# MUNICIPAL BORROWING BULLETIN

# ISSUE 9

June 2018

INSIDE
KEY HIGHLIGHTS
DATA ANALYSIS

**Mbombela:**
Rimers Creek Water Treatment

## PURPOSE

The purpose of the Municipal Borrowing Bulletin (MBB) is to advance transparency, responsibility, prudent and responsible utilization of municipal borrowing to finance infrastructure.

The MBB achieves this purpose by informing partners and invested individuals on developments in the municipal borrowing market. The MBB aim to add to a better understanding of developments and patterns in municipal borrowing through information sharing, analysis, and exchange of topical relating to municipal borrowing.

## CONTEXT

The MBB is issued by the National Treasury on a quarterly basis. This issue covers long term borrowing information up to 31 March 2018, corresponding to the third quarter of the 2017/18 municipal financial year.

Sources used for 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 acquired from lenders; information published by the South African Reserve Bank (SARB); and data from the Johannesburg Stock Exchange (JSE) sourced from STRATE.

## HIGHLIGHTS

- The aggregate of municipal borrowing budgets was adjusted upwards from R13.3 billion to R13.9 billion.
- Only R4.7 billion or 34 percent of the budgeted amount has been borrowed to date.
- The total aggregate outstanding long-term debt reported by municipalities amounted to R65.6 billion against R64.3 billion reported by lenders – a variance of R1.3 billion or 2 percent.
- Long term debt owed by metros accounts for 87 percent of all long term municipal borrowing.
- Results of a recent long term municipal borrowing data verification exercise revealed that there are numerous other institutions which have finance lease contracts with municipalities which have not so far been included in lender-side reporting.

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

2030 NDP

## 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 | 13 962 006 |
| Actuals | 6 490 000 | 7 583 000 | 9 357 000 | 9 222 000 | 8 099 900 | 4 755 369 |
| | 70% | 78% | 78% | 79% | 70% | 34% |

*Source: National Treasury Database*

During the quarter under review, municipalities adjusted their planned borrowing budgets upward by R635 million or 5 percent from R13.3 billion to R13.9 billion. This is more than the previous year's adjusted budgets by R1.9 billion. As shown in table 1 above, municipalities have so far borrowed only R4.8 billion or 34 percent of the adjusted budget as of the third quarter of FY2017/18. Municipalities tend to increase borrowing towards the end of financial year, hence we might see a sharp increase of new borrowing during the fourth quarter.

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

At the end of the third quarter of FY2017/18, 203 municipalities out of 257 municipalities have reported their borrowings. Of these, 87 municipalities reported that they have outstanding long term debt, whilst 116 municipalities reported that they have no outstanding long term debt. While 54 municipalities have not yet submitted borrowing reports for this quarter, these are not municipalities with significant long term debt.

**Table 2: Capital expenditure, new borrowing and outstanding debt**

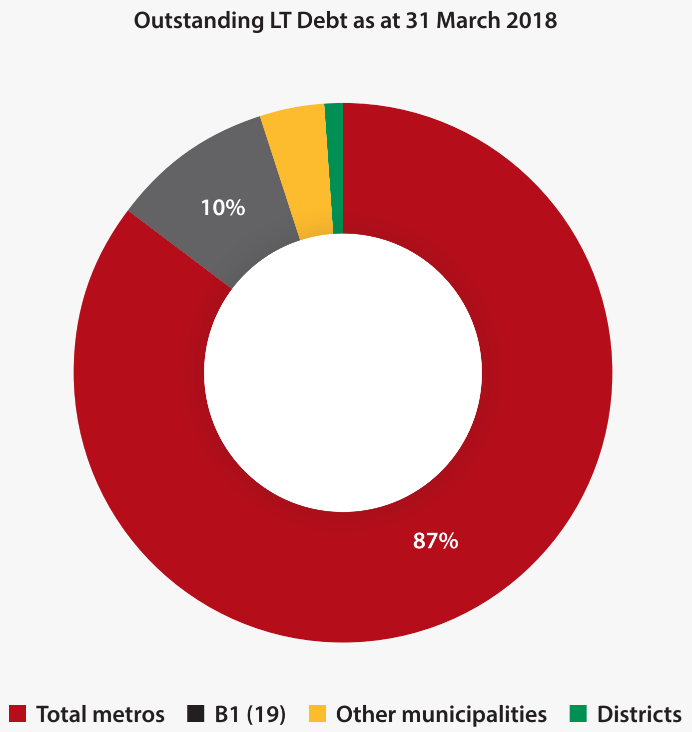
| R million | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 |
|---|---|---|---|---|---|---|---|---|---|---|
| | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | 3rd Quarter |
| Capital expenditure | 39 577 | 39 625 | 30 945 | 33 239 | 41 679 | 47 932 | 53 241 | 54 682 | 54 411 | 31 619 |
| New Borrowing | 9 463 | 8 226 | 6 401 | 6 211 | 6 490 | 7 583 | 9 357 | 9 222 | 8 099 | 4 755 |
| New borrowing as a % of CAPEX | 24% | 21% | 21% | 19% | 16% | 16% | 18% | 17% | 15% | 15% |
| **Outstanding debt** | 32 366 | 35 388 | 43 190 | 45 640 | 48 078 | 51 431 | 53 493 | 60 903 | 62 043 | 65 616 |

