MUNICIPAL BORROWING BULLETIN

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INSIDE: KEY HIGHLIGHTS / DATA ANALYSIS / TOPICAL ISSUES

ISSUE 24

SHEZI ROAD
ETHEKWINI 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 31 December 2021, corresponding to the end of the second quarter of the 2021/22 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

- Over the past decade, South Africa's economy has been trapped in stagnating productivity after having been on a decent growth trajectory previously.
- Lenders reported a total of R70.2 billion in outstanding long-term borrowing to municipalities while R70.3 billion was reported by municipalities.
- New borrowing incurred in the second quarter of the financial year was reported at R2.3 billion which is about 19 percent of the budgeted borrowing for the financial year.
- Between December 2020 and December 2021, outstanding long-term debt across all municipalities grew by almost R1.9 billion.
- This issue highlights the various challenges government faces in relation with the delivery of infrastructure projects, as revealed by National Treasury's recent provincial infrastructure site visits.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

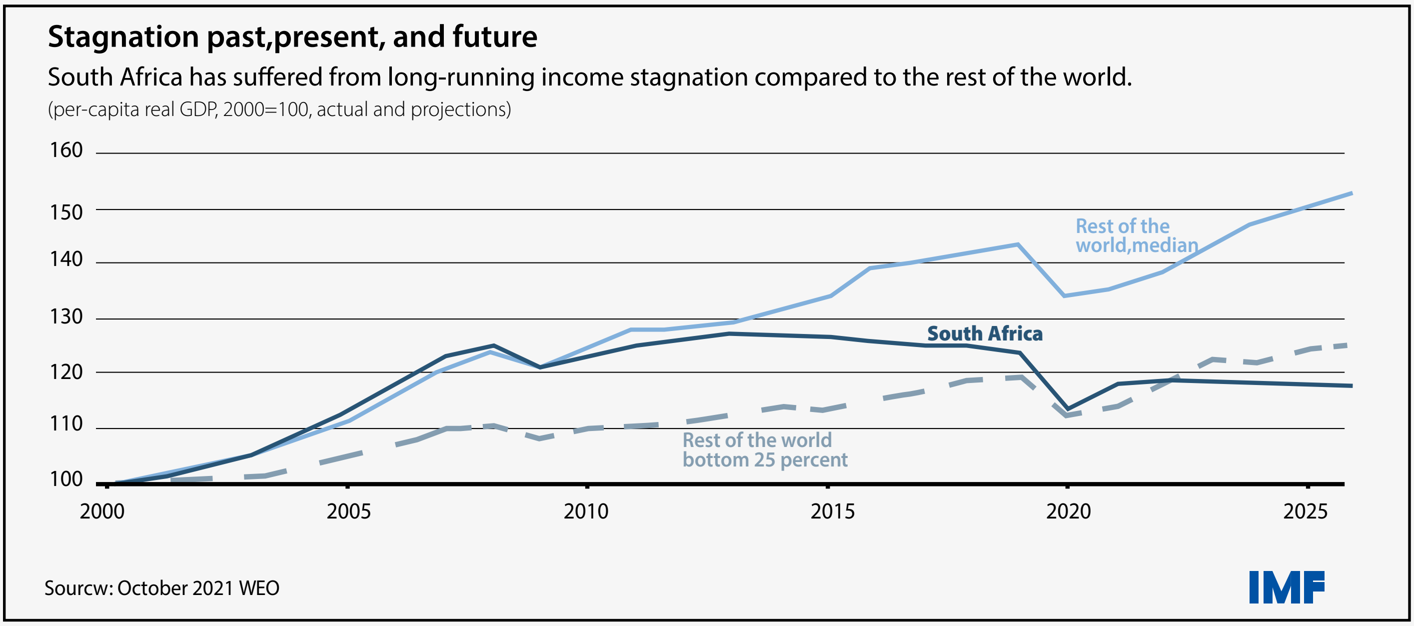
2030 NDP

STAY SAFE
VACCINATE TO SAVE SOUTH AFRICA

DATA AND ANALYSIS

1. Municipal borrowing budgets

Figure 1: Real GDP per-capita



After having been on a decent growth trajectory before, South Africa's economy has been trapped in stagnating productivity for over 10 years now. South Africa has gone from tracking the global medium GDP per capita, to tracking the bottom 25 percent, and it is projected to fall further. Like the rest of the world, the early 2000s were years of steady economic growth for South Africa until around the time of the global financial crisis (2008) where, together with the rest of the world, South Africa suffered a slump in economic productivity as depicted in Figure 1 above. While the rest of the world recovered soon after the global financial crisis, South Africa has struggled to recover and in the wake of COVID-19, things have gotten worse to the point that South Africa's per capita GDP has fallen into the bottom 25 percent of world economies. South Africa's sluggish economic productivity over the last decade has meant that very little progress has been made with addressing the triple challenge of inequality, poverty, and unemployment over that period. With almost a generation's worth of potential economic development forgone between 2009 and 2021, there are numerous factors that have contributed to the status quo however this report will focus on one Infrastructure Development.

