MUNICIPAL BORROWING BULLETIN

ISSUE 4

March 2017

INSIDE
- KEY HIGHLIGHTS
- DATA ANALYSIS

BACKGROUND

The Municipal Borrowing Bulletin is a quarterly publication aimed at updating and informing 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 and the public to promote transparency, accountability, and the prudent and responsible use of municipal borrowing for infrastructure finance.

This report covers information up to 31 December 2016, which corresponds to the second quarter of 2016/17 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.

RECENT DEVELOPMENTS AND POSSIBLE IMPACT

The sovereign's credit rating was relegated by Standard & Poor's (S&P) and Fitch rating agencies to a speculative (non-investment grade) BB+ status. Moody's is also reviewing the country's credit rating for a possible downgrade. A downgrade in a country's credit rating can affect sub-sovereign issuer's credit rating, potentially resulting in higher interest rates and more expensive borrowing. It is anticipated that borrowing patterns may be affected. Domestic interest rate hikes also affect consumers negatively as the repayment costs for current

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

debt are likely to increase resulting in some consumers not being able to meet their financial obligations. As a result; collection of revenues by municipalities from consumers could decline, resulting in municipalities possibly struggling to honor their financial commitments

KEY HIGHLIGHTS

- The consolidated total long term debt outstanding has increased to R62.9 billion from R60 billion in the previous quarter.
- Actual new borrowing to date amounts to R3 billion which is 25 percent of the 2016/17 financial year budgeted borrowing.
- A downgrade in the country's credit rating could result in higher interest rates making borrowing more expensive, affecting future borrowings and capital expenditure.
- The same bank that did not report in the previous quarter has not provided data to National Treasury again in this quarter despite repeated requests. Therefore the analysis does not provide a complete picture as far as the aggregate banks' data is concerned. Non-submission of information delays the publication of the bulletin and disrupts the publication schedule. National Treasury will be pursuing this matter with the appropriate authorities.

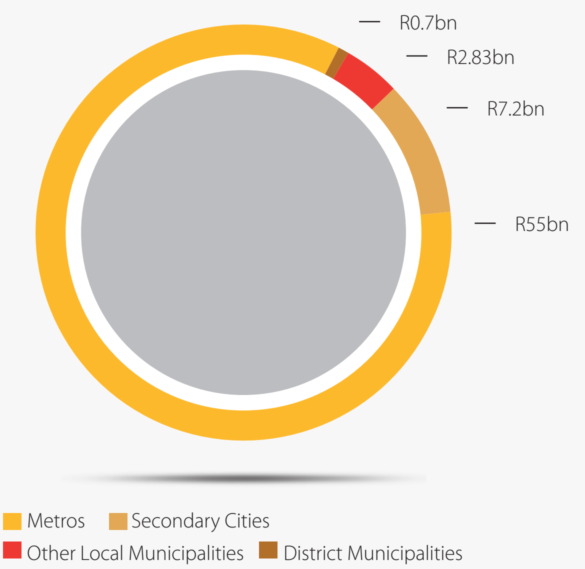
DATA AND ANALYSIS

The amount budgeted for municipal borrowing for the 2016/17 financial year amounts to R12 billion of which R3 billion or 25 percent of the budgeted borrowing has been reported as actual borrowing by the municipalities as at mid-year. A total amount of R2.6 billion or 83 percent of the actual borrowing is accounted for by the metros and the remaining portion by local and district municipalities.

Figure 1 below shows the total outstanding debt as at the end of the second quarter of the 2016/17 municipal financial year.

1. Total debt outstanding as reported by municipalities

Figure 1: Long term municipal debt outstanding as at 31 December 2016



The municipalities reported aggregate long term debt amounting to R62.9 billion of which R18.4 billion or 29 percent is for the bonds issued by the four metropolitan municipalities (City of Johannesburg, City of Cape Town, City of Tshwane and Ekurhuleni) and the remaining R44.5 billion is for long term loans. The metropolitan municipalities accounts for an outstanding debt of R55 billion or 87 percent, followed by secondary cities and other local municipalities at R7.2 billion and R2.83 billion respectively, districts only account for R0.7 billion.

As stated above, actual new borrowing for the year to date amounts to R3 billion, redemptions reported for this quarter amounted to R1.1 billion, therefore the total outstanding debt has increased by R2.9 billion when compared to the previous quarter.

