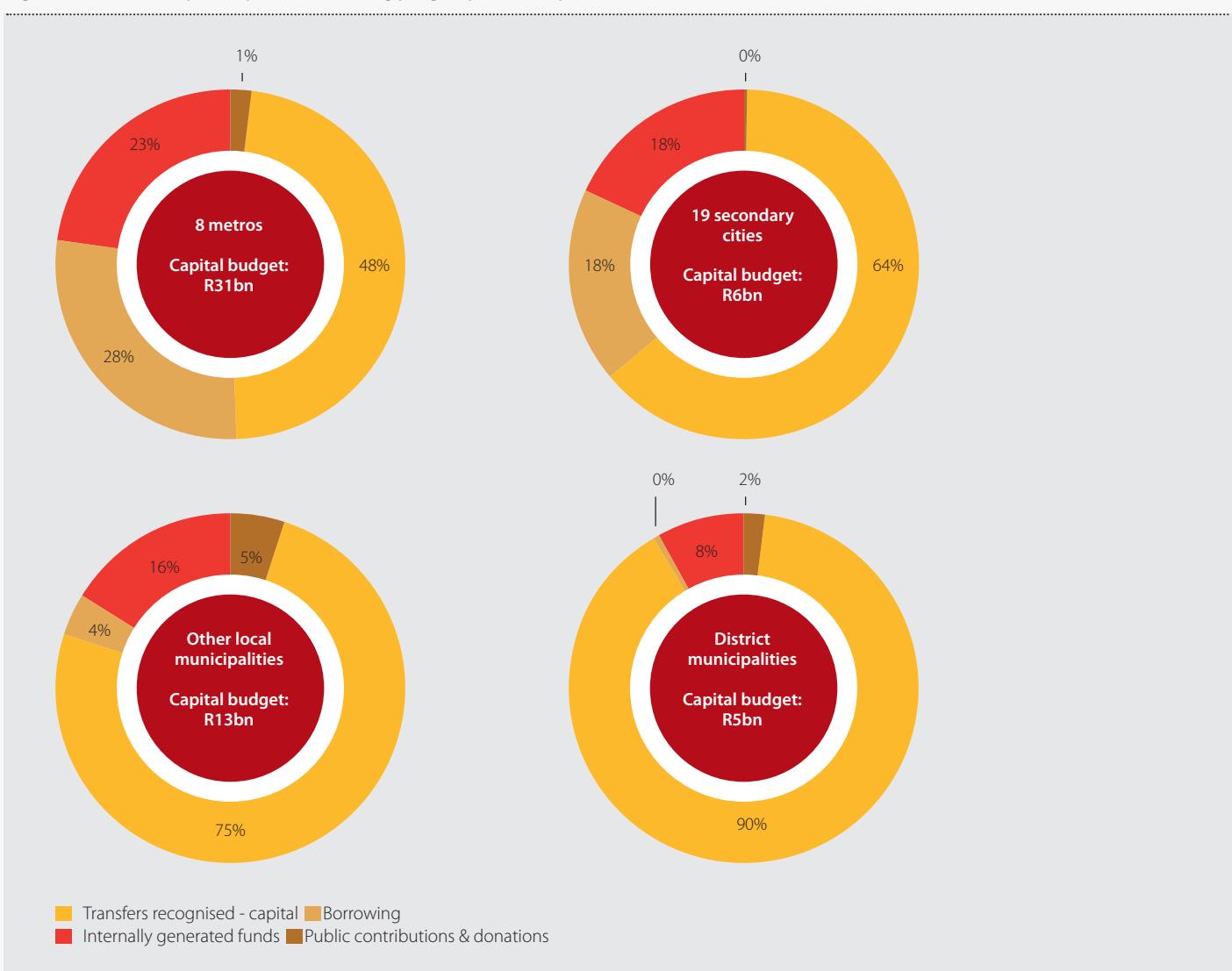




Figure 7 below illustrates the historic development of the funding mix in municipalities over a 5 year period. Over the period under analysis, one can see that metros have increased their reserves and at the same time leveraged them through borrowing; but grants grew more significantly. Secondary cities are increasingly borrowing and local and district municipalities have kept own-revenue contributions to their capital programmes relatively constant.

