



## Qumza Highway

# BUFFALO CITY METROPOLITAN MUNICIPALITY

## PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to advance transparency, prudence and responsible utilisation of municipal borrowing for infrastructure delivery. The MBB informs 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 2021,

corresponding to the end of the fourth quarter of the 2020/21 municipal financial year.

This MBB includes 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

- Public sector investment in municipal debt obligations grew substantially while investment by the private sector declined sharply during the 2020/21 financial year.
- Lenders reported a total of R70.4 billion

in outstanding long-term borrowing to municipalities, while R70.9 billion was reported by municipalities.

- Municipalities have borrowed more in relation to their adjustment budget during the 2020/21 financial year compared to the year before.
- New borrowing incurred during the 2020/21 financial year was reported at R5.8 billion which is about 80 percent of the planned borrowing as per adjustment budgets.
- The substantial growth in municipal debt obligations held by public sector lenders during the 2020/21 financial year was dominated by the DBSA.
- In this issue, we discuss whether municipalities should use borrowing only for revenue generating assets.



**national treasury**

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



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## DATA AND ANALYSIS

### 1. Municipal borrowing budgets

On 23 July 2021, National Treasury together with the South African Local Government Association (SALGA) and the Department of Cooperative Governance (DCoG) held a Budget Forum Lekgotla on Asset Management and Infrastructure Funding. Of particular interest were the discussions on infrastructure funding where panellists from the financial sector shared their thoughts on infrastructure funding for municipalities. Panellists briefly outlined their perception of the state of infrastructure funding in municipalities, existing challenges and proposed solutions. One common suggestion was that municipalities need to build confidence by starting at project-level financing and gradually progressing to municipal-level financing. It was highlighted that to be successful at project-level financing, municipalities need to focus on project bankability which depends on the credibility of cashflow projections. However, due to revenue management challenges in municipalities, there is significant forecasting risk which affects the number of projects

that can be banked by the private sector. Municipalities will have to improve on these aspects to realise success with project finance.

It was agreed that municipal bond issuance is an under-utilised financing mechanism. For the municipal bond market to function optimally for municipalities, a volume of issuances that is sufficient to enable activation of the secondary market for municipal bonds is needed. The panellists acknowledged that bond issuance by smaller municipalities would be less sizeable, while bigger municipalities with considerable investment needs are better positioned and therefore need to explore this to the full extent. A suggestion was made that government should build a centre for municipal finance excellence in order to stand on equal ground with the private sector. Currently, the National Treasury is testing the need and possibility of an independent municipal financial advisory service as a mechanism to level the playing field in the municipal debt market. Currently, municipalities cannot be confident that they are getting impartial advice when borrowing given their reliance on the services of advisors and arrangers who are associated with the large banks, who often buy a significant portion of the bonds issued.

**Table 1: Budgeted borrowings**

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
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	11 395 889
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	7 280 462
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	5 818 870
	70%	78%	78%	79%	70%	64%	65%	37%	80%

*Source: National Treasury Database*

Municipalities have borrowed more in relation to their adjustment budget plans during the 2020/21 financial year, as compared to the year before. About 80 percent of the adjustment borrowing budgets was implemented during the 2020/21 financial year compared to only 37 percent for the 2019/20 financial year. Largely, this is because the borrowing plans for 2020/21 were revised down by about 36 percent during the adjustment process, compared to a 9 percent downward adjustment in the previous financial year. Hence, in absolute Rands, the numbers are not far from each other as R5.81

billion was incurred in new borrowings during 2020/21, while R5.89 billion was incurred during the previous financial year. The borrowing outlook coming into the 2020/21 financial year has declined as only R11.4 billion was planned to be borrowed at the start of the financial year while R17.6 billion was planned at the beginning of the 2019/20 financial year. Understandably, municipalities had to exercise some level of caution during these uncertain times. They had the ability to factor the impact of COVID-19 into their planning for 2020/21, which did not happen in the 2019/20 financial year.