The strategic importance of infrastructure in accelerating economic growth is well known and has been widely spoken about. Investment in critical infrastructure such as transport, energy, water, and telecommunications can unlock investment by the private sector as well as foreign direct investment, as it makes it easier and more efficient to do business. Many of the fastest growing economies have been infrastructure-led, such as China, Rwanda and Singapore, to name a few. South Africa, in its National Development Plan 2030, identifies infrastructure development as a catalyst for sustainable economic growth. In terms of the National Development Plan 2030, public infrastructure investment needs to reach 10 percent of GDP by 2030 and should be focused on transport, energy and water. This could stimulate economic productivity, increase employment and reduce poverty and inequality. A significant share of the infrastructure investment will have to be done by municipalities which are legally mandated to ensure the provision of basic services in a sustainable manner as well as to promote social and economic development within their jurisdictions.

However, public-sector infrastructure investment has been below par since the adoption of the National Development Plan in 2012. National Treasury publications show that public-sector infrastructure investment has averaged only 6,7 percent of GDP during the period between 2009 and 2019, well below the National Development Plan target of 10 percent of GDP. Apart from the obvious challenges the country faces with limited fiscal resources, the public-sector faces many challenges with the actual delivery of infrastructure projects which government is undertaking a number of initiatives to address. Some of these challenges will be highlighted later in this report, including the respective steps that government is taking to adress them.

Table 1: Budget Borrowings

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Original Budget	9 728 855	12 038 295	12 155 568	12 015 730	13 327 264	16 195 667	17 620 931	11 395 889	11 927 324
Adjusted Budget	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	7 583 000	9 357 000	9 222 000	8 099 900	8 749 729	8 004 007	5 897 860	5 818 870	2 304 343
	78%	**78%**	**79%**	**70%**	**64%**	**65%**	**37%**	**80%**	**19%**

Source: National Treasury Database

Aggregated performance on planned municipal borrowing budgets has not been impressive so far in the year. The end of December 2021 marked halfway into the 2021/22 financial year and the aggregated implementation of overall municipal budgets was 50 percent whereas only 19 percent of the borrowing budgets had been implemented. So, out of nearly R12 billion budgeted borrowings for all municipalities in relation to the 2021/22 financial year, only R2,3 billion had been borrowed by the end of December 2021.

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

Table 2: Outstanding long term debt as at 31 December 2021

Municipal Category	Municipality	"Total Debt Q2 2021/22 R'000"	Share of Total Debt	"Budgeted Revenue 2021/22 R'000"	Debt to Revenue Ratio
A	BUF	211 179	0,3%	8 234 112	3%
	NMA	1 134 118	2%	12 835 948	9%
	MAN	679 455	1%	8 073 601	8%
	EKU	9 270 183	13%	42 935 624	22%
	JHB	23 180 500	33%	65 846 786	35%
	TSH	11 255 490	16%	38 994 328	29%
	ETH	8 622 404	12%	43 656 807	20%
	CPT	6 890 315	10%	47 512 224	15%
	Total Metros	**61 243 644**	**87%**	**268 089 430**	**23%**
B	**B1 (19)**	5 938 756	8%	64 475 253	9%
	Other Municipalities	2 699 306	4%	91 076 152	3%
C	**Districts**	476 403	1%	24 234 007	2%
	Total all municipalities	**70 358 109**		**447 874 842**	**16%**