**Figure 7: Development of funding mix for capital expenditure per group of municipalities**

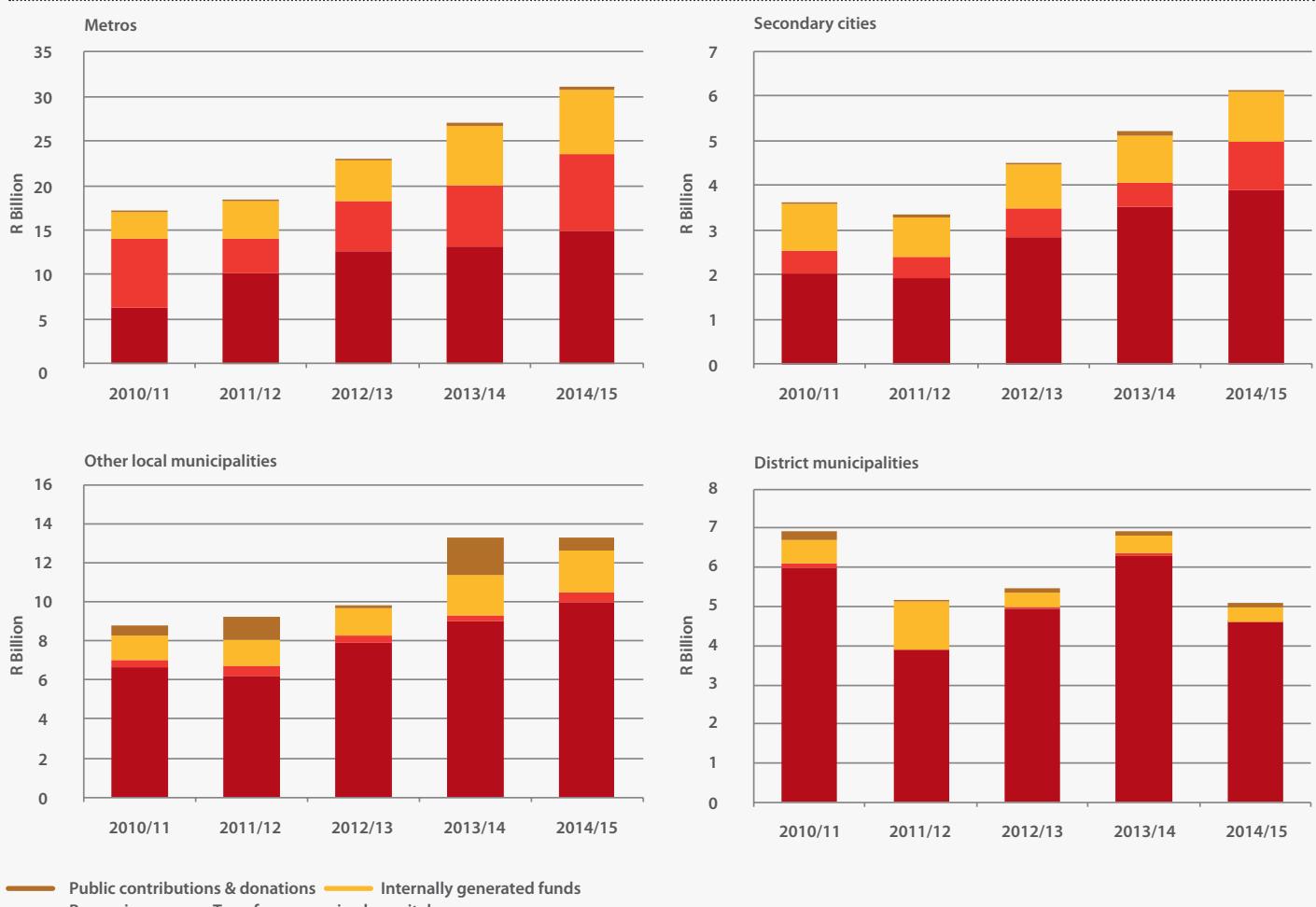
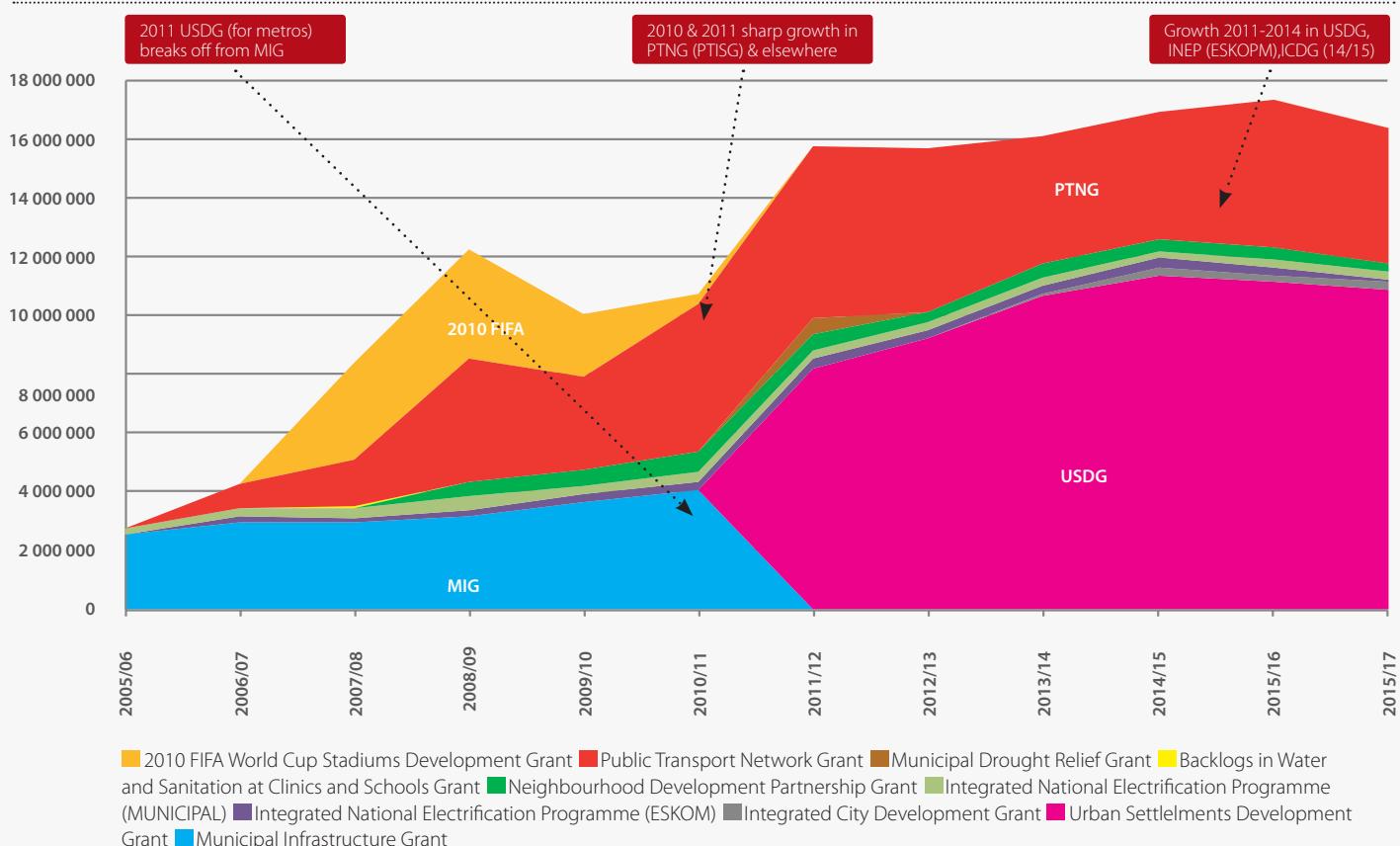


