MUNICIPAL BORROWING BULLETIN

ISSUE 8

March 2018

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Rustenburg Local Municipality: Bospoort Water Treatment Works

BACKGROUND

PURPOSE

The Municipal Borrowing Bulletin provides an update to stakeholders and interested parties on 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. The main aim of the bulletin is to promote transparency, accountability as well as the prudent and responsible use of municipal borrowing for infrastructure finance.

The Bulletin is published on a quarterly basis. This eighth edition covers information up to 31 December 2017, corresponding to the second quarter of the 2017/18 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.

HIGHLIGHTS

- The total long term outstanding debt as reported by municipalities amounts to R68.1 billion
- New borrowing so far in the current financial year amounts to R2.1

national treasury
Department:
National Treasury
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billion or 9.9 percent of budgeted borrowings.
- A 12 percent year on year increase in the proportion of total outstanding long term debt held in loans, and a 5 percent decrease in securities
- Public sector lending accounts for 53 percent of outstanding long term debt, compared to 47 percent for the private sector.
- Based on the spreads analysis on vanilla bonds, the cost of borrowing remains affordable.
- Data issues continue to challenge the analysis of the borrowing market. For this quarter, municipalities reported total borrowings that are R3.7 billion more than the amount reported by lenders. This variance fluctuates between quarters. **An analysis of the drivers of the variance and its fluctuation is underway and will be reported on in the next Bulletin.**

DATA AND ANALYSIS

1. Analysis of long term debt as reported by municipalities

At the end of the second quarter of 2017/18, a total of 203 municipalities out of 257 municipalities reported on their borrowings. Of these, 124 municipalities reported that they have outstanding long term debt, whilst 79 municipalities reported that they have no outstanding long term debt. A total of 54 municipalities did not submit their borrowing reports for this quarter.

Table 1: Capital expenditure, new borrowing and outstanding debt

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18
R million	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	2nd Quarter
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	54 411	13 117
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	8 099	2 130
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	17%	15%	16%
Outstanding debt	32 366	35 388	43 190	45 640	48 078	51 431	53 493	60 903	62 043	68 176

Source: National Treasury Database

Table 1 above shows actual capital expenditure, new borrowing and the total outstanding long term debt for municipalities from 2008/09 to the end of the second quarter of FY2017/18. The total outstanding long term debt as reported by municipalities has increased by R1.9 billion or 3 percent from R66.2 billion in the first quarter of FY2017/18 to R68.1 billion in the second quarter of FY2017/18. Municipalities incurred capital expenditure amounting to R13.1 billion at the end of the second quarter. Of this amount, 16 percent or R2.1 billion was funded from new borrowing undertaken during this financial year. In the second quarter alone, municipalities raised new borrowing amounting to R1.3 billion. This constitutes 9.9 percent of the budgeted borrowing, and is 15 percent less than what was raised in the second quarter of FY2016/17.

Table 2: Outstanding long term debt as at 31 December 2017

Municipal Category	Municipality	Total debt Q2 2017/18 R'000	Share of total debt	Budgeted revenue 2017/18* R'000	Debt to revenue ratio
A	BUF	422 644	1%	6 200 028	7%
	NMA	1 268 176	2%	9 363 536	14%
	MAN	1 108 799	2%	6 275 571	18%
	EKU	6 162 950	9%	64 589 797	10%
	JHB	22 846 477	34%	48 849 779	47%
	TSH	11 371 462	17%	30 226 013	38%
	ETH	8 428 097	12%	33 384 656	25%
	CPT	7 082 769	10%	38 292 542	18%
	Total Metros	58 691 374	86%	237 181 922	25%
B	Other municipalities	8 867 074	13%	118 223 144	8%
C	Districts	617 867	1%	19 438 435	3%
	Total all municipalities	68 176 315		374 843 501	18%