Table 1: Outstanding long term debt as at 31 December 2016

Municipal Category		Total debt Q2 2016/17 R'000	Share of total debt	Budgeted revenue 2016/17* R'000	Debt to revenue ratio
A	BUF	471 904	1%	5 907 039	8%
	NMA	1 365 904	2%	9 535 857	14%
	MAN	998 224	2%	6 641 627	15%
	EKU	5 234 071	8%	32 378 969	16%
	JHB	20 151 392	32%	46 175 187	44%
	TSH	10 650 004	17%	30 209 869	35%
	ETH	9 495 547	15%	31 267 560	30%
	CPT	6 510 546	10%	34 520 879	19%
	Total Metros	54 877 592	87%	196 636 987	28%
B	Other municipalities	7 214 981	11%	107 676 448	7%
C	Districts	788 099	1%	19 218 926	4%
	Total all municipalities	62 880 672		323 532 361	19%

** excluding capital transfers*
Data source: Q2 2016/17 Quarterly Borrowing Monitoring Report from municipalities to National Treasury and 2016/17 budgets

Table 1 above shows the share of long term debt amongst all municipalities. The metropolitan municipalities have issued a total of R54.9 billion of borrowing and remain the largest borrowers when compared to the other municipalities and districts combined.

The City of Johannesburg has the largest share of long term debt at 32 percent when compared to the rest of the metros. The average debt to revenue (excluding capital transfers) ratio for all municipalities is 19 percent which is within the norm of 45 percent suggested by National Treasury, however when looking at the individual municipalities, City of Johannesburg has the highest debt to revenue ratio at 44 percent followed by City of Tshwane and eThekwini at 35 percent and 30 percent respectively. Buffalo city has the lowest ratio at 8 percent.

Table 2: Capital expenditure, new borrowing and outstanding debt

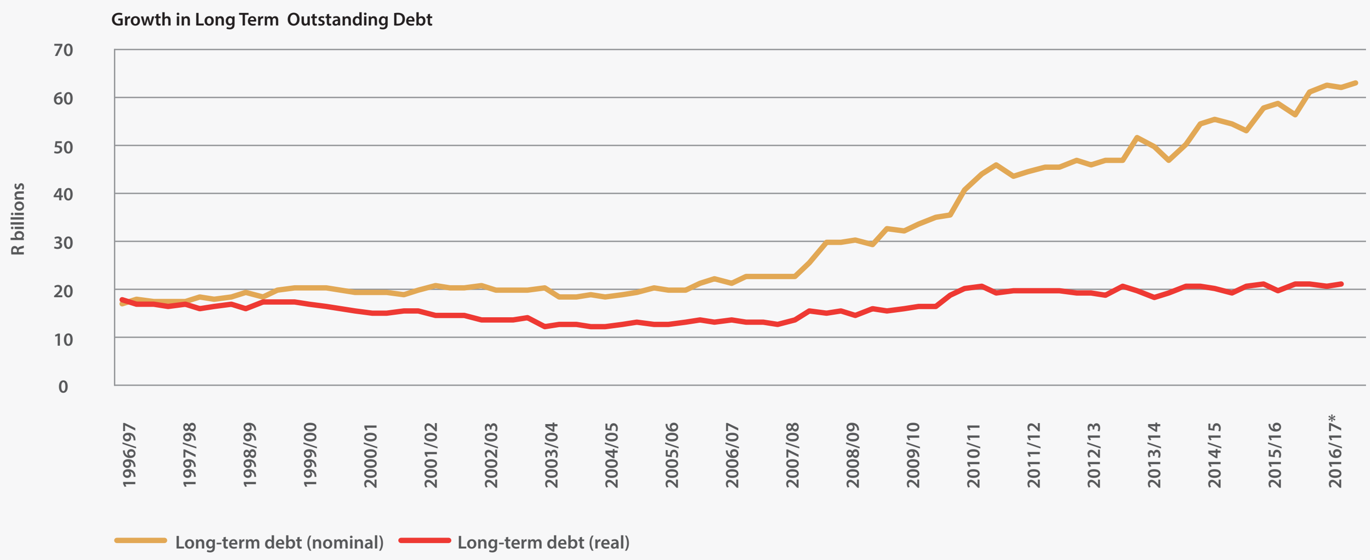
R million	2008/09 Actual	2009/10 Actual	2010/11 Actual	2011/12 Actual	2012/13 Actual	2013/14 Actual	2014/15 Actual	2015/16 Actual	2016/17 Full-year forecast	2016/17 Q2 Actual
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	69 425	22 352
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	12 016	2 975
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	17%	17%	13%
Outstanding debt	32 366	35 388	43 190	45 640	48 078	51 431	53 493	60 903	67 119	62 888