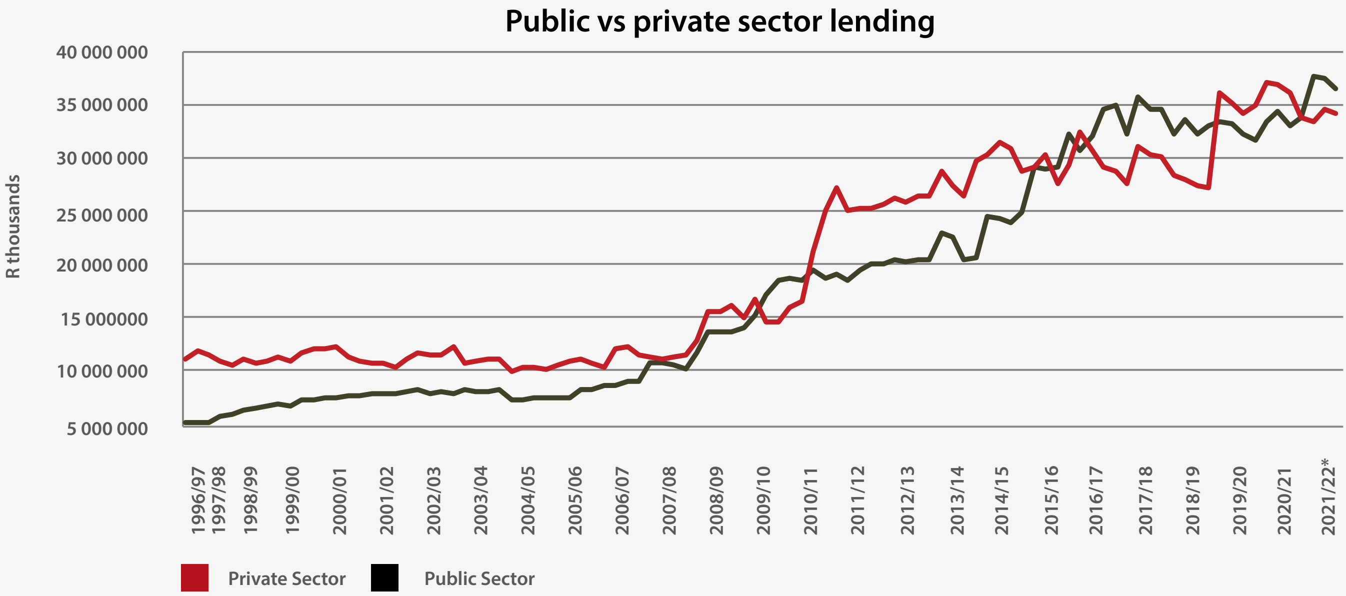
**excluding capital transfers*
Source: National Treasury Database

Outstanding long-term debt aggregated for all municipalities grew by almost R1.9 billion between December 2020 and December 2021. Despite municipalities having taken up a total of R5.2 billion in new long-term borrowings between December 2020 and December 2021, overall outstanding long-term municipal debt has only gone up by about R1.9 billion over the same period. Municipalities owed R68.4 billion at the end of the second quarter of the previous financial year but as at the end of the second quarter of the current financial year, that amount stood at R70.3 billion as reported by municipalities. The increase in outstanding long-term debt over the period is mainly attributed to three metros; eThekwini, Ekurhuleni, and the City of Tshwane, which reported increases of R703 million, R577 million and R323 million respectively.
Overall, long-term debt owed by the metros has increased from R59.3 billion to R61.2 billion. Also, long-term debt owed by secondary cities over the past twelve months slightly increased while districts and the rest of the local municipalities saw their outstanding long-term debt decrease in the aggregate.

The debt to revenue ratio aggregated for all municipalities, which measures total outstanding debt against operating revenue, is one percentage point down to 16 percent over the past twelve months. This doubtless reflects a conservative approach to taking on new debt in a challenging economy.

