MUNICIPAL BORROWING BULLETIN

ISSUE 7

December 2017

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BACKGROUND

PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to promote transparency, accountability, the prudent and responsible use of municipal borrowing for infrastructure finance.

The MBB achieves this purpose by updating stakeholders and interested parties on the developments in the municipal borrowing market. It contributes to a better understanding of movements and trends in municipal borrowing through data sharing, analysis, and discussion of topical issues relating to municipal borrowing.

CONTEXT

The MBB is published by the National Treasury on a quarterly basis and this is the seventh of the publications. This edition covers borrowing information up to 30 September 2017, corresponding to the first quarter of the 2017/18 municipal financial year. During the course of consolidation of the information, the Municipal Standard Chart of Account came into effect for implementation and municipalities experienced challenges when submitting Section 71 reports which further resulted in delays with the processing of the MBB.

national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Sources of data used in this MBB 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.

HIGHLIGHTS

- In their FY 2017-18 budgets, South Africa's municipalities have budgeted to raise R13.3 billion worth of long term debt. However, past performance trends indicate a strong possibility of deviation – it is likely that significantly less long term debt will be originated this financial year.

- Standard and Poor's (S&P) has downgraded South Africa's sovereign credit rating, citing inter alia the lack of economic growth. Among the reasons cited by S&P is stagnant economy and the eroded external competitiveness. It was anticipated that there would be political instability post the African National Congress elective conference that was held in December. It was also anticipated that the cost of borrowing will increase which could discourage municipal borrowing.

- The aggregate long term outstanding debt as reported by municipalities amounts to R66.3 billion which is marginally lower (by R0.1 billion) than the amount reported by lenders. This consistency in lender-side and borrower-side data is an immense improvement when compared to the R2.0 billion discrepancy we saw in Q4 of 2016/17.

DATA AND ANALYSIS

1. Municipal borrowing budgets

Table 1: Budgeted borrowings

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
Original Budget	9 631 795	9 728 855	12 038 295	12 155 568	12 015 730	13 327 264
Adjusted Budget	9 273 438	9 747 836	12 033 281	11 674 332	11 602 644	-
Actuals	6 490 000	7 583 000	9 357 000	9 222 000	8 099 900	908
	70%	78%	78%	79%	70%	0%

Source: National Treasury Database

The municipalities have budgeted to borrow R13.3 billion for the 2017/18 municipal financial year. This is an increase of R1.7 billion when compared to budgets for the previous financial year. When observing the budgeting trend for the previous years, as seen in table 1 above, it is anticipated that municipalities may downwardly adjust their borrowing budgets for the current year. The concerning trend is that municipalities have been borrowing less than 80 percent of their budgeted projections. This trend has a negative effect on their capital budget expenditure. The downward trend may be attributed to high borrowing costs and possibilities that municipalities could be opting to replace borrowing with own revenue as it becomes available (as observed from the municipal borrowing proceeds study, referred to in the MBB issue no.6).

2. Analysis of long term debt as reported by municipalities

At the end of the first quarter of the 2017/18 municipal financial year, a total of 246 municipalities have reported on their borrowings. This includes all metros and secondary cities. Of these municipalities, 130 municipalities reported that they have outstanding long term debt while 116 municipalities have no outstanding long term debt. A total of 11 municipalities did not submit their borrowing reports for this quarter, however, these are smaller municipalities and their data is not likely to significantly alter the overall picture.

Table 2: Capital expenditure, new borrowing and outstanding debt

R million	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	Full Year 2017/18	2017/18
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Forecast	1st Quarter
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	54 411	70 623	7 410
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	8 099	13 327	908
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	17%	15%	19%	12%
Outstanding debt	32 366	35 388	43 190	45 640	48 078	51 431	53 493	60 903	62 043	67 701	66 250

Source: National Treasury Database

Table 2 above shows actual capital expenditure, new borrowing and the total outstanding debt for the first quarter of 2017/18 financial year for all municipalities. Municipalities have budgeted to spend R70.6 billion on their capital programmes, of which only 12 percent is planned to be funded from borrowing. A total of R7.4 billion or 10 percent of the budgeted capital amount has been spent to date of which R908 million has been funded from new borrowing and possibly from some unspent borrowed funds from the previous year.