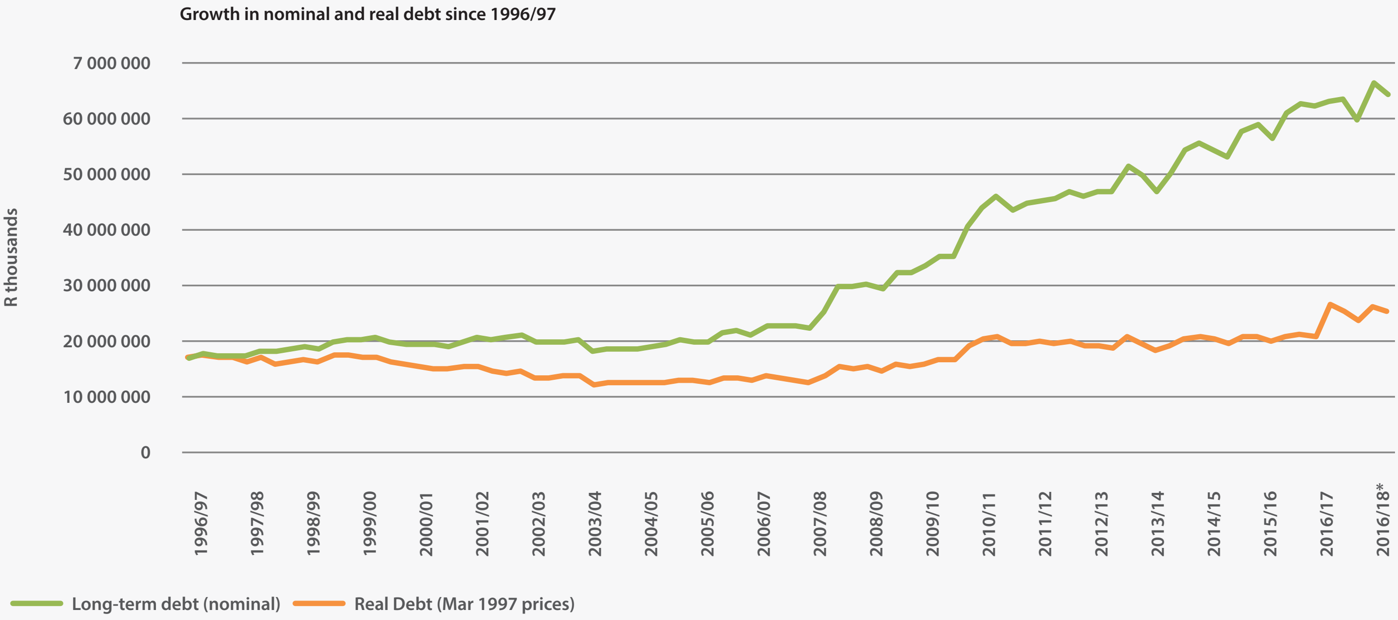
*excluding capital transfers
Source: National Treasury Database

Table 2 above indicates the share of long term debt as reported by municipalities for the second quarter of FY2017/18. The City of Johannesburg continues to be the largest borrower with total outstanding long term debt amounting to R22.8 billion or 34 percent of the total outstanding debt for all municipalities. Within the metros, there is significant variation in the use of long-term borrowing, with Buffalo City, Nelson Mandela Bay and Mangaung collectively accounting for only 5 percent of total municipal borrowing. Other municipalities and especially district municipalities still borrow less.

The average debt to revenue ratio for all municipalities for the second quarter of 2017/18 stands at 18 percent, which remained unchanged when compared to the quarter 1 of FY2017/18. The City of Johannesburg continues to have the highest debt to revenue ratio at 47 percent, followed by City of Tshwane at 38 percent.