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

Figure 2: Public and private sector lending to municipalities

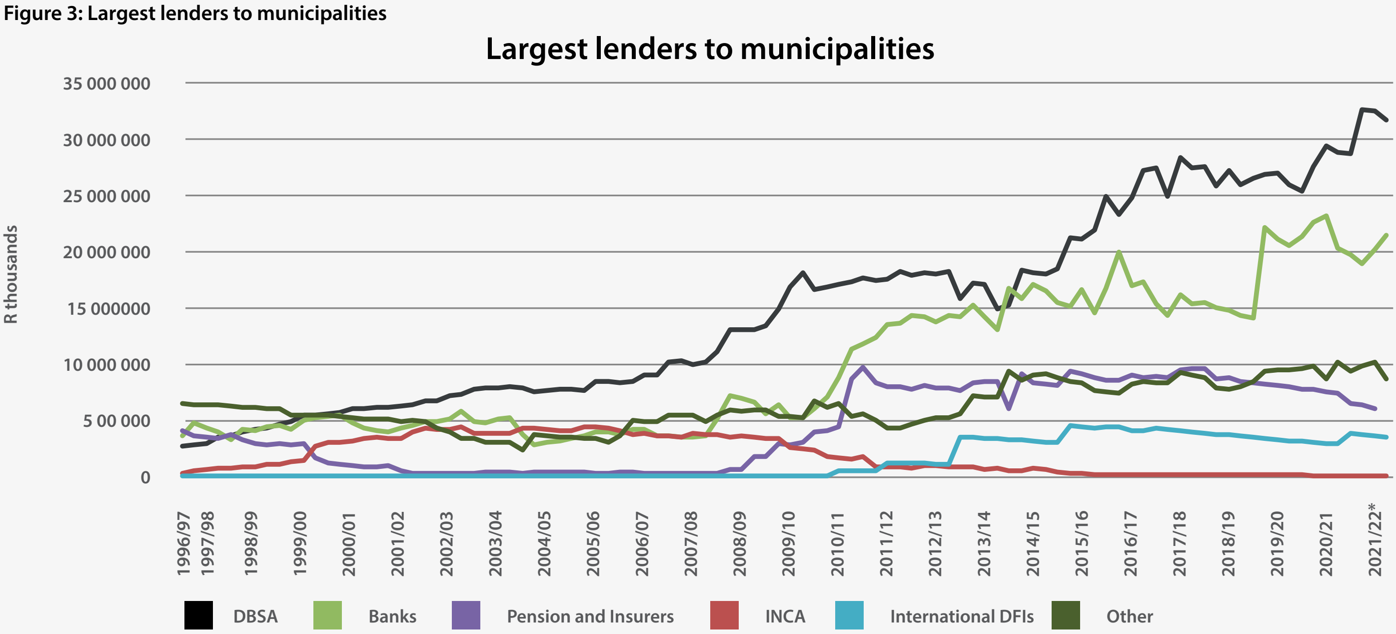


*Incl QII

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

Public sector investment in municipal debt obligations remains above investment by the private sector. Public sector financiers continue to dominate lending to municipalities. They are owed R36.2 billion compared to R33.9 billion owed to the private sector. Municipal long-term debt owed to public sector lenders grew by almost R3.4 billion while municipal long-term debt held by private sector lenders declined by R1.8 billion over the past twelve months.

Figure 3: Largest lenders to municipalities



*Incl QII

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

The growth in municipal debt obligations held by public sector lenders during the past twelve months is attributable to the DBSA. The DBSA added a total of R2.9 billion to its existing investment in municipal long-term debt obligations and is now owed R31.2 billion, up from R28.3 billion this time last year. Also, the stake of commercial banks in municipal debt obligations increased by about R1.1 billion over the past twelve months. Municipal debt held by pension funds and insurers fell by R1.6 billion since the end of December 2020 as a portion of their stock of municipal bonds was redeemed. International DFIs are now owed R3.4 billion, up from R2.8 billion at the end of December 2020.

TOPICAL ISSUES

2021/22 Provincial and Municipal Infrastructure Site Visits

National Treasury conducted infrastructure site visits in 7 of the 9 provinces between August 2021 and March 2022. The aim of the visits was to verify data (financial and non-financial) reported in the Infrastructure Reporting Model (IRM)[1] with actual progress on sites, assess whether the delivery of projects is progressing on time, within cost and quality; to establish the extent of scope changes (where applicable), and to understand how project outcome(s) will improve the livelihood of communities. The projects that were visited were mainly from the sectors of Education, Health, Agriculture, Sports as well as Roads and Transport. Although this was primarily a process for the provinces, municipal infrastructure projects were also visited in some of the provinces to assess the level of collaboration in the planning, implementation, and management of infrastructure assets between provinces and municipalities. To achieve meaningful impact, it is important that public funds are spent on the purpose for which they are allocated. Through prioritisation, government funds are directed where they are needed the most which means that when money is not spent on the purpose for which it was allocated, the most pressing needs of citizens are not being addressed.

Also, it's important that public funds are spent effectively and efficiently. This means that the delivery of infrastructure projects must be on time, within cost and at the required quality standard. When infrastructure projects are not completed on time, it means government is not getting much done as capability is committed elsewhere for longer than required and as a result infrastructure development is not progressing at the desired pace, and thus economic development becomes equally slow paced. Additionally, time delays can impact on project cost. Cost management is key to achieving project outcomes. Without proper cost control measures, a project is at risk of running over budget, depleting funds to complete the project due to wastage. This could mean that the initial investment is lost if money is not found to complete the project, and many of the projects that have been abandoned before completion in the public sector are testament to that fact. Compromises on quality could lead to infrastructure assets wearing out quickly, and thus requiring replacement sooner than expected.