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

Table 2: Outstanding long term debt as at 30 June 2021

Municipal Category	Municipality	Total debt Q4 2020/21 R'000	Share of total debt	Actual Revenue 2020/21* R'000	Debt to revenue ratio
<b>A</b>	BUF	233 185	0,3%	7 590 865	3%
	NMA	1 130 446	2%	12 102 045	9%
	MAN	743 366	1%	6 844 945	11%
	EKU	9 600 922	14%	37 417 870	26%
	JHB	23 665 301	33%	66 045 762	36%
	TSH	10 307 881	15%	34 834 607	30%
	ETH	9 015 666	13%	38 951 056	23%
	CPT	7 076 063	10%	42 527 468	17%
<b>Total Metros</b>		<b>61 772 830</b>	<b>87%</b>	<b>246 314 618</b>	<b>25%</b>
<b>B</b>	<b>B1 (19)</b>	5 873 150	8%	68 207 632	9%
	<b>Other Municipalities</b>	2 777 554	4%	84 821 585	3%
<b>C</b>	<b>Districts</b>	484 238	1%	21 477 544	2%
<b>Total all municipalities</b>		<b>70 907 772</b>		<b>420 821 379</b>	<b>17%</b>

\*excluding capital transfers

Source: National Treasury Database

Outstanding long-term debt for all municipalities grew by just over R1 billion during the 2020/21 financial year. Municipalities owed R69.8 billion at the end of the fourth quarter of last year but as of the end of June 2021, that amount stood at R70.9 billion as reported by municipalities. Long-term debt balances fluctuate each quarter during the financial year as debt gets repaid while municipalities habitually wait until towards the end of the financial year to undertake new borrowings. For example, the long-term debt balance was R70.6 billion and R67.4 billion for the second and third quarters of the 2020/21 financial year respectively. Even though the net increase in total outstanding debt has been marginal at R1.1 billion, new long-term borrowing incurred during the 2020/21 financial year was measured at R5.8 billion which means that long-term debt of approximately R4.7 billion was repaid during the financial year. As is usually the case, the bulk of the new borrowings was incurred by the metros with Ekurhuleni taking up new borrowing of R1.97 billion while the City of Johannesburg and

eThekini incurred new borrowings of R1.5 billion each, per the Quarterly Borrowing Monitoring Returns for quarter 4 of FY 2020/21. The City of Tshwane's planned borrowings of R1.5 billion did not materialise as none of the lenders were no willing to finance the city over concerns around the city's governance and its state of financial health.

The debt to revenue ratio aggregated for all municipalities is down from 19 percent to 17 percent over the past twelve months. More important than the simple measure of debt to revenues is the manageability of annual debt service. In the end, the sustainability of long-term borrowing lies in the affordability of the periodic payments of principal and interest. Take the City of Johannesburg, for example, which has the highest debt to revenue ratio of any of the metropolitan municipalities – the city's debt service appears to be manageable, and the city has seldom experienced challenges with paying its lenders.