*Source: National Treasury Database*

Table 2 above demonstrates actual capital expenditure, actual new borrowing and the total outstanding debt at the end of third quarter of FY2017/18 for all municipalities. During the adjustments period, municipalities have increased their capital programme for FY2017/18 from R70.6 billion to R73.7 billion, of which only 18 percent is intended to be funded from borrowings. Municipalities have raised new borrowing amounting to R4.7 billion or 15 percent of actual capital expenditure during the third quarter of FY2017/18, this amount has increased by R0.3 billion when compared to the third quarter of FY2016/17.

Figure 1 below demonstrates the distribution of outstanding long term debt as reported by municipalities as at quarter 3 of FY2017/18. Of the R65.6 billion, the largest share is held by metros at R56.8 billion or 87 percent. This is followed by secondary cities, i.e. R6.3 billion or 10 percent of outstanding long term debt. Other local municipalities and districts owe the remaining R2.5 billion.

**Figure 1: Share of Outstanding LT debt as at 31 March 2018**

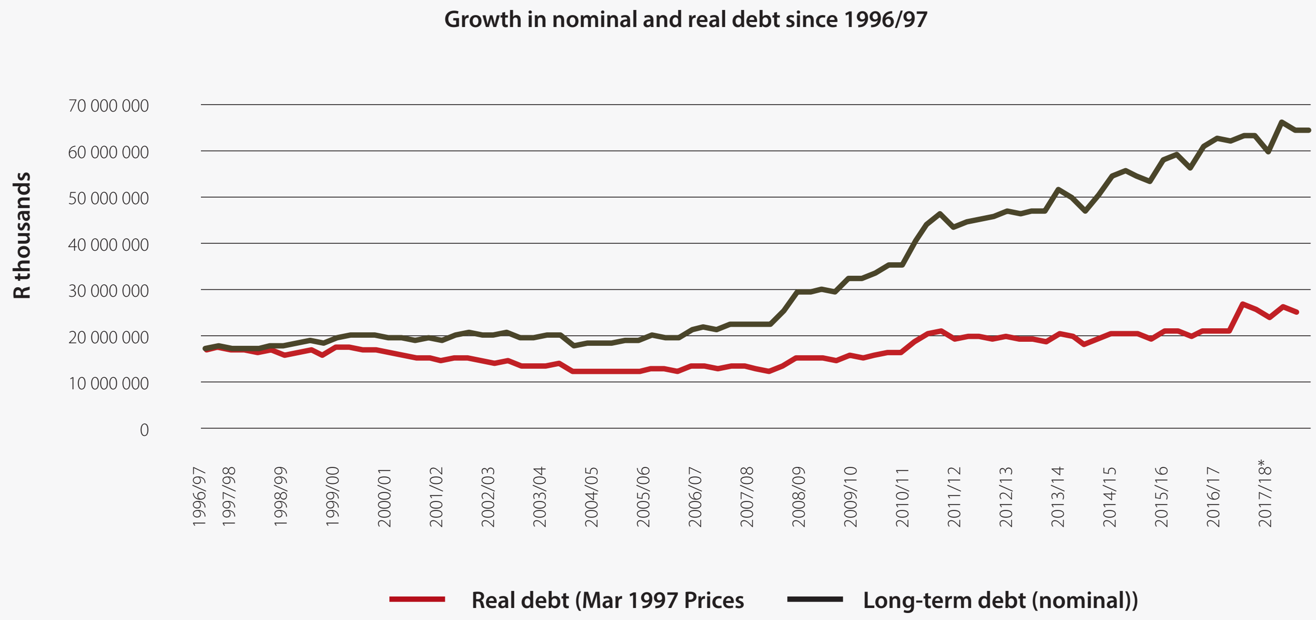



*Source: National Treasury Database*

Relating to the debt-to-revenue ratio, the aggregated average for all municipalities is at 19 percent. City of Ekurhuleni's debt-to-revenue is at 19 percent {Note that there was an error in the revenue reported by City of Ekurhuleni during the previous quarter hence the huge difference in the debt-to-revenue ratio which was reported as 10 percent in the previous Issue}. Although the City of Johannesburg has the highest debt to revenue ratio at 46 percent which is a little over the recommended benchmark of 45 percent, the history of stringent credit control measures and the reputation of good repayment structures provides comfort that the city will be able to manage its current debt levels.