Source: National Treasury

The actual capital expenditure for the second quarter was R22.3 billion of which 3 million or 13 percent was funded from long term borrowing. Based on the second quarter's reports from the municipalities, budgeted borrowing has decreased slightly by R337 thousand hence the share of capital expenditure funded by borrowing is expected to remain the same when compared to the previous financial year. It should be noted that this could be an issue of misreporting by some municipalities.

2. Growth in long term debt as reported by lenders

Figure 2: Growth in long term municipal borrowing



**Q2 2016/17*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 2 shows the movement in long-term municipal borrowing since inception (1996/97 to date). In the quarter under review, lenders reported real long term debt to be R63.3 billion while municipalities reported R62.9. The lender side data is distorted however because data was not received from the same bank that did not report in the previous quarter. As at the end of the second quarter, the nominal debt amounted to R20.9 billion which has increased by R85 million when compared against the previous quarter. The figures on this diagram have been updated using the baseline inflation of December 2016.

Figure 3: Split between debt instruments issued by municipalities over time

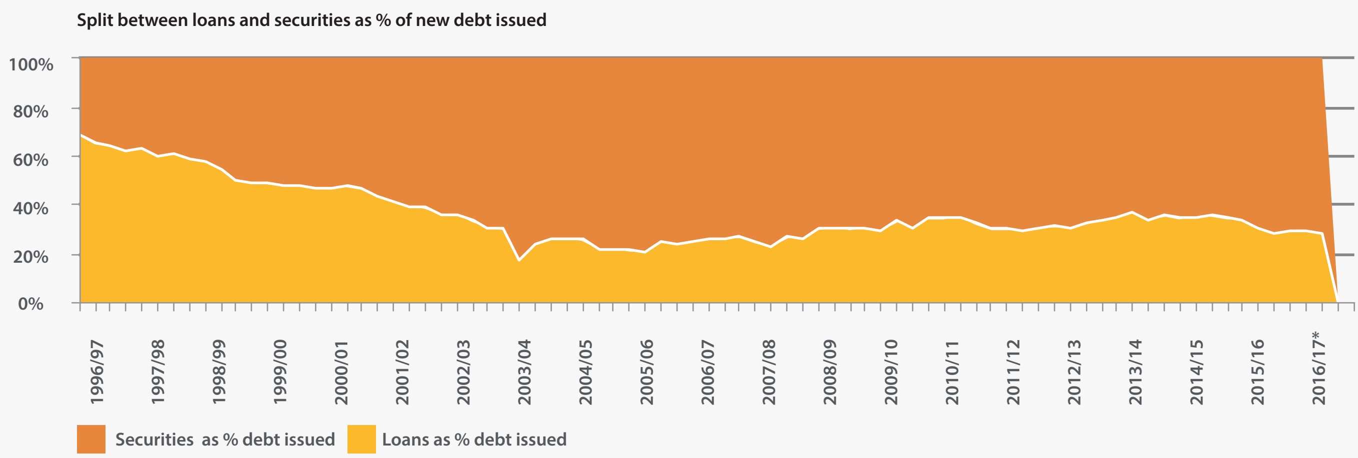
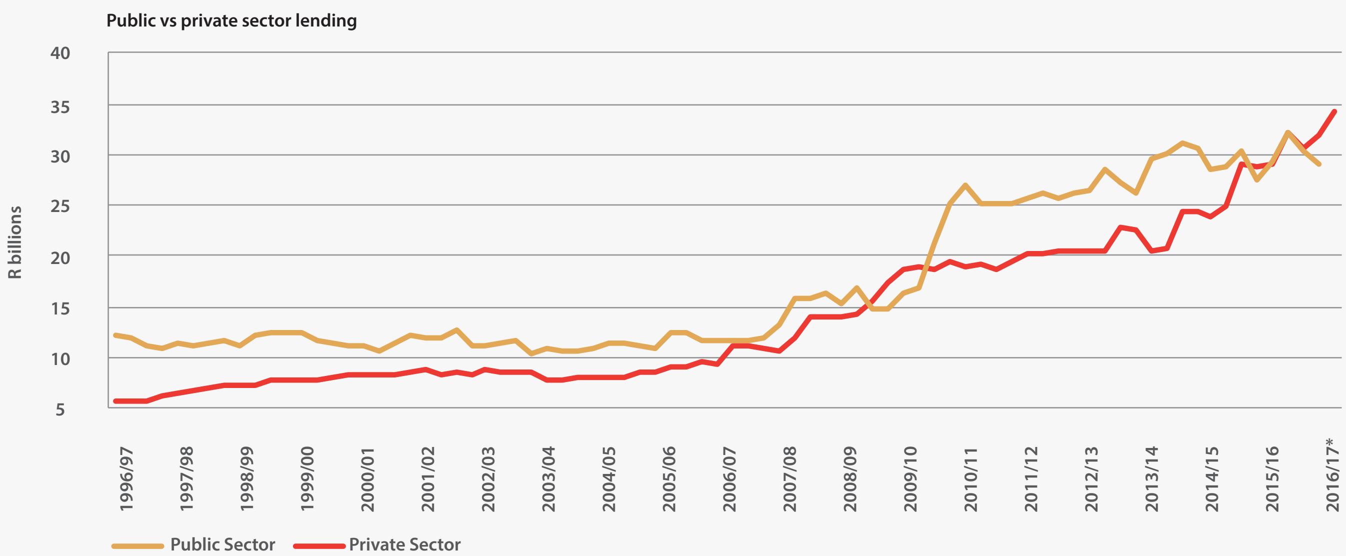


