STERKWATER WASTEWATER TREATMENT PLANT
MANGAUNG 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 and infrastructure delivery.

CONTEXT

The MBB is issued by the National Treasury on a quarterly basis. This issue covers long-term borrowing information up to 31 December 2023, corresponding to the end of the second quarter of the 2023/24 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

- Rating agencies have an important role to play as barometers of how the debt market perceives municipal financial management.

- Lenders reported a total of R68.2 billion in outstanding long-term borrowing to municipalities while R68.4 billion was reported by municipalities.
- So far, municipalities have raised only R3.5 billion in new borrowings, which is about 27 percent of the budgeted borrowings for the 2023/24 financial year.
- Long term debt owed to the private sector declined faster than that owed to the public sector.
- Metros are more leveraged in proportion to revenue compared to the other municipal categories.
- This issue looks at various national government initiatives to improve efficiency within the municipal revenue value chain.

DATA AND ANALYSIS

1. Municipal borrowing budgets

The impact of downgrades to municipal credit ratings. In the wake of the recent downgrade of Ekurhuleni metro's crediting rating by Moody's, it is important to reflect on the role of credit rating agencies and the impact of their credit rating actions in the municipal debt space. Credit rating agencies play an important role in the municipal debt market by providing an independent assessment of a municipality's creditworthiness to fulfil different user needs. Municipalities use these credit assessment reports to strengthen their case when procuring long-term financing capital while lenders/investors use them to inform decisions about lending/investing in municipal debt instruments. Additionally, credit ratings promote fiscal discipline as municipalities are aware that there is an extra eye overlooking their financial affairs over and above residents, national and provincial governments.

Given the context outlined above, credit rating actions relating to municipalities are bound to attract the attention of different interest groups for different reasons. However, the impact of a downgrade to a municipality's credit rating can only be truly felt by the affected municipality and the lenders/investors who hold a stake of the municipality's long-term debt obligations. A municipality who is a

subject of a credit rating downgrade will find it more expensive to raise long-term debt in the general long-term debt market. And in the worst-case scenario, depending on the severity of the rating downgrade, the municipality might experience market rejection – where the debt market lacks the appetite to advance credit to the municipality. This situation must be avoided at all costs as it is detrimental to municipal infrastructure development, especially amongst the metros where long-term borrowing is a key component of the capital investment funding mix.

Holders (investors/lenders) of municipal debt securities have 2 options. They can either hold on to the security until maturity, in which case a credit rating downgrade will have no impact to the investor as the interest rate payable on municipal debt securities is fixed, or they can sell the security on the secondary debt market for liquidity reasons. However, in the case of the latter an investor will have some difficulty with selling a municipal debt security whose issuer is a subject of a credit rating downgrade. The investor will likely be only able to sell the security at a discount as the market will only be prepared to buy the security at less than face value owing to the increased perceived risk of default by the issuer because of the credit rating downgrade. In conclusion, rating actions are a key barometer of how the market perceives financial management within municipalities and a sharp reminder to all that it matters how municipalities are run.

Table 1: Budgeted Borrowings

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
Original Budget	12 038 295	12 155 568	12 015 730	13 327 264	16 195 667	17 620 931	11 395 889	11 927 324	10 348 260	13 127 198
Adjusted Budget	12 033 281	11 674 332	11 602 644	13 572 036	12 241 682	16 017 275	7 280 462	7 282 004	8 935 181	-
Actuals	9 357 000	9 222 000	8 099 900	8 749 729	8 004 007	5 897 860	5 818 870	5 905 562	6 417 269	3 516 291
	78%	79%	70%	64%	65%	37%	80%	81%	72%	27%

Source: National Treasury Database

Just over a quarter of the aggregated borrowing budgets have been implemented by municipalities halfway into the financial year. By the end of December 2023, municipalities had borrowed only R3.5 billion, which equates to almost 27 percent of the R13.1 billion aggregated borrowing budget. This R13.1 billion borrowing budget is anticipated to contribute about 17 percent towards the

aggregated capital expenditure program for all municipalities which is set at R76 billion for the 2023/24 financial year. However, as it has become common practice, the borrowing budgets will likely be significantly reduced during the budget adjustment process which will consequently lower the amount of capital investment that will be undertaken during the current financial year.