The new borrowing amount of R908 million represents a decline of R39 million or 4 percent when compared to R947 million for Q1 of FY 2016/17. When taking into account new borrowings and debt redemptions for Q1 of FY 2017/18; total outstanding long term debt as reported by municipalities has increased by 7 percent from R62.0 billion in Q4 of 2016/17 financial year to R66.3 billion in Q1 of 2017/18.

Table 3: Outstanding long term debt as at 30 September 2017

Municipal Category	Municipality	Total debt Q1 2017/18 R'000	Share of total debt	Actual revenue 2017/18* R'000	Debt to revenue ratio
A	BUF	437 522	1%	6 200 028	7%
	NMA	1 296 681	2%	9 363 536	14%
	MAN	1 148 174	2%	6 275 571	18%
	EKU	6 333 638	10%	64 589 797	10%
	JHB	20 048 354	30%	48 849 779	41%
	TSH	11 239 409	17%	30 226 013	37%
	ETH	8 705 010	13%	33 384 656	26%
	CPT	7 129 727	11%	38 292 542	19%
	Total Metros	56 338 515	85%	237 181 922	24%
B	Other municipalities	9 241 249	14%	118 223 144	8%
C	Districts	669 847	1%	19 438 435	3%
	Total all municipalities	66 249 611		374 843 501	18%

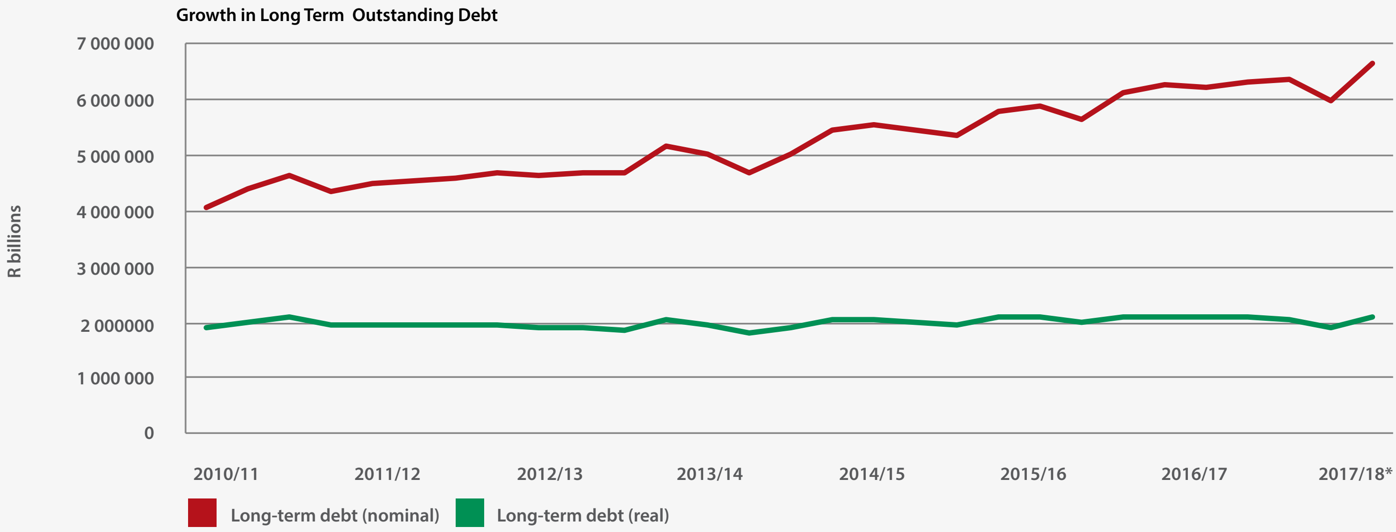
*excluding capital transfers
Source: National Treasury Database

Table 3 above indicates the share of long term debt as reported by municipalities for Q1 of FY 2017/18. As indicated above, aggregated long term outstanding debt has increased by R4.3 billion between Q4 of FY 2016/17 and Q1 of 2017/18. City of Johannesburg continues to be the largest borrower with total outstanding long term debt amounting to R20.0 billion or 30 percent of the total outstanding debt for all municipalities. Buffalo City and district municipalities are the smallest borrowers with outstanding long term debt amounting to R438 million and R670 million respectively or 2 percent of total outstanding debt.