## 3. Analysis of long term debt as reported by lenders

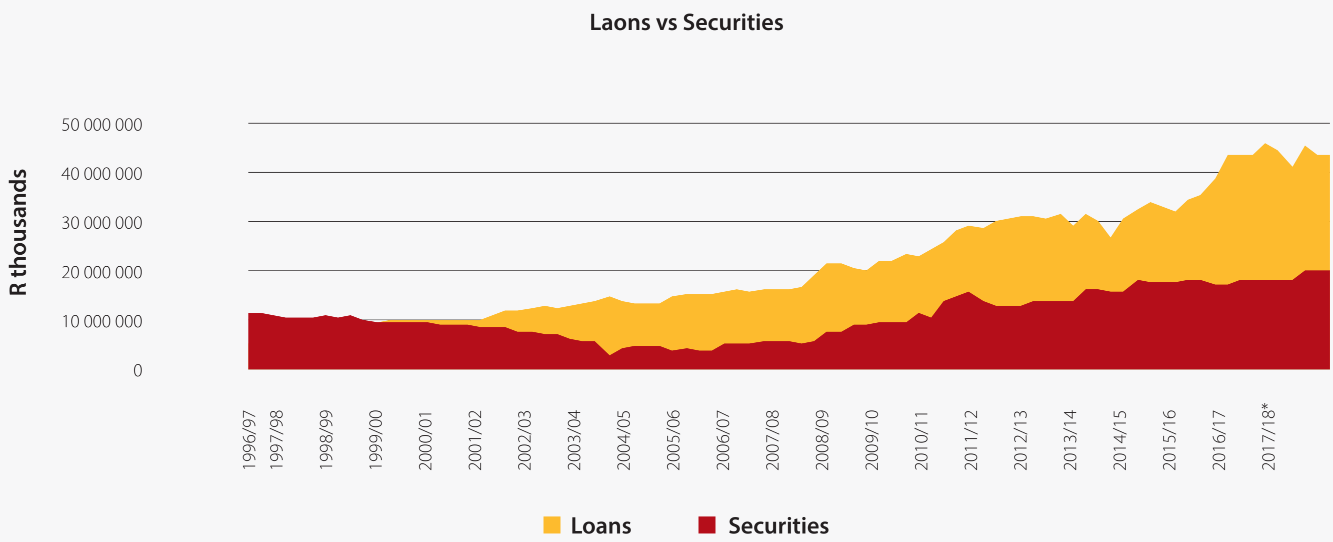
**Figure 2: Growth in long term municipal borrowing**




**Incl QIII*
*Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB*

Figure 2 above shows outstanding long-term debt from the third quarter of FY1996/97 to the third quarter of FY2017/18. Nominal debt, represented by the black line, increased to R64.3 billion when compared to R63.4 billion in the third quarter of FY2016/17 – indicating a growth of R0.9 billion or 1 percent. The red line indicates the growth of debt in "real" terms (adjusted for inflation using March 1997 prices). This shows a decline of 2 percent when compared to R20.4 billion in the third quarter of the 2016/17 financial year. In the third quarter of FY2017/18, lenders reported long term debt amounting to R64.3 billion which is R1.3 billion less than what was reported by municipalities. As noted above, National Treasury believes that a significant portion of the difference is accounted for by non-bank financial institutions, from whom National Treasury will be collecting data going forward.