### 3. Analysis of long term debt as reported by lenders

Figure 1: Public and private sector lending to municipalities

#### Public vs private sector lending



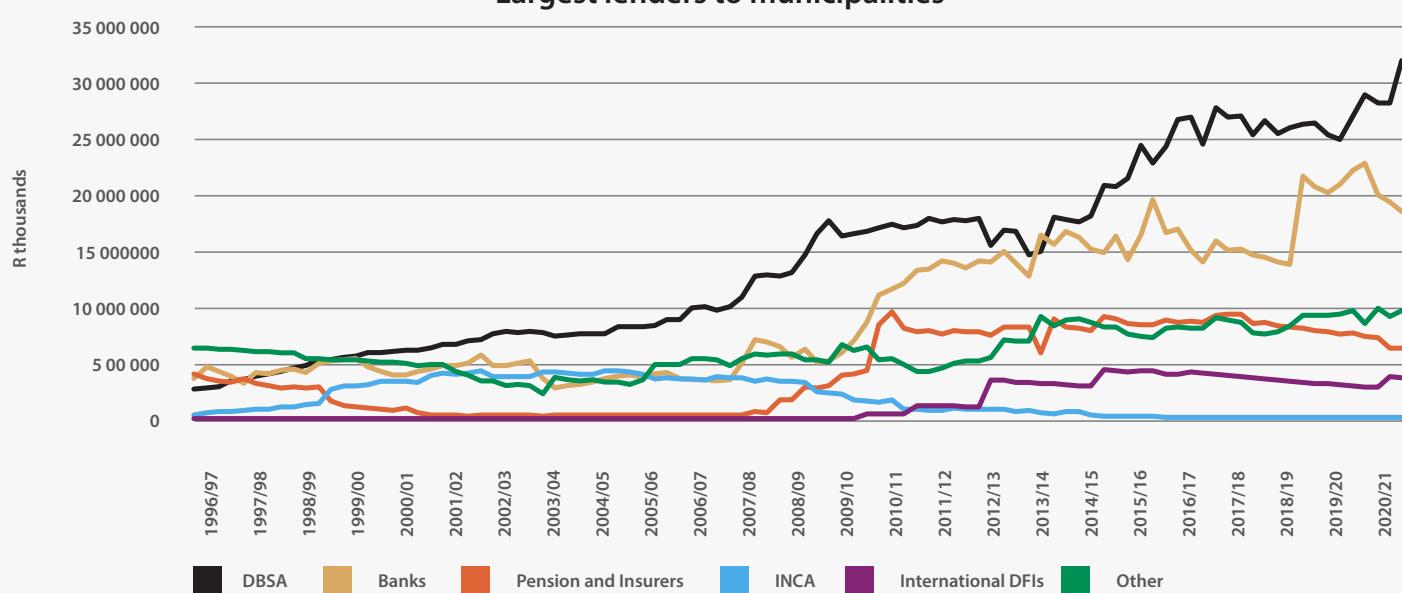
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Public sector investment in municipal debt obligations grew substantially while investment by the private sector declined sharply during the 2020/21 financial year. Municipal long-term debt owed to public sector lenders grew by R4.1 billion from R33.1 billion to R37.2 billion, surpassing municipal long-term debt held by private sector

lenders, which declined by R3.4 billion from R36.6 billion to R33.2 billion over the year. It is clear that the bulk of the R5.8 billion new borrowings incurred by municipalities was provided by public sector lenders and it was exclusively in the form of loans, as no new bonds have been issued during the 2020/21 financial year.

Figure 2: Largest lenders to municipalities

#### Largest lenders to municipalities



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

The substantial growth in municipal debt obligations held by public sector lenders during the 2020/21 financial year was dominated by the DBSA. The DBSA added a total of R4.9 billion to its existing investment in municipal long-term debt obligations and is now owed R33 billion from R27.1 billion this time last year. In contrast, the stake of commercial banks in municipal debt obligations fell dramatically by about R3.8 billion over the past twelve months. Perhaps given the current economic conditions, private sector lenders are risk averse while the DBSA is more inclined to continue to lend to municipalities given its developmental mandate. Municipal debt held by pension funds and insurers fell by R1.3 billion since the end of June 2020 as a portion of their stock of municipal bonds is periodically redeemed. International DFIs are now owed R3.6 billion, up from R2.9 billion at the end of June 2020.

## TOPICAL ISSUES

### SHOULD LONG-TERM BORROWING BE USED ONLY FOR REVENUE GENERATING ASSETS?

One interesting debate that arises from time to time is the issue of what kind of projects municipalities “should” finance through long-term borrowing. A common argument is that municipalities should only borrow for revenue-generating projects. Given the precarious financial condition of many municipalities, the concern is that incurring more long-term debt will increase financial stress.

On the other hand, a municipality that invests only to earn a financial return is not performing its Constitutionally mandated function. Subsection 152(1) of the Constitution tells us that the objects of local government are—

- a) to provide democratic and accountable government for local communities;
- b) to ensure the provision of services to communities in a sustainable manner;
- c) to promote social and economic development;
- d) to promote a safe and healthy environment; and
- e) to encourage the involvement of communities and community organisations in the matters of local government.

Subsection 152(2) goes on to impose a duty and a limitation on the municipality – it must strive to achieve the enumerated objects and it can do so only to the extent of its financial and administrative capacity. The drafters of the Constitution were realists: they understood that the realisation of these laudable aims would be limited by municipalities’ financial and administrative capacity. Progress on achieving some of these goals will cost money (e.g. providing democratic and accountable local government), others may generate revenue (e.g. the provision of services). In striving to achieve the objects of local government, a municipality must balance its revenues and expenditures so that it is financially healthy.