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

Table 2: Outstanding long term debt as at 31 December 2023

| Municipal Category	Municipality	Total debt Q2 2023/24 R'000	Share of total debt	Budgeted Revenue 2023/24 R'000*	Debt to revenue ratio
A	BUF	122 134	0,2%	9 415 557	1%
	NMA	1 178 364	2%	16 055 280	7%
	MAN	387 141	1%	9 311 433	4%
	EKU	9 440 214	14%	55 326 542	17%
	JHB	21 446 417	31%	75 393 870	28%
	TSH	9 346 358	14%	44 704 931	21%
	ETH	9 461 384	14%	52 562 916	18%
	CPT	7 219 460	11%	58 890 332	12%
	Total Metros	**58 601 472**	**86%**	**321 660 861**	**18%**
B	**B1 (19)**	6 642 640	10%	78 726 766	8%
	Other Municipalities	2 815 903	4%	105 318 880	3%
C	**Districts**	330 980	0%	30 284 499	1%
	Total all municipalities	68 390 995		535 991 006	13%

excluding capital transfers
Source: National Treasury Database

Table 3 shows the distribution of outstanding long-term debt per municipal category. The metros boast the largest share which has hovered around 85 percent since the first publication of the municipal borrowing bulletin. The remaining 15 percent belongs to the rest of the other municipal categories including secondary cities which take up 10 percent of the total outstanding debt, leaving only 5 percent to the rest of the local municipalities and districts. However, in terms of comparisons of revenue distribution between the different municipal categories, the numbers are not as aggressively skewed in favour of the metros. The revenue share of metros to aggregated municipal revenues is 60 percent while nearly 15 percent belong to the secondary cities. The rest of the local municipalities and the districts own 19 percent and 6 percent respectively. The metros are evidently more leveraged in proportion to revenue and their aggregated debt to revenue ratio compared to the other municipal categories affirms this.

**Figure 1: Public and private sector lending to municipalities**

Public vs private sector lending
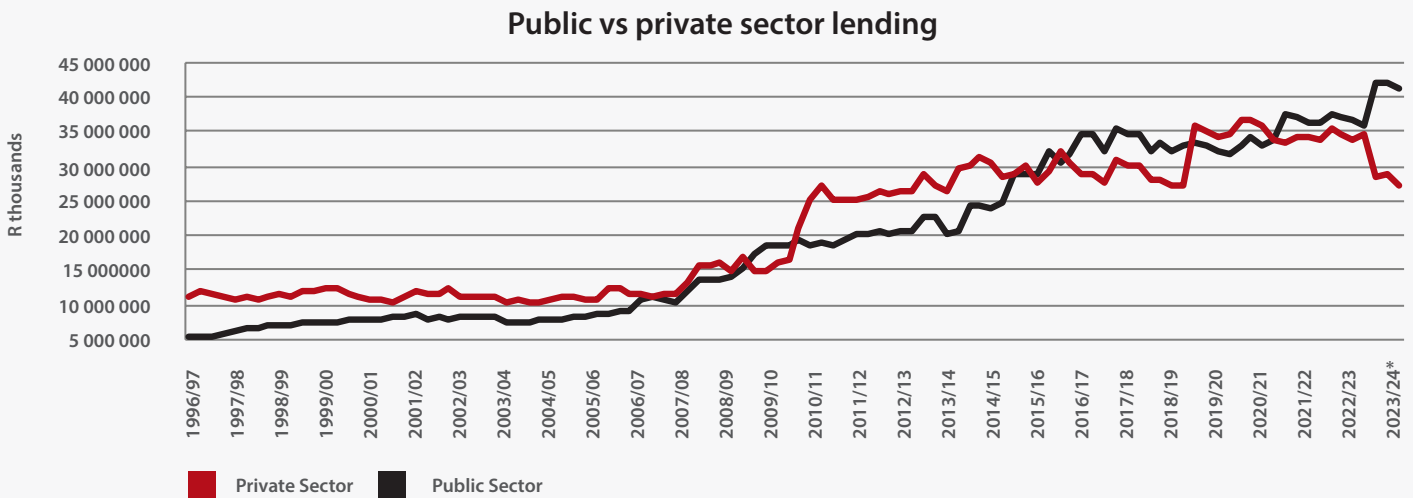
*Inc Qll
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB*