2. Analysis of long term debt as reported by lenders

Figure 1: Growth in long term municipal borrowing

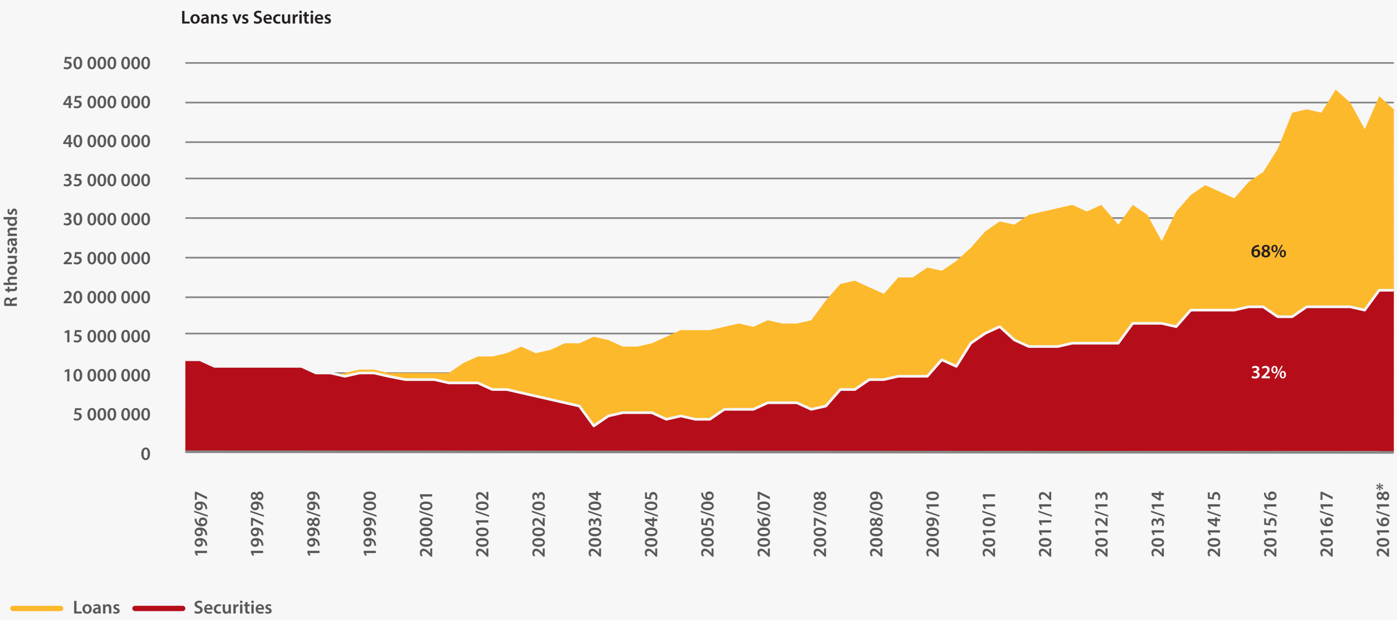


**Inc. QII*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

The figure above shows how long term borrowing has grown over the years since 1996/97 to Q2 of FY2017/18. In the second quarter of 2017/18 financial year, nominal debt indicated by the green line, shows a decline of 3 percent from R66.3 billion in Q1 of FY2017/18 to R64.4 billion in Q2 of FY2017/18. The orange line indicates real debt (adjusted for inflation using March 1997 prices) amounting to R20.3 billion in the second quarter of FY2017/18. This is a quarter-to-quarter decrease of 5 percent for the current financial year. During the quarter under review, lenders reported long term debt amounting to R64.4 billion which is R3.7 billion less than what was reported by the municipalities[1].

[1] *This might be attributed to the data inconsistencies. A data cleansing exercise has been initiated to understand this trend.*

