MUNICIPAL BORROWING BULLETIN

ISSUE 5

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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 data sharing, analysis, highlighting trends and also discussing topical issues relating to municipal borrowing. 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.

To date, four Bulletins have been issued. This is the fifth Bulletin which covers information up to 31 March 2017, corresponding to the third quarter of the 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

In July 2017, which is beyond the date range of data included in this report, the City of Cape Town issued a "green bond" in the amount of R1 Billion. This bond is aimed at financing approved green projects which have positive environmental benefits. This will be the second green bond to be issued by a South African municipality.

- A green bond can help raise capital for investment that is characterised as particularly sustainable such as projects related to clean water, renewable energy, energy efficiency, river/habitat restoration, and avoidance or mitigation of climate change impact.

KEY HIGHLIGHTS

- Progress has been made in obtaining data from all the top four commercial banks. This Bulletin covers information from the overwhelming majority of financial institutions involved in the municipal borrowing market. There has been significant improvement in the information reported by both the supply side and the demand side - these reported R63.4 billion and R63.5 billion respectively.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

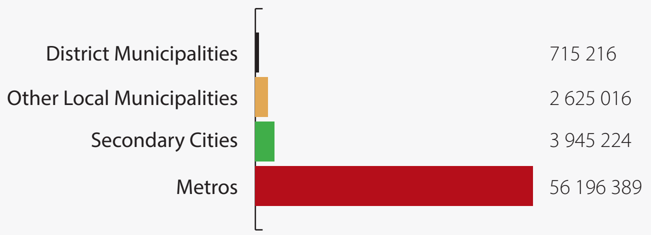
2030 NDP

- The consolidated outstanding long term debt has increased to R63.5 billion in the third quarter from R62.9 billion in the previous quarter as reported by municipalities.
- Municipalities adjusted their budgets to include slightly more borrowing in the remainder of their 2016/17 financial year. Projected borrowing was adjusted upwards by 0.6 percent, although the actual new borrowing to date amounts to R4.4 billion, which is only 37 percent of the adjusted budget for borrowing.
- The municipal borrowing market continues to be dominated by the metros with comparatively limited borrowing by the secondary and other municipalities. Strategies to assist these municipalities to improve their borrowing capacity are required.

DATA AND ANALYSIS

Subsequent to the budget adjustments, municipalities are projecting total borrowings for the 2016/17 financial year of R12.1 billion. This is an increase of just 0.6 percent when compared to the original budget. Against this adjusted budget, municipalities reported new borrowing amounting to R4.4 billion or 37 per cent of the adjusted budget as at the end of the third quarter. This performance suggest that the full projected borrowing may not be taken out by the end of the financial year; however the borrowing trend of the past years indicates that long term debt is often incurred during the fourth quarter.

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



Source: National Treasury Database

Municipalities reported aggregate total outstanding long term debt amounting to R63.5 billion, of which R18.4 billion or 29 percent is in the form of bonds and the remaining R45.1 billion is in the form of long term loans. The total outstanding long term debt of metropolitan municipalities amounted to R56.2 billion or 89.6 percent of the local government debt. Secondary cities and other local municipalities accounted for R3.9 billion and R2.6 billion respectively, while district municipalities account for only 1 percent of the aggregate long term debt.

Table 1: Outstanding long term debt as 31 March 2017

Municipal Category	Municipality	Total debt Q3 2016/17 R'000	Share of total debt	Budgeted revenue 2016/17* R'000	Debt to revenue ratio
A	BUF	460 137	1%	5 943 457	8%
	NMA	1 339 624	2%	9 401 671	14%
	MAN	1 195 914	2%	6 641 229	18%
	EKU	5 217 532	8%	32 374 950	16%
	JHB	21 830 203	34%	44 394 466	49%
	TSH	10 502 441	17%	29 790 048	35%
	ETH	9 256 431	15%	31 358 677	30%
	CPT	6 394 107	10%	35 822 027	18%
	Total Metros	56 196 389	89%	195 726 525	29%
B	Other municipalities	6 570 240	10%	109 474 617	6%
C	Districts	715 216	1%	17 854 390	4%
	Total all municipalities	63 481 845		323 055 532	20%

**excluding capital transfers*
Source: National Treasury Database

Table 1 above shows the share of long term debt for all municipalities. The City of Johannesburg remains the largest borrower with outstanding long term debt amounting to R21.8 billion or 34 percent of the total debt for all municipalities.