The site visits documented many challenges with the delivery of infrastructure projects, and these problems exist across the whole infrastructure delivery value chain. Many of the current challenges with infrastructure delivery in government date as far back as the dawn of democracy. Many government projects are either abandoned or completed late, running out of budget, and delivered at a quality that is below par. The main challenges that municipalities and provinces are facing with the delivery of infrastructure projects, as observed from the site visits, are highlighted below:

- **Weak intergovernmental collaboration**
  Collaboration between provinces and municipalities in many projects is very weak. Because of weak intergovernmental collaboration, provinces run into challenges during project implementation that could have otherwise been avoided with joint planning between the province and the concerned municipality and vice versa. For example, many projects face challenges with the identification and relocation of existing bulk services whereas this can be addressed at the planning stage through consultation with the relevant intergovernmental stakeholder. Also, the challenge that many provincial projects face with local business forums can be better dealt with in collaboration with municipalities as municipalities have social facilitation departments that are better equipped to deal with such issues.

- **Procurement challenges**
  The procurement process in some projects is carried out in contravention of supply chain management policies where preference is given to some contractors over others. As a result, in some cases, contractors that are not suitably qualified are appointed. The consequences include poor contractor performance or project failure and tender awards being challenged resulting in termination, readvertising and ultimately delayed contractor appointment which is costly to government. To be effective and efficient, public-sector procurement must be carried out subject to the general principles of fairness, equitability, transparency, competitiveness, and cost-effectiveness. To this end, National Treasury has developed a Framework for Infrastructure Delivery and Procurement Management (FIDPM) which prescribes procurement gates which specify processes that must complied with as the project progresses through the stages from concept to completion to improve procurement efficiency and possibly reduce the cost of doing business by provinces and municipalities.

[1] The Infrastructure Reporting Model is a monitoring and reporting tool used by provincial departments to report on their infrastructure projects.

- **Poor project management**
  Implementation in some projects is not supported by appropriate project management skills and as a result, the projects either fail, experience delays, or go over budget owing to poor scheduling of project activities and lack of proper cost planning, oversight, and control. The use of qualified and experienced project managers could ensure that project outcomes are achieved within budget, at the required quality standard and within the stipulated timeframe. Apart from dealing with procurement challenges, the FIDPM also seeks to support the asset management, infrastructure planning, infrastructure delivery management and decision-making systems for provincial departments and municipalities. Currently, National Treasury is running a pilot programme in 8 municipalities that is aimed at institutionalising the Infrastructure Delivery Management System as the chosen government wide system for infrastructure delivery. Upon conclusion of the pilot programme, a plan will be developed to roll-out the programme to all municipalities.

- **COVID-19 pandemic**
  Progress on all the projects was affected by the COVID-19 pandemic, which restricted working conditions during the hard lock-down between the end of March 2020 and June 2020. This meant that some infrastructure projects had to be paused as they were deemed non-essential. Additionally, after the hard lock-down, before work could resume on project sites, provisions had to be made for compliance with health regulations, which impacted on total project costs.

- **Timely payment of contractors**
  Many projects have experienced challenges with the on-time payment of contractors and in some instances, this has resulted in major delays on completion of some projects. When contractors are not paid on time, their cashflow suffers and as a result, they find it difficult to fund operations on projects sites. Ultimately contractors have no choice but to stop work until payment is received. Even worse, contractors, especially SMMEs, may be pushed into insolvency and rendered incapable of continuing with the work even after payment has been made. This obviously defeats government policy on SMMEs development and business support.

- **Local business forums action**
  The issue of "business forums" has been for some time an endemic that is causing disruptions on government infrastructure projects. Organised local "business forums" go to project sites and demand 30 percent of the contract value of the projects without following proper channels. In many instances, they are motivated by an incorrect interpretation of the legislation on local procurement. Even criminal elements have started to emerge as they are finding platforms to carry out illegal activities such as theft, intimidation of contractors and vandalism on construction sites, disguised as local business forum action. Some municipalities use their social facilitation departments to engage constantly with local business forums regarding plans in relation to capital projects, available skills in the local market and jointly design work plans. This helps as it clears out most of the issues that usually emerge with local business forums even before the projects start. The observation is that there is very little local business forum disruptions in the municipalities where this approach is being utilised and so, provincial departments are encouraged to partner with the respective local municipalities where projects are planned to be implemented. Additionally, government is increasing efforts to deal with the criminal elements that have emerged.