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

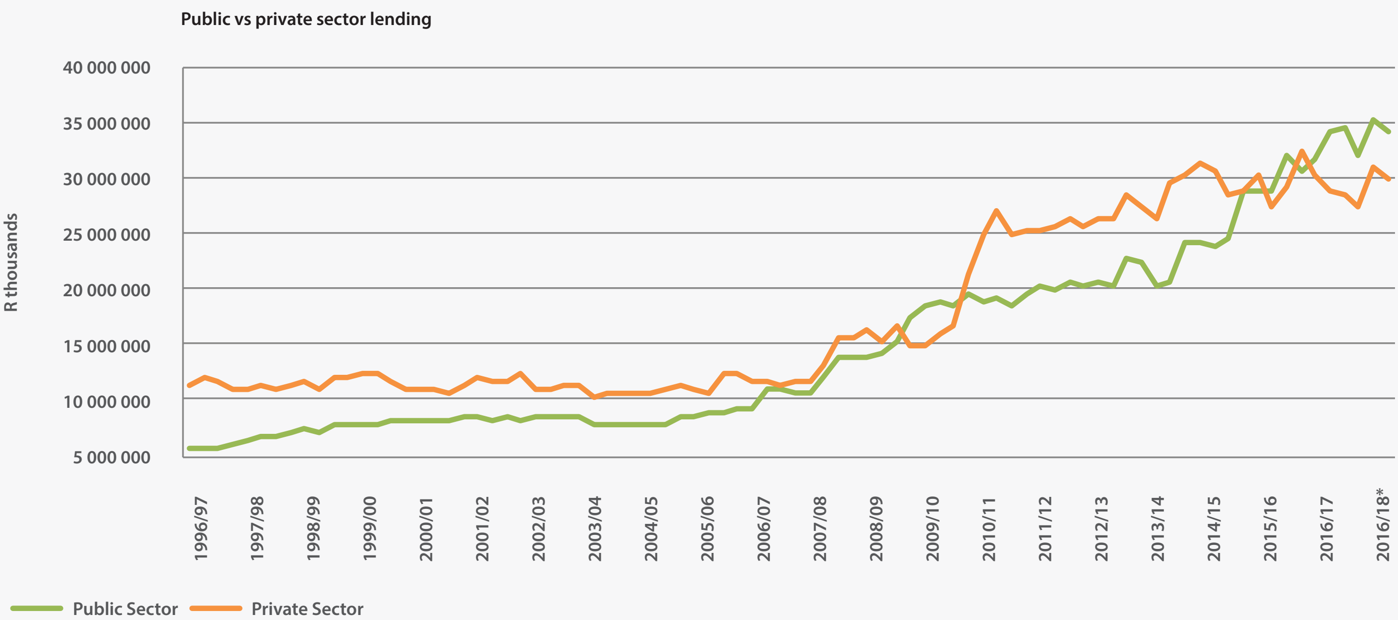


**Inc. QII*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 2 above indicates the share of outstanding municipal long term debt between loans and securities. There were no new bonds issued during the first and second quarters of FY2017/18. In the second quarter of 2017/18 financial year, the share of outstanding long term loans increased by 12 percent while securities decreased by 5 percent when compared to the same period of the previous financial year. The share of long term securities as a percentage of aggregate long term outstanding debt was at 32 percent while long term loans were at 68 percent as observed in the first quarter of 2017/18 financial year.