The unweighted average debt to revenue ratio (excluding capital transfers) for the metros is 29 percent while the average debt to revenue ratio for all municipalities (including the metros) is 20 percent. The City of Johannesburg has the highest debt to revenue ratio at 49 percent, followed by the City of Tshwane and eThekwini municipality at 35 percent and 30 percent respectively. The recommended norm is 45 percent although this is only one indicator of borrowing capacity and may vary with local circumstances and strategies.

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 Q3 Actual
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	69 425	33 092
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	12 016	4 429
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	63 482

Source: National Treasury Database

Table 2 above indicates actual capital expenditure as at the end of the third quarter. An amount of R33 billion was spent by municipalities, of which R4.4 billion or 13 percent was funded from new long term borrowing. It was anticipated that municipalities would have taken out at least 75 percent of the budgeted borrowing by this point. Low levels of borrowing activity may impact negatively on total capital expenditure.

Table 3: Metros outstanding bonds - tenor and interest rate

R'000	Bonds	Date of origin	Tenor (Years)	Weighted Average Tenor	Interest rate %	Weigthed Average Interest Rate
CPT	1 000 000	2008/06/23	15		12.57	
	1 200 000	2009/06/12	15		11.62	
	2 000 000	2010/03/15	15		11.16	
Total CPT	4 200 000			15.0		11.63
JHB	1 733 000	2006/06/05	12		9	
	2 268 000	2008/06/05	15		12.21	
	850 000	2011/03/23	10		10.78	
	1 458 000	2014/06/09	10		10.18	
	1 440 000	2016/06/22	10		11.46	
Total JHB	7 749 000			11.9		10.81
TSH	560 000	2013/04/02	15		10.2	
	830 000	2013/04/02	10		9.11	
	750 000	2013/06/05	15		9.46	
Total TSH	2 140 000			13.1		9.52
EKU	815 000	2010/07/28	10		10.56	
	800 000	2011/03/11	10		11.72	
	800 000	2012/05/04	12		10.05	
	586 667	2013/05/16	15		9.16	
	628 000	2014/05/17	15		10.67	
	600 000	2015/06/23	10		10.25	
Total EKU	4 229 667			11.8		10.46

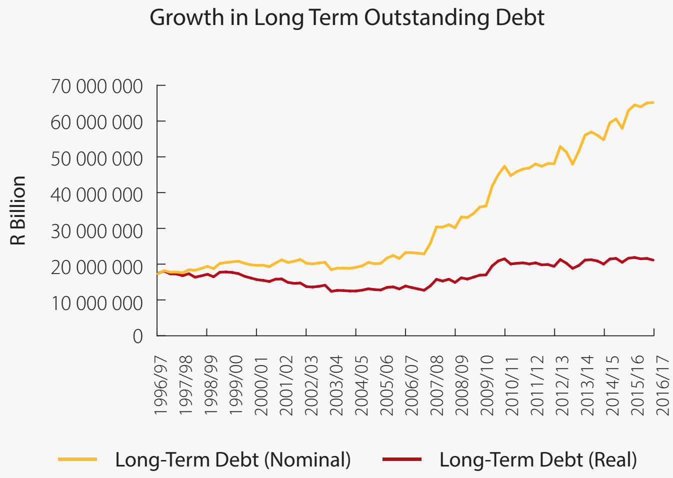
Source: National Treasury for outstanding bonds as at 31 March 2017

The table above reflects the bonds that were in circulation as of 31 March 2017. The City of Cape Town, City of Johannesburg, City of Tshwane and Ekurhuleni remain the only cities currently issuing bonds.

Amongst the top four metros, a range of interest rates is observed, from a low of 9 percent issued by the City of Johannesburg in 2006 to a high of 12.57 percent issued by City of Cape Town in 2008. City of Tshwane has the lowest aggregate cost of bond financing while Cape Town has the highest. On the other hand, Cape Town has issued the bond with the longest maturity. The weighted average costs of capital for bonds vary significantly from city to city.