Balance is the key. Debt is a powerful tool – it can make wise choices more impactful and poor choices disastrous. The key is to use debt as

part of an overall sustainable fiscal strategy. In a municipality with lots of economic activity, revenues might come mainly from property tax and service charges. In a municipality without a solid economic base, revenues may depend heavily on “equitable share” transfers from the national fiscus.

Regardless of the sources of revenues, a well-managed municipality can borrow, provided it does so “within its financial and administrative capacity.” If it is to borrow sustainably, a municipality must be able to afford both its operational expenses and any debt service. “Debt service” refers to the amount of principal and interest that is paid each year to pay back long-term borrowing.

So, what kind of investments should be financed through borrowing? The strategic answer is that a municipality must invest in everything that is needed for the community to be economically productive, happy and healthy. This includes both public goods – the benefits of which are shared by everyone, such as parks and public spaces; and private goods – which benefit the user of a service such as water or electricity. The challenge is to keep an appropriate balance – if municipalities only invest in a subset of projects that make money in the near term, city streets will be filthy and full of potholes. There will be no streetlights at night and no money will be spent on public safety or local police services.

Public goods matter to the people living in a municipality and they also matter to businesses that invest in economic activities. From a strategic perspective, the “public goods” that a municipality provides are essential for a city’s social and economic health. Good roads and mass transit make moving around the city more efficient for workers, students, businesses and consumers – they enhance productivity, economic activity, job creation and ultimately the long-run sustainability of municipal finances. A municipality may not be able to point to specific “public goods” investments and say, that is why Company X opened its new factory here, or Company Y located its African headquarters there, but these things do matter to the executives that make investment decisions and to workers that have a choice about where to live. Attracting private sector investment leads to more jobs, more development and more taxpayers – all of which generate revenue for the municipality in the long run.

Whether a municipality is investing borrowed capital or the municipality’s own operating surpluses, there is a danger in focusing narrowly on whether a project makes money in the near term. That perspective could lead a municipality to prefer investments in affluent communities, where people can readily afford the municipality’s property taxes and service charges. In the long run, this reinforces privilege and disregards the needs of the poor. That would not be consistent with the South Africa that we fought for, and it would disregard the constitutional obligations of local government. By generating substantial revenues from those who can afford to pay, a project can serve the indigent at a relatively small marginal cost. Where the financial backbone of the project is provided by middle and upper class residents, commercial and industrial users; the incremental

cost of extending service to the poor is quite manageable. The incremental cost does not have to be fully recovered from the poor: rather it is subsidised by the national budget in the form of equitable share transfers and by the locally generated funds in the form of property taxes- and other levies.

Both the equitable share, at a national scale and the property tax at a local scale, are inherently redistributive. Both are fiscal tools that generate revenue from those who can afford to pay and make funds available to the municipality for the public good. Those redistributive principles are enshrined in the Constitution and in the fiscal architecture of South Africa.

When a municipality extends water and electricity services to newly developing areas on the urban periphery, some of the cost can be recovered from builders of middle and upper class housing; some can be recovered from developers of shopping malls, industrial estates and other commercial properties. The remainder of the cost, that which is needed

to serve the indigent, can be covered by equitable share transfers and general funds of the municipality, for example, property taxes.

Our municipalities must provide public goods for the entire community and subsidised services for the poor. The borrowing question is then rather simple: if a municipality wants its people and its businesses to prosper; it must borrow to provide both public goods and user-specific services within the limits of its financial and administrative capacity. We owe this to future generations, especially to our children – by providing them with healthy environments and with access to electricity and internet connections as well as other infrastructure. Though the future generation may not be in a position to pay taxes until a decade or more has passed, we cannot afford to exclude them from current economic activity. If South Africans want a vibrant, healthy, globally competitive economy, we cannot go forward with a small percentage of the population supporting the rest. The return on these investments will not be immediate, but it will be lasting and profound.