3. Holders of municipal loans and bonds as reported by lenders

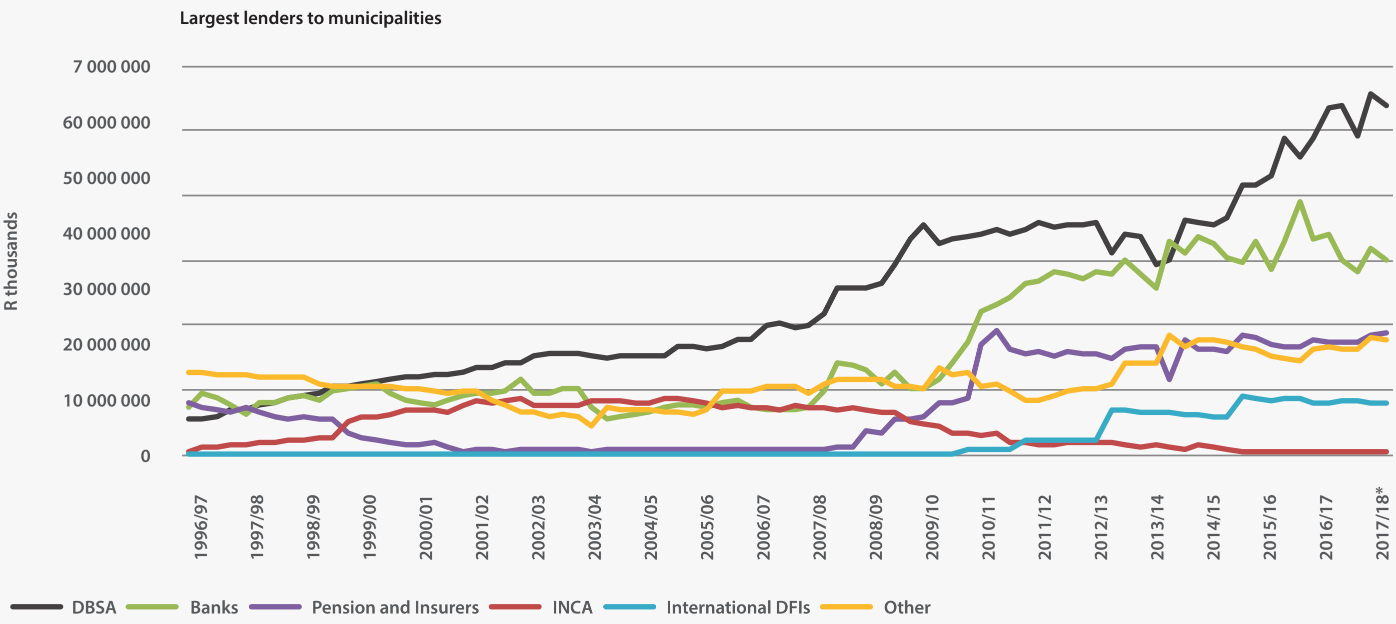
Figure 3: Public and private sector lending to municipalities



**Inc. QII*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 3 illustrates the total outstanding debt owed by the municipalities to the public and private sectors as at the end of Q2 of FY2017/18. The public sector holds the largest share of municipal long term debt at R34.4 billion, which remained unchanged from the second quarter of FY2016/17. The private sector holds R30.0 billion, which is 4 percent more than the second quarter of FY 2016/17. Public sector lending accounts for 53 percent of outstanding long term debt, compared to 47 percent for the private sector.

Figure 4: Largest lenders to municipalities



**Inc. QII*
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 4 above shows municipal long term debt held by different investors. The Development Bank of Southern Africa (DBSA) holds the largest share at R27 billion and has been in this position since the early 2000s. This is almost twice as much as the share held by commercial banks. This is followed by pension funds and insurers which account for R9.4 billion, while the category 'other' (consisting of the household sector, non-residents and other financial institutions) has invested a total of R8.8 billion. International DFIs, consisting of AFD and IFC, hold R3.9 billion. A now negligible R131 million is accounted for by the old INCA portfolio.

DISCUSSION

Update to Municipal Borrowing Policy

Borrowing from the private sector has grown more slowly than what was anticipated when the first municipal borrowing policy framework was adopted. The draft policy update that is currently available aims to facilitate more private sector lending and to also encourage DFIs to play a developmental role in supporting the development of the market when they lend to municipalities, including by offering longer tenor that matches the life cycle of financed assets. The National Treasury wants to safeguard that DFI lending does not crowd-out the private sector but instead crowd it in.

Municipal Bonds Spreads and Ratings

It is mandatory for municipalities to be rated by independent credit ratings institutions if they intend to incur long-term debt through the issuing of municipal debt instruments[2]. Of the credit rating agencies active in South Africa, only Moody's currently rates municipalities, and only upon request by these municipalities. Likewise, drawdowns from the metros' Domestic Medium Term Notes (DMTN) programmes are rated upon the issuer's request. Moody's provides ratings for six South African metropolitan municipalities namely, City of Cape Town, Ekurhuleni Metropolitan Municipality, City of Johannesburg, City of Tshwane, Mangaung Metropolitan Municipality and Nelson Mandela Bay Metropolitan Municipality – the first four being the only cities that are currently having outstanding bonds.