1. GROWTH IN LONG TERM DEBT AS REPORTED BY LENDERS

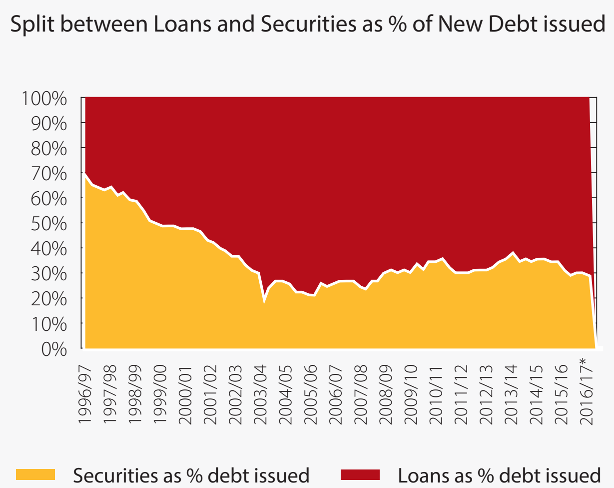
Figure 2: Growth in long term municipal borrowing



**QIII 2016/17*
Source: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 2 above demonstrates the movement in outstanding long-term municipal debt since the 1996/97 fiscal year. During the third quarter, lenders reported long term debt to be R63.4 billion while municipalities reported R63.5 billion. Adjusted for inflation, the real value of this debt in 1996 rand terms, was only R20. 9 billion. These inflation adjustments were computed using the CPI baseline for December 2016.

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

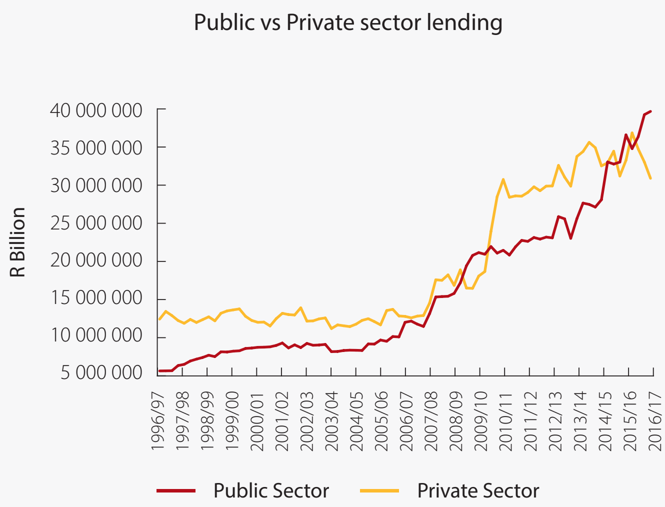


** incl. Q I-III*
Source: Banks, DBSA , INCA, DFI's, STRATE, SARB

Figure 3 above shows the share and movement of municipal debt obligations, as between loans and securities. During this period, outstanding long term loans amounted to R45 billion or 71 percent of the aggregate; and long term debt securities (bonds) amounted to R18.4 billion or 29 percent. The share of long term loans against the aggregate long term debt has declined by just 1 percent when compared to the previous quarter.

2. HOLDERS OF MUNICIPAL LOANS AND BONDS

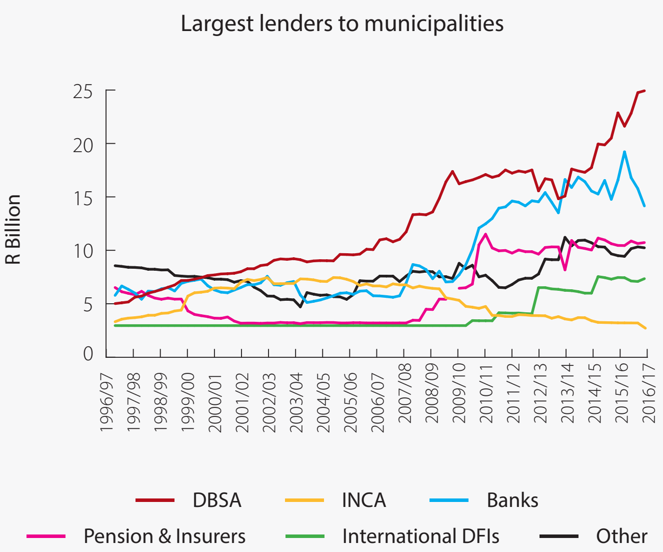
Figure 4: Public and private sector lending to municipalities



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

As seen in figure 4 above, the public sector remains the largest investor, holding R34.7 billion or 56 per cent of the total municipal debt as at the end of the third quarter. This has increased by 2 percent when compared to the second quarter of the current municipal financial year. Debt held by the private sector has declined to R27.1 billion in the third quarter as compared to the R29 billion reported in the previous quarter.