**Figure 3: Split between debt instruments**



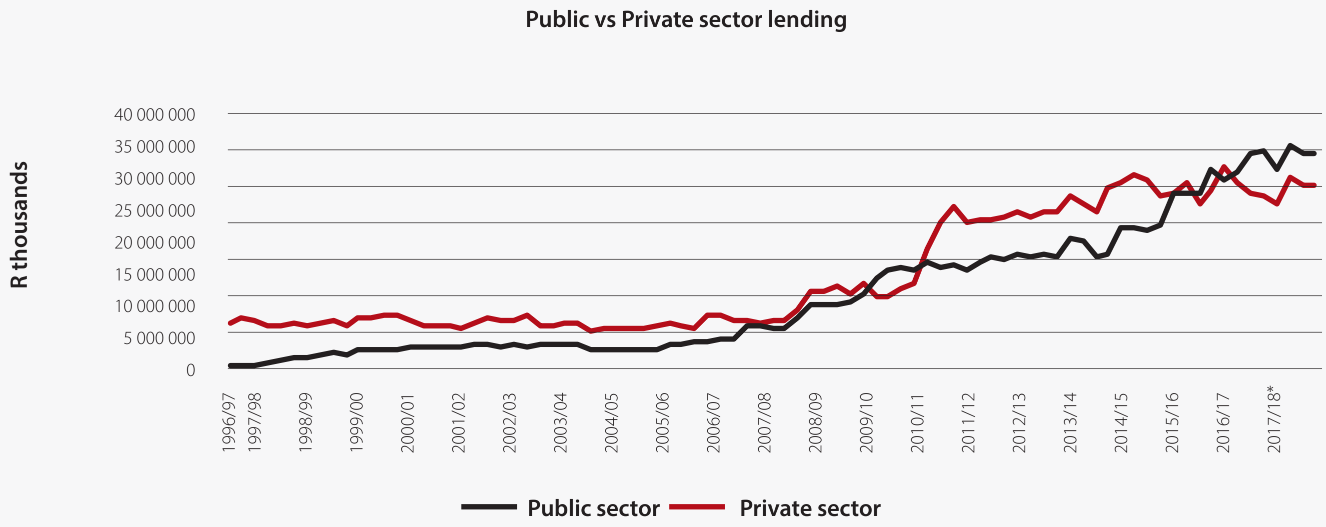

**Incl. QII*
*Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB*

As indicated by Figure 3 above, the distribution of outstanding long term debt between loans and securities amounts to 68 percent and 32 percent respectively. This is an increase of R1.0 billion or 2 percent for loans and R2.0 billion or 10 percent for bonds when compared to the same period of the previous financial year. No new bonds have been issued after the issuances by City of Cape Town and City of Ekurhuleni in July 2017.

## 4. Holders of municipal loans and bonds

Public sector lenders hold 53 percent of outstanding long-term municipal debt, while private sector lenders hold 47 percent, as of the third quarter of FY2017/18. In rand terms, the long term debt held by the public sector amounts to R34.3 billion, indicating a decline of 1 percent when compared to R34.7 billion in the third quarter of previous year. The private sector held R29.9 billion, which has increased by 2 percent compared to R28.6 billion of third quarter of FY2016/17.

**Figure 4: Public and private sector lending to municipalities**




**Incl. QIII*
*Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB*

Public sector lenders consist of the DBSA, being the largest lender especially to smaller municipalities; Public Investment Corporation; Local authorities & Public Enterprises and International Development Finance Institutions including the French Development Agency as well as the International Finance Corporation.

## DISCUSSION

### Findings of the Municipal borrowing data verification exercise

As part of our municipal borrowing data verification exercise, we have met with one lender to better understand the municipal borrowing data reporting principles. The findings of which have been discussed with the rest of the lenders and **three lenders have confirmed the principle below:**

a. The outstanding balances reported by lenders comprise: the outstanding capital and the capitalized interest. The lender accrues interest on a monthly basis and capitalizes it after six months. The lender would then subtract the capitalized interest after the municipality has made the payment due as per the agreed instalment.

b. The municipalities report their outstanding balances net of the payment due for that period irrespective of whether they have made the payment or not. It appears that the interest accrued from these long term loans are classified as short term debt by the municipalities as the understanding is that this interest is usually paid within 12 months.

From this, National Treasury understand that the differences in the balance of long term debt reported by the lender and those reported by the municipalities is mainly the payment due for that period if the municipality has not yet made the payment – differences can be large for those quarters that are affected by holidays (i.e. March, December). However, municipalities always report more than the financial institutions, thus this does not account for the discrepancy we have continually noted in the opposite direction.

c. Some municipalities would incorrectly report short term loans as long term. Municipalities are also reporting what could still be mere commitments of loans before the actual loan has been disbursed to the municipality.

d. There are numerous other institutions which have finance lease contracts with municipalities, from whom data has not been collected. This seems to be the main cause of the continuing data discrepancy.

To enable better cross-checking, the reporting principles must be the same for both parties.

**Going forward, National Treasury will require that:**

- All institutions involved in the municipal borrowing market provide the National Treasury on a quarterly basis with data that reflects outstanding principal amounts of long term municipal debt.
  - Neither lenders nor borrowers should include interest due in the quarterly balances.

- Municipalities and lenders must both insure that they do not report short term loans as long term, and that they do not report loan commitments as actual loans. We have found examples of both types of misreporting. Because short term borrowing is legally permitted only for bridging purposes within a financial year and long term borrowing is permitted only for capital expenditure on property, plant and equipment; the two types of borrowing should never be combined.
- Both lenders and borrowers must report all long term debt, regardless of the type that is bonds, loans, financing leases and other instruments that are the functional equivalent.