[2] *Regulation 6(1) of the Municipal Debt Disclosure Regulations, 15 June 2007 (GG. 29966)*

Representatives from Fitch, S&P, and Global Credit Ratings confirmed that none of them currently provide municipal ratings.

Table 3: Metros outstanding bonds - tenor and interest rate

R'000	Original Principal	Balance to date	Date of origin	Date of maturity	Payment Structure	Tenor (Years)	Interest rate %	Sovereign YTM		RSA		Spread	Moody's rating
CPT 830014004	1 000 000	1 000 000	6/23/2008	8/3/2023	Vanilla	15	12,570%	10,410%	10,575%	R186	R207	208	Not rated
CPT 830016003	1 200 000	1 200 000	6/12/2009	6/12/2024	Vanilla	15	11,620%	8,795%	8,885%	R186	R207	279	Not rated
CPT 830017007	2 000 000	2 000 000	3/15/2010	6/15/2025	Vanilla	15	11,160%	9,025%	8,955%	R186	R208	219	Aa2.za - High grade
CPT 830019504	1 000 000	1 000 000	7/17/2017	7/17/2032	Amortising	10	10,170%	9,375%	9,255%	R2 032	R213		Aaa.za - Prime
Total CPT	5 200 000	5 200 000											
COJ04	1 733 000	1 733 000	6/5/2006	6/5/2018	Vanilla	12	9,000%	7,745%	7,750%	R204	R203	125	Not rated
COJ05	2 268 000	2 268 000	6/5/2008	6/5/2023	Vanilla	15	12,210%	9,910%	10,025%	R186	R207	241	Not rated
COJ07	850 000	850 000	3/23/2011	3/23/2021	Vanilla	10	10,780%	8,700%	8,640%	R208	R207	208	Not rated
COJG01	1 458 000	1 458 000	6/9/2014	6/9/2024	Vanilla	10	10,180%	8,200%	8,085%	R186	R2 023	206	Not rated
COJ08	1 440 000	1 440 000	6/22/2016	6/22/2026	Vanilla	10	11,460%	9,240%	8,605%	R2 030	R2 023	255	Aa1.za - Low medium grade
Total JHB	7 749 000	7 749 000											
TSH 10001900	560 000	560 000	4/2/2013	4/2/2028	Vanilla	15	10,200%	7,898%	7,362%	R213	R186	267	Not rated
TSH 10001901	830 000	830 000	4/2/2013	4/2/2023	Vanilla	10	9,110%	7,898%	6,500%	R186	R208	233	Not rated
TSH 10007950	750 000	750 000	6/5/2013	6/5/2028	Vanilla	15	9,460%	8,242%	7,629%	R213	R186	162	Not rated
Total TSH	2 140 000	2 140 000											
EMM01	815 000	815 000	7/28/2010	7/28/2020	Vanilla	10	10,560%	8,350%	8,255%	R208	R207	226	Not rated
EMM02	800 000	800 000	3/11/2011	3/11/2021	Vanilla	10	11,720%	8,845%	8,780%	R208	R207	288	Aa2.za - High grade
EMM03	800 000	800 000	5/4/2012	5/4/2024	Vanilla	12	10,050%	8,080%	7,435%	R186	R207	222	Aa2.za - High grade
EMM04	800 000	560 000	5/16/2013	5/16/2028	Amortising	15	9,160%	7,486%	6,799%	R213	R186		Aa3.za - High grade
EMM05	785 000	601 833	5/17/2014	5/17/2029	Amortising	15	10,670%	8,666%	8,102%	R213	R186		Aa3.za - High grade
EMM06	750 000	562 500	6/23/2015	6/23/2025	Amortising	10	10,250%	8,276%	8,120%	R186	R2 023		A1.za - Medium grade
EMM07	500 000	500 000	7/5/2017	7/5/2027	Amortising	10	10,520%	9,375%	8,850%	R213	R186		Aaa.za - Prime
EMM07P	800 000	800 000	7/12/2017	7/12/2032	Amortising	15	11,320%	9,370%	9,250%	R2 035	R2 032		Aaa.za - Prime
Total EKU	6 050 000	5 439 333											