Figure 3 above shows the share and movement of municipal debt obligations between loans and securities. There have been no new bonds issued in the second quarter. There are only four metros that have issued bonds. Based on the information received from the lending institutions, there is a 28:72 percentage split between securities and long term loans respectively hence loans are mostly preferred as the main source of long term debt than securities. The split differs slightly from that reported by the municipalities, which is 29 percent for securities and 71 percent for long term loans.

3. Holders of municipal loans and bonds

Figure 4: Public and private sector lending to municipalities



**Q2 2016/17*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 4 shows the distribution of long term debt obligations between the public and private lenders. In the second quarter of 2016/17 public sector remains the largest investor, holding R34.4 billion or 55 per cent of the total debt. Debt held by the private sector has declined from R30.4 billion in the first quarter to R28.9 billion in the second quarter.

Figure 5: Largest lenders to municipalities

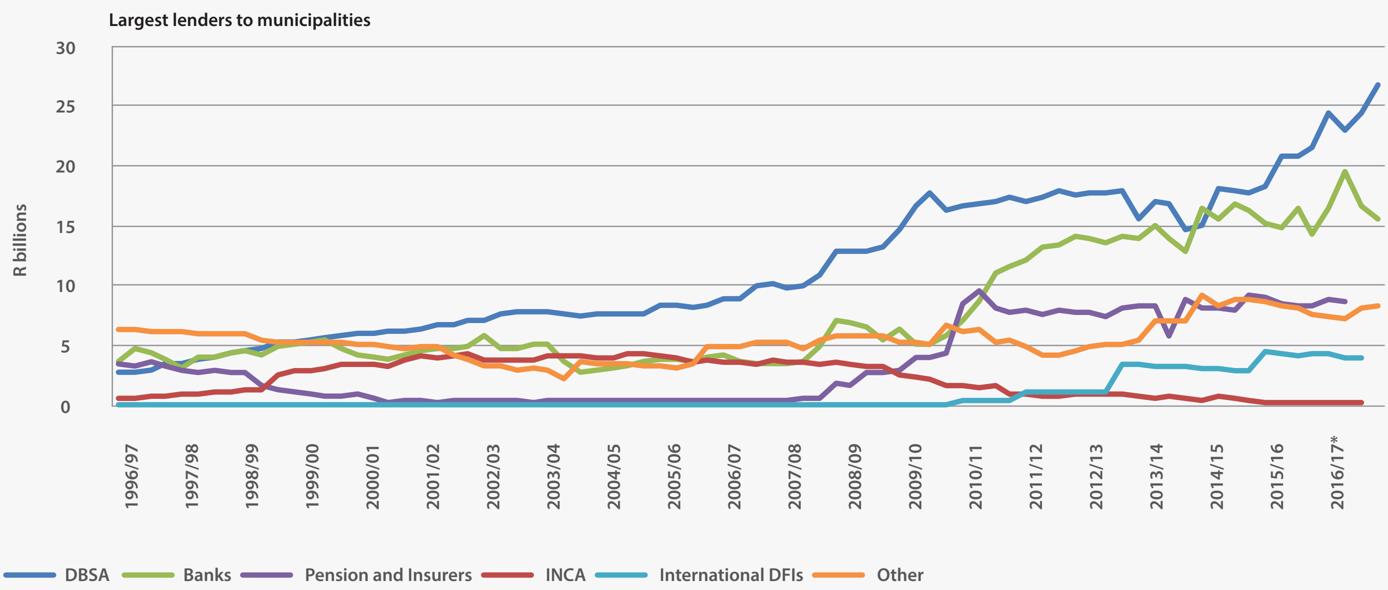


Figure 5 above illustrates the different types of lenders currently lending to municipalities. The Development Bank of South Africa has maintained its position as the largest investor in the municipal space, followed by banks, pension & insurers, other, international finance institutions and INCA as observed in the previous quarters. INCA's portfolio now stands at R167 million.

DISCUSSION

Understanding Municipal Borrowing

In 1998, the White Paper on Local Government[1] set forth a vision for financing local infrastructure in a democratic South Africa:

National government's approach emphasises the importance of achieving financial discipline through decentralised market relationships (between borrower and lender), rather than the direct, centralised control of local government.

Two years later, Cabinet adopted the Policy Framework for Municipal Borrowing and Financial Emergencies.[2] The Policy Framework refers to several reasons why municipal access to capital markets is important. First among these is the size of local infrastructure needs, which greatly exceeds what can be made available on a grant basis from the central fiscus.

In 2003, the anticipated policies were incorporated into Chapters 6 and 13 of the Municipal Finance Management Act[3], which authorizes long-term borrowing for "capital expenditure on property, plant or equipment to be used for the purpose of achieving the objects of local government."