Figure 5: Largest lenders to municipalities



** incl. Q I-III*
Source: Banks, DBSA , INCA, DFI's, STRATE, SARB

As observed in the previous quarters, the Development Bank of South Africa remains the largest investor in the municipal space, followed closely by the top four commercial banks, pension fund & insurers, other, international finance institutions and INCA as observed in the previous quarters. INCA's portfolio now stands at R160 million and is no longer lending to municipalities. Please refer to figure 5 above.

DISCUSSION

TAX INCREMENT FINANCING (TIF)

Some of South Africa's Metros have explored the use of tax increment financing (TIF) mechanisms to finance infrastructure investments in specific areas within the municipality. This note explains how the mechanism works, and some of the issues that might arise in implementation.

TIF originated in the United States as a way to finance redevelopment of blighted inner city areas. Property values (and therefore property taxes collected) in such areas are typically low, but can be expected to rise significantly if public and private investments are mobilized to transform the area.

HOW TIF WORKS

TIF is a way to ring-fence the increased tax revenues that are expected to result from redevelopment, to help pay for the costs of redevelopment. If investment in an area causes property values to increase, the revenue a municipality would receive from property taxes would likewise increase. The increased property tax revenue is referred to as the "tax increment." The stream of expected future tax increments can be used to finance public investment that "unlocks" the increased value.

This is the sequence:

- A municipality defines a specific geographic area within its boundaries, and determines the base year, e.g. 2017.
- Property rates collections from the defined area for 2017 are documented; and projections of future rates collections are prepared.
- The municipality borrows to pay for infrastructure serving the targeted area, and pledges the expected tax increments over time to repay the borrowed funds, with interest.
- The city does not guarantee the repayment from its general fund. The lenders' only source of repayment is the expected tax increments.
- As public investment in infrastructure and private investment in property development occur, the assessed valuation of property in the area rises. (Note that the rate of taxation does not increase – the tax increment is due solely to higher property values in the area).
- Once the borrowed funds are repaid, all property rates collected from the area are available as part of the general funds of the municipality, and can be used to fund any services or infrastructure.

THE BENEFIT OF TIF

The advantage claimed for the TIF mechanism is that it allows infrastructure investments to be financed in an area that might not otherwise be prioritised. The risk is legally shifted away from the municipality and onto the investors. Lenders would have no legal recourse against the general funds of the municipality. The cost of the infrastructure improvements is ultimately borne, through increased valuations and consequent higher rates payments, by property owners in the targeted area, and not by ratepayers across the entire municipality.

THE RISKS OF TIF

It is important to be aware that political tensions can arise. One issue has to do with differing narratives about what might have happened in the absence of public investment:

- TIF opponents might argue that the targeted area would, in any event, have seen property values swing upward as a result of private decisions and investments, and so there was no need for the public investment. The public money might have been better spent elsewhere.
- TIF supporters might argue that the targeted area was performing below its economic potential, and would say that TIF-financed investments were necessary to break out of low-level equilibrium.

Another potential tension involves ordinary property owners, perhaps homeowners in the area, who enjoy the neighbourhood as it is, and do not want their valuations and their rates bills to increase. They may not welcome the planned transformation of the area, and will not think they should pay for it, even if it increases the value of their property.

Because it is difficult to know what might actually happen with and without public investment in the area, these arguments are difficult to resolve. These are inherently local issues, which a municipal council must take into account in deciding whether to use the TIF mechanism. To limit potential controversy, a council might decide to use the TIF mechanism only in an area that is truly dilapidated, and/or only with the consent of most or all of the property owners affected.

Further information on the TIFs and other land based financing mechanisms is available online at http://bit.ly/2toacXg.

CONCLUSION

National Treasury has not taken a policy position for or against the use of tax increment financing. We believe that any decision to use the mechanism should be made at the local level, and only after council takes into account the views of residents and taxpayers. We believe that the TIF mechanism is legally permitted in terms of the Property Rates Act and the Municipal Finance Management Act, although we recognize this is unexplored territory in the South African context.