The City of Johannesburg has a highest debt to revenue ratio at 41 percent followed by City of Tshwane at 37 percent. The rest of the metros' debt to revenue ratios range between 7 percent (Buffalo City) and 26 percent (eThekwini). The average debt to revenue ratio for all municipalities for the first quarter of 2017/18 was 18 percent, which has lessened by 1 percent when compared to the first quarter of 2016/17.

2. Analysis of long term debt as reported by lenders

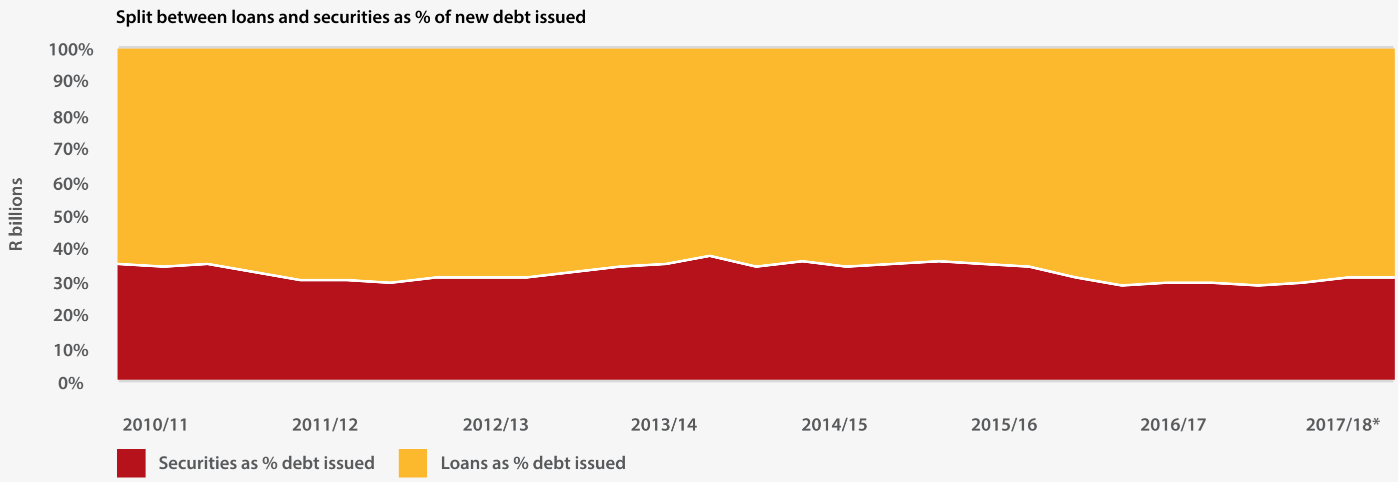
Figure 1: Growth in long term municipal borrowing



**Incl. Q I*
Sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 1 above shows an 8-year trend in outstanding long-term debt, from FY 2010/11 to FY 2017/18. In Q1 of FY 2017/18, nominal debt indicated by the red line increased to R66.3 billion when compared to R62.3 billion in the first quarter of 2016/17. This indicates a growth of R4.1 billion or 7 percent. The green line indicates real debt (adjusted for inflation) which amounted to R21.1 billion in the first quarter of 2017/18, indicating an increase of 1 percent when compared to the first quarter of 2016/17. In Q1 of FY 2017/18, lenders reported long term debt amounting to R66.3 billion which is only R0.1 billion less than what was reported by municipalities.