Long term debt owed to the private sector declined faster than that owed to the public sector. Long-term debt owed to public sector lenders is currently valued at 1.5 times higher than long-term debt in the hands of private sector lenders. Long-term debt owed to public sector lenders declined by R800 million and is currently valued at R41 billion while private sector lending institutions are currently owed R27.3 billion by municipalities after a decline of just over R1 billion from the start of the current financial year. The existence of both types of investors/lenders is crucial in the country as it ensures that well run municipalities can benefit from the availability of a wider pool of private sector financing that is competitively priced, while the smaller municipalities can potentially benefit from the developmental role that will ideally be played by public sector lenders in terms of financial management capacity building and availability of debt financing that will otherwise not be available from the private sector. Ideally, the actions of the public sector lenders should not hinder but accelerate progress towards more private sector-based financing for municipalities.

Figure 2: Largest lenders to municipalities

Largest lenders to municipalities
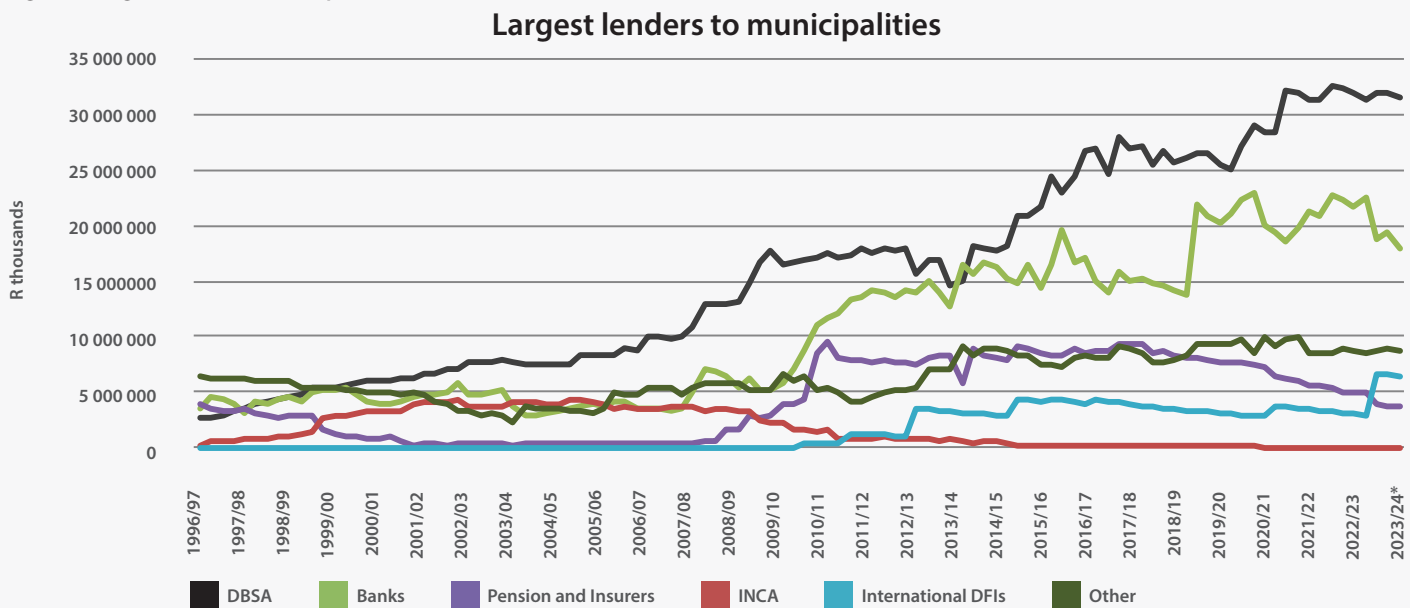
*Inc Qll
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB*