Now, after a decade and half of experience with these policies, National Treasury has undertaken a comprehensive review of the Policy Framework for Municipal Borrowing and Financial Emergencies. National Treasury is taking stock of South Africa's experience with municipal borrowing to date and know which municipalities are borrowing, and which institutions are lending. Furthermore, National Treasury has investigated the evolving infrastructure needs of municipalities, and has proposed clarifications and adjustments to policy that will take these into account. However, the understanding of municipal borrowing remains incomplete, because of a missing link of how municipalities have invested the capital they have raised through borrowing.

Accordingly, National Treasury has engaged the consulting firm Palmer Development Group (PDG) to assist it in undertaking research and developing an analysis of the sources and uses of municipal capital funds over the period from 2006/07 financial year to 2014/15 financial year, with particular attention to expenditure financed by long term municipal borrowing.

1 *http://mfma.treasury.gov.za/MFMA/Guidelines/whitepaper.pdf*
2 *http://mfma.treasury.gov.za/MFMA/Guidelines/framework.pdf*
3 *No. 56 of 2003,*

The study has three components:

1. The first component is to estimate how much of the proceeds of long term borrowing have been used for various types of property, plant and equipment.

2. The second component is to identify the outputs (what was financed) and the outcomes (what the impact of the investments has been).

3. The third component, based on a sample of investments financed by each of three means (long term borrowing, intergovernmental grants, and own source funding) is to understand how the source of funds impacts factors such as economic return on investment (ROI); financial and environmental sustainability; and the characteristics of households and firms that benefit from the investment.

The overall intention is to gather evidence about the effectiveness and impact of the current legal and regulatory framework, and identify areas of potential improvement.

Your comments and suggestions are also an important part of the process. If you have experiences that you would like to share, or suggestions for National Treasury's municipal borrowing team, please share them with us by email at: Municipalborrowing@treasury.gov.za