Figure 2: Split between debt instruments issued by municipalities over time

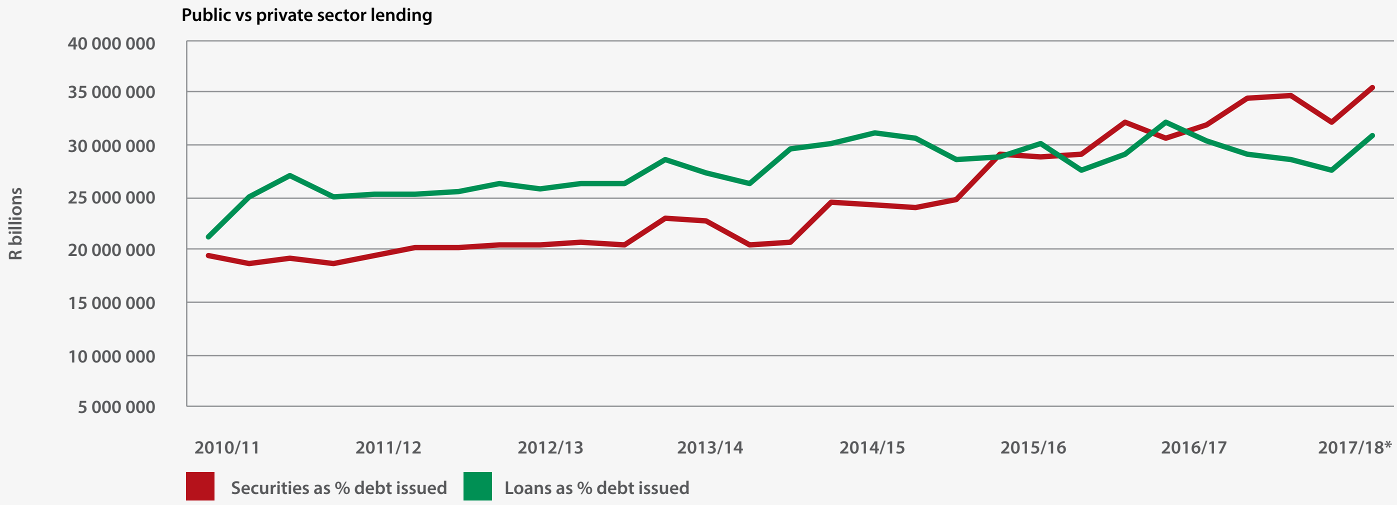


** incl. Q I*
Source: Banks, DBSA , INCA, DFI's, STRATE, SARB

Figure 2 above shows the share of outstanding municipal long term debt between loans and securities. Apart for the new bonds issued by City of Cape Town and Ekurhuleni during FY 2016/17, no new bonds have been issued since then. Therefore, total bonds outstanding amounts to R20.6 billion as at the end of Q1 of FY 2017/18. This shows an increase of R2.3 billion or 13 percent between Q4 of FY 2016/17 and Q1 of FY 2016/18. The share of long term securities as a percentage of aggregate long term outstanding debt is at 31 percent while long term loans are 69 percent as observed in Q4 of the previous year.