The profile of investors in municipal debt obligations has remained the same throughout the years. Institutional investors such as pension funds and insurers generally have longer term mandates which make them ideal investors for municipal securities with longer tenors. Although these institutions' investment in municipal debt rose sharply between the 2008/09 and 2011/12 financial years; it has since been on the decline owing to the limited number of municipal bonds in the market. Their investment in municipal debt has solely been in municipal bonds and as at the end of the second quarter of the 2023/24 financial year, their share of municipal bonds was valued at R3.7 billion, making them the second largest holders of municipal debt securities currently valued at R11.9 billion in aggregate.

TOPICAL ISSUES

NATIONAL TREASURY INITIATIVES FOR THE IMPROVEMENT OF REVENUE MANAGEMENT

The state of local government has further deteriorated, largely as a result of substandard revenue management practices. Many municipalities have difficulties to sustain the revenue management function, particularly billing households and businesses accurately and the culture of non-payment are key challenges. This has heavily contributed to the defective financial position in some municipalities. Recovering from the crippling impact caused by the COVID-19 pandemic, the current economic climate further pressurises municipal collection of revenue from trading services and the ability to pay creditors on time.

Revenue management in this context, is more-and-more becoming a crucial function in securing the sustainability of a municipality. Most municipal own revenue is derived from the property within the municipal demarcation either in the form of property tax or service charges. The latter is centred around the reciprocal relationship between the municipality as the provider of service(s) and the consumer as the recipient of the service(s) in exchange for payment at an affordable tariff that directly relates to what was consumed. When this relationship is not honoured, inefficiencies arise within the revenue value chain where services are not delivered or charged at affordable tariffs or payment is not received.

This in turn translates as low internally generated revenue, insufficient to cover the municipality's operating expenditure, especially creditors. With debt accumulating, many municipalities struggle to meet their financial obligations and end-up in a spiral where the municipal council also adopts an unfunded budget, in some cases, persistently for years. This is where the implementation of the relevant legal framework becomes critical from the perspective of the municipality. Thus, it is important for any municipality to have an efficient revenue management function complying with the minimum legal prescripts to facilitate the timely generation and collection of revenue at affordable charges.

There are several revenue management challenges that municipalities are currently facing. The key challenge is inadequate leadership to enforce proper implementation of revenue management best practices. This includes failure to implement the relevant legislation such as the Municipal Systems Act (MSA), Municipal Property Rates Act (MPRA), Municipal Finance Management Act (MFMA) and policies set out to govern rates, tariff setting and credit control effectively and efficiently. This perpetuates the culture of non-payment, which has also filtered into organs of state, whereby many departments owe accumulated debt to municipalities to date.

The lack of integration across the functions within the revenue management value chain and other areas of dependence within the municipality is another major challenge. For example, customer care, billing for services consumed, data integrity which ensures that the correct customer is billed and based on actual consumption, collection of payment, clearances and refunds, town planning, property valuation, and infrastructure provision for water and electricity are interdependent, however, often operated in isolation across different municipal departments. This weakens the efforts made towards maximum revenue generation and frequently, the organisational structure of many municipalities does not promote integration of these functions.