Source: National Treasury for outstanding bonds as at 30 September 2017, Moody's Invetsor Service (South Africa)
Amortising: Spread not calculated

The table above indicates the municipal bonds issued by the four metros currently issuing bonds (Ekurhuleni, City of Johannesburg, City of Cape Town and City of Tshwane). Of note on the above table are the credit ratings and spreads of some of these bonds.

Interestingly, in the chart above, we see one anomaly: the earliest Johannesburg issue in the table had a spread (over comparable sovereign debt) when it was issued in 2006, that was much tighter than the other issues shown. In fact, the COJ04 issue was not so unusual at the time – it was rather the last of its breed. Johannesburg's COJ02 and COJ03 issues also had low spreads when issued, and maintained these in trading through early 2006.

In a future issue, we will include our analyses of pricing at date of issue for amortizing bonds and for loans.

Ratings on drawdowns: Municipal Bonds

The *City of Johannesburg* established a R6 billion DMTN programme in June 2016 which was later increased to a R30 billion programme. The city invited a rating for its COJ08 bond to the value of R1.4 billion issued in June 2016. This was assigned a global and national scale long term debt rating of Baa2/Aa1.za. According to Moody's, the ratings reflect the city's ability to access a broad tax base. The ratings also reflected an improved financial performance and moderate debt levels.

The *City of Cape Town's* R7 billion DMTM programme was rated Aa2.za in May 2008 by Moody's. Two of City of Cape Town's drawdowns from the programme, CPT830017007 to the value of R2 billion and CPT830019504 to the value of R1 billion have been assigned ratings of Aa2.za (high grade) and GB1 (excellent) respectively. As per Moody's, the rating is based on the city's buoyant budgetary performance and comfortable liquidity position as well as its dynamic and diversified economic base.

Ekurhuleni Metropolitan Municipality has a R4 billion DMTN programme which was launched in July 2010 and almost all of Ekurhuleni's drawdowns from this programme are rated by Moody's Investors Service. The first two bonds for Ekurhuleni, EMM02 and EMM03 were given a high grade rating of Aa2.za, while EMM04 and EMM05 were rated Aa3.za also high grade, EMM06 on the other hand was provided a medium grade rating of Aa1.za and finally, the latest two bonds issued in 2017 were given a prime rating of Aaa.za. As quoted from Moody's statement, the ratings assigned are based on Ekurhuleni's traditionally conservative financial management and overall moderate indebtedness.

Spreads analysis

In order to calculate the spread on a vanilla or bullet municipal bond, we compare the interest rate to the yield for a sovereign bond hypothetically issued on the same date as the municipal instrument, and due on the same date. The yield for the hypothetical RSA bond is estimated by linear interpolation using the yields on the date of the municipal issue for the two RSA bonds with the closest maturities before and after the municipal bond maturity.

Calculating the spreads for an amortizing structure would follow the same approach, but with a separate calculation for each principal payment, and then calculating an average spread with weight given to the tenor of each principal payment.

Generally, when sovereign yields are lower, spreads should narrow, and when sovereign yields are higher, we might expect the municipal spread to widen. Apart from the R1.7 billion bond issued by City of Johannesburg and the R750 million City of Tshwane issue, which indicates spreads of just 125 basis points and 162 basis points respectively (above similar sovereign yields); results obtained from the calculations indicates that the price charged on a given bond ranges between 200 basis points and 290 basis points above the sovereign. With the limited size of the municipal bond market, it is not clear what explains these variations.