3. Holders of municipal loans and bonds

Figure 3: Public and private sector lending to municipalities

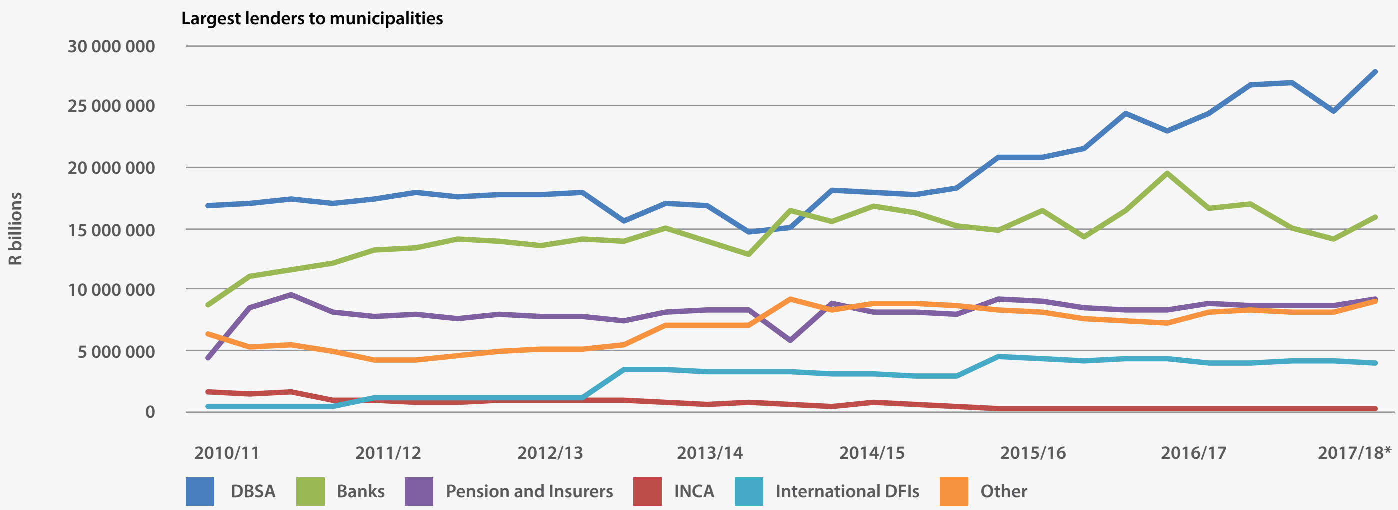


** incl. Q I*
Source: Banks, DBSA , INCA, DFI's, STRATE, SARB

Figure 3 above illustrates the total outstanding debt owed by the municipalities to the public sector versus private sector as at the end of Q1 of FY 2017/18. According to the reports submitted by lenders; the public sector portfolio is at 53 percent, surpassing the private sector portfolio by 6 percent which holds 47 percent of the total municipal long term debt. In rand figures, the long term debt held by the public sector amounts to R35.4 billion, an increase by 11 percent when compared to Q1 of FY 2016/17; while private sector holds long term debt amounting to R31.0 billion which increased by 2 percent.

The Development Bank of Southern Africa (DBSA) continues to be the largest lender to municipalities followed by the commercial banks with a substantial growth of 14 percent respectively, when compared to Q1 of 2016/17. The DFIs' exposure has regressed by 2 percent between Q1 of FY 2016/17 and Q1 of FY 2017/28. Among the private sector, commercial banks hold the largest portfolio of municipal long term debt at R15.9 billion, indicating an increase by 13 percent. The exposure for the category 'other' (consisting of the household sector, non-residents and other financial institutions) as well as pension fund & insurers which remained relatively flat in the 2016/17 financial year, increased by 12 percent and 5 percent when comparing Q1 of FY 2016/17 and Q1 of 2017/18. Pleases refer to figure 5 below:

Figure 4: Largest lenders to municipalities



**Incl. Q I-IV*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

DISCUSSION

4. Policy discussion- Development Charges

Municipalities, especially metropolitan municipalities and other large urban municipalities play a critical role in increasing economic growth and providing an enabling environment for job creation by providing well-maintained and functioning infrastructure services. The infrastructure required to execute this mandate is typically very costly and necessitates that municipalities innovate various ways of leveraging private finance to mobilise additional resources to fund infrastructure investments.

Development charges have the potential to play a significant role in financing the upgrading and expansion of municipal infrastructure. They are once-off capital infrastructure fees imposed on a land owner by the municipality as a condition of approving a land development that will substantially increase the use of, or need for, municipal infrastructure. Development charges are imposed to enable municipalities to recover the costs incurred by municipalities in the provision of municipal infrastructure. They are based on the concept that urban growth and expanded land use creates the need for additional infrastructure; therefore, the land owner or the developer should cover the costs of laying such infrastructure. Alongside this, municipalities can use long term borrowing to finance strategic infrastructure which is capable of unlocking development. Proceeds from development charges can be used for leveraging municipal borrowing.

Despite their potential scope of providing an option for financing infrastructure, development charges have not been fully utilised by municipalities due to uncertainty on the regulatory framework. Development charges are currently regulated through various pieces of legislation, such as the Municipal Finance Management Act, Municipal Systems Act, Municipal Fiscal Powers and Functions Act, the Spatial Planning and Land Use Management Act, and various provincial land use ordinances. None of these acts provide clear guidelines with regard to the methodology for calculating development charges, how the funds collected from development charges should be spent, and how municipalities must account for this revenue and expenditure.

Estimates suggest that each year South African municipalities fail to recover in the region of R7,5 billion that could be raised as development charges.

In dealing with this challenge of the regulatory framework, processes are underway to amend the Municipal Fiscal Powers and Functions Act to incorporate the regulation of development charges by creating legal certainty and regulating the power of municipalities to impose development charges. The proposed amendments will therefore establish a clear, fair and consistent base for municipalities to recover development charges for new land development projects that require approvals through a municipal land use planning system. This has a potential to be a game-changer for municipal infrastructure finance, and to drive economic growth and job creation.