Figure 8 shows the growth of infrastructure grants to metropolitan municipalities since 2005/06 in real terms, (i.e. adjusted for inflation). One can see a sharp increase in 2010/11 for public transport grants and again around 2013/14 with an increase in the Urban Settlements Development Grant. This growth is not matched by a similar growth in own revenues contributed to the capital budget.

**Figure 8: Real growth of infrastructure grants to metros**

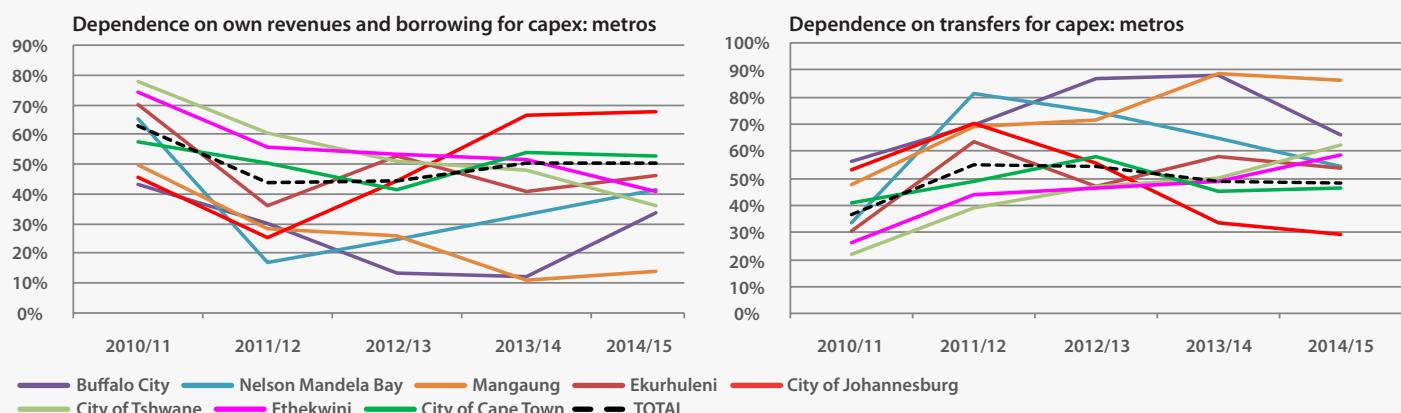
Growth of metro infrastructure grants, original allocations (including allocations to Buffalo City and Mangaung local municipalities 2005/06 - 2010/11) constant June 2016 R'000



Data source: National Treasury

The composition of capital funding sources varies across metropolitan municipalities. Figure 9 demonstrates this by showing the relative dependence of municipal capital budgets on transfers and on own revenues (including borrowing), respectively. Larger reliance on own revenues tends to correspond with larger capital programmes.

**Figure 9: Dependence on own revenues vs. transfers for capital expenditure per metro**



Data source: National Treasury