The lack of consequence management for non-implementation of revenue management processes and weak internal controls is another key challenge. This leads to revenue leakages in the areas of billing estimates, water and electricity meters that are incorrectly or not read, slow address of water leakages and faulty / by-passed electric meters resulting in losses, unlimited supply of free basic services (FBS) in excess to the national FBS policy limits and new properties and / or meters not updated for billing purposes. Many municipalities also have poor asset management practices whereby revenue generating infrastructure like electricity and water networks, waste removal trucks and meters, etc. are not well-maintained which causes significant revenue losses. Efficiently resolving customer queries further pressurises the local revenue collection efforts.

In collaboration with other departments, the National Treasury has stepped up to put initiatives in place to assist municipalities with many of the challenges identified in revenue management. Which, if correctly utilised, will facilitate a step forward in improving the financial sustainability of local government.

The National Treasury initiatives are aimed to assist municipalities improve efficiency within the revenue value chain, to ensure existing revenue sources are optimised and to capacitate officials on best practices. Initiatives include providing support for the development and strengthening of municipal policies and workforce transformation, the identification and financial analysis of top defaulting municipalities owing Eskom and other creditors, the automation of various revenue management related assessment tools, tariff modelling, assisting the pursuit of outstanding debt owed to municipalities and further

research into alternative revenue options in the local sphere. Furthermore, the National Treasury in collaboration with provinces developed socio economic profiles for all 257 municipalities to facilitate a sense of the customer base within municipalities and inform the affordability assessment during the tariff setting process. Economic and financial viability studies have been undertaken in four provinces (Eastern Cape, North West, Gauteng and Northern Cape) to determine to what extent the customer base of municipalities can potentially translate into revenue.

A user-friendly tariff setting tool was issued in the MFMA Circular 98 to facilitate improved municipal self-assessment and stakeholder oversight of whether the revenue component of the municipal budget is funded, realistic and provide for certain critical budgeting components necessary to provide basic services. The existing budget assessment tool was enhanced to facilitate improved consideration of various issues, including outstanding debt owed to creditors (particularly Eskom and the Water Boards). The National Treasury also independently assessed the tariffs of the 43 municipalities identified to be in a service delivery and financial crisis , as well as the completeness of their revenue base through a tool developed to reconcile the general valuation roll with the billing system across the various property categories set-out in the Municipal Property Rates Act.

Following a piloting phase, a panel of smart meter service providers were appointed in June 2024 through the RT29 transversal to assist the smart prepaid metering and wider meter replacement programme across local government. The same panel will be used to support the smart meter grant targeted at selected debt relief participants during the initial year and wider roll-out over the 2024/25 MTREF. The National Treasury: Revenue Management directorate, with support from the Office of the Accountant General (OAG) and CIGFARO, to continue facilitating a Revenue Management Masterclass programme to capacitate officials and councillors on the revenue function and their role therein.

The National Treasury also approved 71 municipalities as at 31 January 2024, to participate in a municipal Eskom debt relief programme geared at facilitating a recovery by returning and enforcing basic best practise of financial management. The Department of Water and Sanitation working with the National Treasury is in the planning stage of designing a similar relief programme for Water Boards and municipalities owing them. Through the National Treasury: Municipal Finance Improvement Programme (MFIP) technical capacity has been deployed to selected districts aligned to the 43 municipalities identified to be in a service delivery and financial crisis with additional deployments underway to support particularly debt relief participants. These technical advisors are strategically placed to address revenue management issues, assist with Financial Recovery Plans (FRPs), tariff setting, the updating of budget related policies and implementation and reconciliation of the valuation roll with the financial system and the Deeds' office, just to name a few. The implementation of these initiatives is aimed at improving the completeness of the revenue base in local government, facilitate cost reflective tariffs, funded budgets, initiate further research and development of revenue norms and standards and explore innovative solutions to improve efficiency in revenue management.

As set-out above, there is various National Treasury support available and / or provided to all municipalities, however, ultimately the decision to integrate and enforce such support within the municipal functionality to fully benefit remains the prerogative of the individual municipal council, senior management and officials.